

No. A11-1330

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STATE OF MINNESOTA

IN COURT OF APPEALS

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

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RESPONDENT  
PUBLIC EMPLOYEES RETIREMENT ASSOCIATION (PERA)'S  
BRIEF AND APPENDIX

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The appendix to this brief is not available for online viewing as specified in the *Minnesota Rules of Public Access to the Records of the Judicial Branch*, Rule 8, Subd. 2(e)(2).

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**STATE REGULATIONS**



## LEGAL ISSUES

- I. Whether the PERA Board's decision to exclude employer-paid deferred compensation and insurance supplemental payments from the definition of "salary" for determining PERA benefits is an error of law, or is unsupported by substantial evidence in the record as a whole, or is arbitrary and capricious.

*Decision Below: The PERA Board affirmed the PERA Executive Director's Decision in all respect.*

**Apposite Authority:**

*In Re McGuire*, 765 N.W.2d 517 (Minn. Ct. App. 2008)

- A. Whether PERA's longstanding application and interpretation that Employer-Paid Contributions To Deferred Compensation And Insurance Supplemental Payments Are Not Salary For The Purposes Of PERA Benefits, Pursuant To Minn. Stat. § 353.01, Subd. 10 (b), is an error of law or an unpromulgated rule.

*Decision Below: The PERA Board ruled that its longstanding interpretation is not an unpromulgated rule.*

**Apposite Authority:**

*Bunge Corp. v. Commissioner of Revenue*, 305 N.W.2d 779 (Minn. 1981)

- B. Whether substantial evidence in the record as a whole, including the City of Duluth's payroll records and testimony of the city auditor, rather than mere estimates as permitted by Minn. Stat. § 353.27, supports the decision of the PERA Board.

*Decision Below: The PERA Board ruled that there was substantial evidence in the record to support the Executive Director's decision regarding benefit recalculations.*

**Apposite Authority:**

*In The Matter of the Application of John Allers and Konrad Stroh for Ret. Benefits*, 533 N.W.2d 646 (Minn. Ct. App. 1995)

*In re Lakedale Telephone Company*, 561 N.W.2d 550, 554 (Minn. Ct. App. 1997)

Minn. Stat. § 353.01, subd. 10b

Minn. Stat. § 353.01, subd. 11(b)

- C. Whether the PERA Board's decision to treat City of Duluth employees like all other PERA employees is arbitrary and capricious.

*Decision Below: The PERA Board ruled that Duluth employees and retirees should be treated like all other public employees.*

**Apposite Authority:**

*In re Rochester Ambulance Service*, 500 N.W.2d 495 (Minn. Ct. App. 1993)

Minn. Stat. § 356A.02

Minn. Stat. § 356A.05

- II. Whether Promissory Estoppel and Equitable Estoppel can be applied against the PERA Board, where the Board Lacks the authority to act outside the bounds of its authority.

*Decision Below: The PERA Board did not address this issue: the ALJ ruled that estoppel did not apply.*

**Apposite Authority:**

*In the Matter of the Application for PERA Retirement Benefits of Michael M. McGuire*, 756 N.W.2d 517 (Minn. Ct. App. 2008), rev. den. (Minn. Dec. 16, 2008)  
*Axelson v. Minneapolis Teachers Retirement Association*, 544 N.W.2d 297 (Minn. 1996)

- III. Whether PERA's actions are barred by the statute of limitations, where the City of Duluth failed to adopt special legislation that would have specifically adopted a three year statute of limitations for the City, its employees, and retirees.

*Decision Below: The PERA Board did not address this issue: the ALJ ruled that PERA's actions were not barred by a statute of limitations.*

**Apposite Authority:**

2011 Minn. Laws, 1st Special Session, Ch. 8, Art. 1, Sec. 4

*Har-Mar, Inc. v. Thorsen & Thorson, Inc.* 300 Minn. 149, 218 N.W.2d 751 (Minn. 1974)

- IV. Whether PERA's correction of benefits is an unconstitutional impairment of contract or an unconstitutional taking.

*Decision Below: There was no ruling below.*

**Apposite Authority:**

*AFSCME Councils 6, 14, 65 & 96 v. Sundquist*, 338 N.W.2d 560 (Minn. 1983)  
*Christensen v. Minneapolis Municipal Retirement Bd.*, 331 N.W.2d 740 (Minn. 1983)

- V. Whether Relators are entitled to attorneys fees when they are not prevailing parties and PERA's position is substantially justified.

*Decision Below: There was no ruling below.*

**Apposite Authority:**

*Mbong v. New Horizon Nursing*, 608 N.W.2d 890 (Minn. Ct. App. 2000)  
Minn Stat. § 15.472

**STATEMENT OF THE CASE**

This is an appeal from a decision made by the Public Employees Retirement Association ("PERA") Board of Trustees denying Relators' claim to have employer-paid deferred compensation and insurance supplemental payments included in the definition of "salary" pursuant to Minn. Stat. § 353.01, subd. 10 (2010).

The Auditor for the City of Duluth (City) reported to PERA in 2008 that the City had been improperly including employer-paid deferred compensation and insurance supplemental payments as "salary" for PERA benefit purposes. The City of Duluth provided PERA with official city records to show the treatment of these benefits by the City of Duluth.

PERA's Executive Director determined that employer-paid deferred compensation and insurance supplemental payments are not salary for PERA purposes, pursuant to Minn. Stat. § 353.03, subd. 3(b) (2010), and applied this determination to current and former Duluth city employees in the matter at issue. The determination that these benefits are to be excluded from salary determinations has been PERA's long standing interpretation since before 1995.

The Executive Director for PERA recalculated proper PERA benefits of current and former Duluth city employees, as required by Minn. Stat. § 353.27 (2010) and Minn. Stat. Ch. 356 to pay only benefits permitted under PERA statutes.

Relators appealed the PERA Executive Director's decision and the PERA Board referred the matter to the Minnesota Office of Administrative Hearings. On April 13, 2010, Administrative Law Judge Bruce H. Johnson (the ALJ) conducted a hearing on the parties' cross-motions for summary disposition.

By order issued on May 20, 2010, the ALJ reopened the record for the limited purpose of enabling parties to submit further evidence regarding the income tax treatment of amounts paid by the City of Duluth (City) to the petitioners' employer-paid compensation and supplemental insurance payments during the period 1995 through September 2007. A hearing was held on this issue and on the issue of estoppel on September 30 and October 14, 2010. The ALJ asked the parties to brief the issues of the taxation of benefit by the City of Duluth, and also what effect, if any, Duluth's tax treatment of benefit payments would have on PERA's decision that the benefit payments are not salary for PERA benefits purposes. The ALJ also asked the parties to address objections to the ALJ's initial order from May 2010 and to address the estoppel issue in their memos.

The ALJ issued his decision on January 18, 2011. The PERA Board allowed filing of exceptions to the ALJ decision, and heard oral arguments from the parties on April 14, 2011. The PERA Board concluded its deliberations on May 12, 2011, and directed that the final PERA Board order reflecting its decision be drafted and signed by

the Vice President of PERA. The PERA Board order affirming the PERA Executive Director's decision in the recalculation of salary, benefits, and pension contributions of current and former City of Duluth employees was signed on June 24, 2011.

## STATEMENT OF FACTS

### I. PERA PENSION PLANS.

PERA manages and administers several pension plans for public employees, including the PERA "general" plan and the PERA Police and Fire Plan. Minn. Stat. chapters 353, 356, 356A set forth the terms and conditions that govern the operations of these plans. (RA 10-15).

PERA is a defined benefit plan under which retirement benefits are determined by a formula utilizing years of service times a percentage factor for each year of service, times the employee's "high five" salary. See Minn. Stat. §353.01, subd. 17 (a). For PERA purposes what qualifies as "salary" is defined by Minn. Stat. §353.01, subd. 10 (a), and what is not salary is defined by Minn. Stat. § 353.01, subd. 10 (b). The definition of what is or is not "salary" is important for PERA purposes because it determines the contribution amounts that governmental entities must pay to PERA; the amount of money available for investment for future benefits; and ultimately the specific monthly amount of benefits that a public employee will receive. (RA 10-15.) An overstatement of a person's salary will result in a retiree receiving a higher benefit than the benefit to which they are legally entitled.

## **II. LONGSTANDING TREATMENT OF EMPLOYER-PAID DEFERRED COMPENSATION AND INSURANCE SUPPLEMENTAL PAYMENTS BY PERA.**

Mary Most Vanek is PERA's Executive Director. (RA 10-15.) Part of her duties as Executive Director include determining whether certain amounts paid by an employer constitute salary for PERA purposes under Minn. Stat. § 353.01, subd. 10. Governmental subdivisions are required to accurately report employee salaries to PERA. Minn. Stat. § 353.27, subd. 4.

As PERA's Executive Director, Ms. Vanek has determined that employer-paid deferred compensation and insurance supplemental payments are not salary for PERA purposes. (RA 10-15.) Ms. Vanek has applied this decision to current and former Duluth city employees. Ms. Vanek's determination that these benefits are to be excluded from salary determinations is consistent with PERA's long standing interpretation since before 1995. (RA 10-19) and Hearing Transcript ( T.) 136-137.

As stated in Minn. Stat. § 353.01, subd. 10(b), the employer contribution toward the payment of insurance is not salary for PERA purposes. Additionally, employer-paid fringe benefits are expressly excluded as PERA salary in Minn. Stat § 353.01, subd. 10(b). Since at least 1992 and continuing to the present, PERA has interpreted Minn. Stat. § 353.01, subd. 10, to exclude employer-paid deferred compensation from treatment as salary for purposes of calculating PERA retirement and disability benefits. T. 136-137, Ex. 14, Ex. 20. For example, in 1992 and again in 2004 PERA informed the City of St. Paul that the employer contribution for deferred compensation was not PERA salary. T. 136.

PERA's determination that employer contributions to deferred compensation and insurance supplemental payments are not "salary" for PERA purposes is consistent with how other states define "salary" to calculate public employee retirement benefits. (RA 10-19.) PERA's interpretation is also consistent with how other Minnesota public pension plans calculate salary. The Minnesota State Retirement System's ("MSRS") statutory language was changed in 1995 to require MSRS to comport with the application of "employer-paid fringe benefits" as desired by the legislature and as already implemented by PERA and Teachers Retirement Association ("TRA"). (RA 16-23.).

When asked, PERA routinely advises local units of government that employer-paid deferred compensation and insurance supplemental payments are excluded from salary. T. 136-138. St. Paul, Virginia, Backus, Duluth Public Schools, and Western Lake Superior Sanitary District are some of the local units of governments that have consulted with PERA about the definition of "salary," and have been advised that these benefits do not qualify as salary under PERA. *See Id.*

### **III. DISCOVERY OF ERROR BY DULUTH.**

Duluth first inquired about whether employer-paid deferred compensation contributions should be treated as salary for PERA purposes in July 2007. *Id.* at 145 - 146. In July 2007, Wayne Parson, the Duluth City Auditor telephone PERA employee Chris Arcand to discuss how employer-paid deferred compensation and insurance supplements were to be treated for PERA salary purposes. *Id.* at 260. When Mr. Parson learned that the employer-paid deferred compensation was not to be considered PERA salary he contacted the City's finance director. *Id.* at 261. In

July 2007, the City of Duluth was counting employer-paid deferred compensation and health insurance supplement as salary for PERA purposes. *Id.* at 261-262. After July 2007, the City of Duluth no longer continued to count such payments as PERA salary. *Id.* The City of Duluth did not, however, tell the employees of that change. *Id.*

When Mr. Arcand received the initial phone call from the Duluth City Auditor in 2007, he believed it was a routine call that he typically receives from employers, and he was not informed that this issue had existed since 1995. As a result, no formal action was taken by PERA on this matter until it received a letter from the City of Duluth on September 18, 2008. *Id.* at 146. *Id.* Nobody else at PERA knew about the initial phone call until 2008. *Id.* at 164.

In September of 2008, the City of Duluth sent PERA letters regarding this matter. *Id.* at 146. Mr. Parson initially found the City's mistake in July 2007 while he was reviewing the paycheck of an employee who had resigned from the City. *Id.* at 265. Mr. Parson saw an insurance supplement payment that the employer paid as being eligible for PERA salary. *Id.* Mr. Parson then looked at the PERA employer manual and concluded that employer-paid insurance supplements and deferred compensation should not count as PERA salary. *Id.* at 265-266. The City of Duluth wrote a letter to PERA in 2008 because Mr. Parson believed that the City of Duluth had an obligation to inform PERA of the error. *Id.* at 267.

PERA has no record that the City of Duluth ever inquired about this issue prior to Mr. Parson's inquiry in 2007. T. 136-38. Nor did the City of Duluth have any written record of such inquiry being previously made to PERA. *Id.* The 2008 letters from Duluth

to PERA were the first official notice to PERA about the length of the problem. *Id.* at 262.

#### IV. CITY OF DULUTH PAYROLL RECORDS.

The PERA Board received official financial records from the City of Duluth which showed how the City had treated employer-paid deferred compensation and insurance benefits.

The City of Duluth sent PERA financial records so that PERA could see the breadth of the financial implications of Duluth's error. T. 263. For the years 1997 through 2004, Mr. Parson obtained year-end backup tapes for the payroll system. *Id.* The backup tapes are official city records. *Id.* at 264. For the years 2005 to 2007, Mr. Parson used Duluth's current accounting system. *Id.*

The payroll registry report provided to PERA by Duluth is an official City document. *Id.* at 295. The payroll registry report historically has been used as evidence of the payroll transactions that were processed by the City. *Id.* at 296. The information on the payroll registry report comes directly from employee pay stubs that are automatically summed up in the report. *Id.*

Exhibit 17 is a payroll registry report from 1998. *Id.* at 298. Based on Mr. Parson's knowledge as an auditor, all divisions in Duluth would have had payroll registry reports generated the same way in 1998. *Id.* at 303. The payroll registry reports from 1999 and 2000 cannot be located by the City of Duluth. *Id.* at 304-305. The City of Duluth does not use a payroll registry report today because it is more electronic and there is no need to print out paper. *Id.* at 311. Mr. Parson also looked at payroll records from

other years. *Id.* The City of Duluth had a city technology employee restore year-end backup tapes of the payroll system so that they could pull up information regarding the deferred compensation and insurance supplement payments. *Id.* at 369.

The City of Duluth provided PERA with its official records showing the employer-paid deferred compensation and insurance supplement payments dating back through 1995. These official records provided more detailed information than the estimates of payroll permitted under PERA statute. The payroll records provided by the City of Duluth to PERA were accurate regarding the amount of employer-paid deferred compensation and insurance supplement payments dating back through 1995. T. 263-265.

#### **V. INVESTIGATION OF DULUTH'S ERROR BY PERA.**

Cheryl Keating, who is the manager of the Account Information Management Division at PERA testified. Her job is to oversee the processes and the employees that determine membership eligibility, salary eligibility, reconcile contributions to payment from employers, and to respond to employer's questions about reporting requirements. T. 131. Ms. Keating has also been designated as the State's social security administrator relating to provisions that cover state and local governments. *Id.*

Ms. Keating was the manager of the division that responded to questions from the City of Duluth about whether employer payments to the deferred compensation accounts of the employees were subject to PERA contributions. *Id.* at 132. Based on PERA staffs' review, they determined that the contributions the employer made were not salary under PERA law. *Id.* Ms. Keating and her employees then proceeded to collect data

from the City of Duluth on the amounts that had been paid by the employer and characterized as employer contributions to the deferred compensation plan. *Id.* PERA used those amounts to determine the salary that had been erroneously reported by the City of Duluth. *Id.* That data was then used to adjust the benefits of retirees. *Id.*

#### **VI. TAX TREATMENT OF PAYMENTS AT ISSUE BY DULUTH.**

Employer-paid deferred compensation is not subject to federal or state income tax. *Id.* at 268. Employer-paid deferred compensation is subject to FICA and Medicare tax unless a public safety officer is the employee and then FICA does not apply. *Id.* For insurance supplements, the City of Duluth did not have payments subjected to any taxes. *Id.* at 268-269. Accordingly, the City of Duluth presently does not withhold any federal or state income tax from employer-paid deferred compensation. *Id.* at 269. And presently, the City of Duluth does not withhold any federal income tax, state income tax, FICA or Medicare from the insurance supplement. *Id.* at 269-70.

Based on Mr. Parson's review of official city records, Mr. Parson had knowledge of Duluth's tax treatment of employer-paid deferred compensation and insurance supplemental payments. *Id.* at 270. Mr. Parson walked through official records and documents which he had created in order to explain prior years' tax treatment by the City of Duluth. *Id.* at 270-312. Based on Mr. Parson's review of the City of Duluth's financial records, it is his opinion that the City did not treat either employer-paid deferred compensation or health insurance supplement payments as taxable income. *Id.*

Mr. Parson is aware that there are different rules for PERA than for taxes. *Id.* at 392-93. Mr. Parson reiterated that if deferred compensation and health insurance

supplements were taxed by the City of Duluth that would have been an error. *Id.* at 393-94. Specifically, it would have been an error made by the person processing the payroll. *Id.* at 394. Although Mr. Parson was cross-examined about a note on this topic by the State Auditor, Mr. Parson testified that the note does not relate to an individual payroll review. *Id.* at 395-395. If the state auditor was talking about PERA salary, the auditor note would have specifically cited a PERA statute, and no PERA statute was cited. *Id.* at 395-396. On cross-examination, Mr. Parson reviewed other payroll stubs and agreed that there appear to be no tax deduction for some supplemental insurance payments or deferred compensation. *Id.* at 383-87. Mr. Parson believed that the City of Duluth incorrectly handled its payroll in reporting taxes on some deferred compensation and insurance supplement payments.<sup>1</sup> *Id.* at 388-89.

## **VII. SPECIAL LEGISLATION FOR AFFECTED LOCAL UNITS OF GOVERNMENT**

The City of Duluth is not the only public entity that mistakenly included employer paid benefits as salary for PERA purposes. *Id.* at 167-68. The City of Virginia, the Western Lake Superior Sanitary Sewer District, and the Duluth Public schools made similar mistakes as Duluth in roughly the same time frame. *Id.*

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<sup>1</sup> An accountant from Wisconsin, Larry Kroll, testified for Relators as to what he believed the tax treatment was by the City of Duluth regarding specific benefits. Mr. Kroll gave inconsistent testimony regarding how he believed Duluth treated benefit payments for tax purposes. In some instances, he suggested that benefits were taxed. T. 57, 92. In other instances he stated that benefits were not taxed. T. 68-69; 80; 88. In still other instances he stated that he could not tell if benefits were taxed. T. 73-74; 78; 80.

PERA initially treated Virginia, Western Lake Superior Sanitary Sewer District and Duluth Public Schools in the same manner as Duluth. *Id.* at 175. Those entities, however, availed themselves of a legislative option to adopt a three year statute of limitations for PERA to collect erroneously calculated benefits. *Id.* at 167; 175-76. As a result, PERA is not authorized or required to collect erroneously calculated benefits after three years. Duluth has not chosen to similarly limit the time frame in which PERA is required to collect erroneously calculated benefits. *Id.* at 182-83; 406-07.

#### **VIII. COLLECTION OF OVERPAYMENT**

Pat Kappelhoff, a PERA employee whose job it is to oversee the benefit claims for retirement, testified. *Id.* at 170. Part of her job is to make required adjustments to benefits if there is an error in calculation. *Id.* at 171. Additionally, if there was an error in payments, PERA would have to correct overpayments. *Id.* PERA routinely collects overpayments on an ongoing basis for a variety of reasons. *Id.* Presently, PERA has somewhere between 300 to 500 employees, not counting those from Duluth, where PERA is collecting overpayments. *Id.* at 172.

Ms. Kappelhoff collected information so that PERA could estimate the new payment for retirees and then go back and adjust those benefits so that overpayments would not get any larger. *Id.* Ms. Kappelhoff did this because PERA is required to apply the law using a properly calculated salary. *Id.* at 173. This is also a requirement of PERA's fiduciary duty. *Id.* PERA includes a disclaimer on all annual statements sent to employees stating that the benefits are estimates and if there is any conflict, that the law would control the benefit amount. *Id.* at 173-74. PERA is legally obligated to collect

overpayments even if it creates financial difficulty for a retiree. *Id.* at 174. PERA is also obligated to make corrections so that the correct amount of benefit is paid even when employees say that they relied on a different level or had different expectations. *Id.* at 175. PERA relied on erroneous salary reports by the City of Duluth in calculating benefits for Duluth retirees. PERA had assumed that Duluth had reported the correct amount. *Id.* at 180.

As it is legally required to do, PERA has recalculated contributions, benefits, and overpayments based on information provided by the City of Duluth to PERA. *Id.* at 173,

#### **IX. INFORMATION TO EMPLOYEES BY DULUTH.**

Mr. Parson knew as an auditor with much experience that there are rules and regulations and that a person should consult with PERA on these issues. *Id.* at 351. Mr. Parson conveyed the payroll mistake to his supervisor, Geni Stark, in July or August of 2007. *Id.* at 353-54. He never talked to her about it again after that. *Id.* at 355-56. In 2007 and 2008 there was no communication with any active employees or any retirees about this issue. *Id.* at 356. Individual people were not notified of potential changes to their retirement benefit estimates by the City of Duluth. *Id.* at 357. Mr. Parson did not notify PERA in 2007 that it should be addressing the payment projections for potential retirees based on the error made by the City of Duluth. *Id.* at 359.

#### **STANDARD OF REVIEW**

PERA is the Minnesota public retirement fund that administers pension plans for county and municipal employees in accordance with the provisions of Minn. Stat. ch. 353

and it is subject to the fiduciary duties and standards imposed by Minn. Stat. ch. 356A (2010). A public retirement fund is analogous to an administrative agency and, decisions of the PERA Board will be reversed only if they are “fraudulent, arbitrary, unreasonable, unsupported by substantial evidence, not within the jurisdiction or based upon an error of law.” See *Axelson v. Minneapolis Teachers’ Retirement Fund Ass’n*, 544 N.W.2d 297, 299 (Minn. 1996) (quoting *Dokomo v. Independent School Dist. No. 11*, 459 N.W.2d 671, 675 (Minn. 1990)). Substantial evidence is “(1) such relevant evidence as a reasonable mind might accept as adequate to support a conclusion; (2) more than a scintilla of evidence; (3) more than ‘some evidence’; (4) more than ‘any evidence’; and (5) evidence considered in its entirety.” *Reserve Mining Co. v. Herbst*, 256 N.W.2d 808, 825 (Minn. 1977); *In re Application of Allers*, 533 N.W.2d 646 (Minn. Ct. App. 1995); *Stang v. Minnesota Teachers Retirement Association Board of Trustees*, 566 N.W.2d 345 (Minn. Ct. App. 1997).

Under the substantial evidence test, a reviewing court will not re-weigh the evidence or substitute the court’s judgment for that of the agency. *In re Lakedale Telephone Company*, 561 N.W.2d 550, 554 (Minn. Ct. App. 1997) (agency was free to conclude that only evidence presented in administrative proceeding was unpersuasive and court would not substitute its judgment for agency’s on this finding given requirement of substantial judicial deference to agency’s fact-finding process). As the Minnesota Supreme Court has said “[u]pon review, courts should not attempt to weigh the credibility of conflicting experts, but should instead review the record to ensure that

decision was legally sufficient - i.e. had support in the record.” *Billy Graham Evangelical Assoc. v. Minneapolis*, 667 N.W.2d 117, 124 (Minn. 2003).

Under the arbitrary or capricious standard, if an agency explained its decision with appropriate references to the record before it, the Court should uphold that decision even if the Court might have reached a different conclusion if it had been the fact finder. *First National Bank v. Department of Commerce*, 350 N.W.2d 363, 368 (Minn. 1984). As this Court has stated “[i]f there is room for two opinions on a matter, [an] agency’s action is not arbitrary or capricious even though the court may believe that an erroneous conclusion has been reached.” *In re Rochester Ambulance Service*, 500 N.W.2d 495, 499 (Minn. Ct. App. 1993). *See also In re Petition of Minn. Power*, 545 N.W.2d 49, 51 (Minn. Ct. App. 1996) (where there is room for two opinions on a matter agency action not arbitrary and capricious even though court may believe that erroneous conclusion has been reached).

At issue in the contested case proceeding is whether certain forms of compensation, collectively characterized as “Employer-paid contributions to deferred compensation plans” and “insurance supplement payments” are “salary” under the PERA definition set forth in Minn. Stat. § 353.01, subd. 10 (2008). This presented an issue of statutory construction which is a question of law. *See Stang v. Minn. TRA Board of trustees*, 566 N.W. 2d 345, 348 (Minn. Ct. App. 1997)(construction of teacher retirement statutes is a question of law).

This Court is not bound by PERA’s construction of its governing statutes. Review by this Court on issues of statutory construction is *de novo*. If, however, the meanings of

the terms in the PERA statutes are in doubt, the Court should give “great weight” to the construction given by PERA, because PERA is the body charged with the fiduciary responsibility to administer the plan. *Goodman v. Department of Public Safety*, 282 N.W.2d 559, 560 (Minn. 1979) (“court accord[s] substantial consideration to the interpretation of the administrators working daily with the problem sought to be remedied”). *Accord Goodnature v. Public Employees Retirement Association of Minnesota*, 558 N.W.2d 19 (Minn. Ct. App. 1997). In this case, the PERA Board was exercising its fiduciary duty to its pension plan members in making membership benefit eligibility determinations. Minn. Stat. § 356A.02 (2010). Therefore, if there is any doubt about the PERA Board’s construction of the terms set forth in Minn. Stat. ch. 353, the Court should defer to the PERA Board’s judgment.

### **SUMMARY OF THE ARGUMENT**

Relators cannot demonstrate that the PERA Board’s recalculation of the salary, benefits and pension contributions of current and former City of Duluth employees and the City of Duluth was based on an error of law, was arbitrary or capricious, or was unsupported by substantial evidence. There is substantial evidence in the record to support the accuracy of PERA’s recalculation of Petitioners’ benefits. Petitioners also failed to meet their burden of proving that PERA should be barred from taking action to recalculate their benefits based on any applicable statute of limitations or promissory or equitable estoppel. The PERA Board cannot breach its fiduciary duty by allowing Petitioners to receive benefits that are greater than is permitted by statute.

## ARGUMENT

**I. THE PERA BOARD'S DECISION TO EXCLUDE EMPLOYER-PAID DEFERRED COMPENSATION AND INSURANCE SUPPLEMENTAL PAYMENTS FROM THE DEFINITION OF "SALARY" FOR DETERMINING PERA BENEFITS IS NOT AN ERROR OF LAW, OR UNSUPPORTED BY SUBSTANTIAL EVIDENCE IN THE RECORD AS A WHOLE, OR ARBITRARY AND CAPRICIOUS.**

The PERA Board's decision is not an unpromulgated rule, is supported by substantial evidence in the record, and is not arbitrary or capricious. Each of these matters will be discussed separately.

**A. PERA's Longstanding Application And Interpretation That Employer-Paid Contributions To Deferred Compensation And Insurance Supplemental Payments Are Not Salary For The Purposes Of PERA Benefits, Pursuant To Minn. Stat. § 353.01, Subd. 10 (B), Is Supported By Law And Is Not An Unpromulgated Rule.**

The ALJ concluded that PERA's interpretation that employer-paid deferred compensation qualified as "fringe benefits" under Minn. Stat. § 353.01, subd. 10, rather than salary was correct. The ALJ went on to determine that although PERA's interpretation was correct, the interpretation was an unpromulgated interpretive rule that could not be given effect.

The ALJ's conclusion that PERA's interpretation was an unpromulgated rule was erroneous. Under Minnesota law, "[a]dministrative policy may be formulated by promulgating rules or on a case-by-case determination. An agency has discretion to decide what method is appropriate in a particular situation." *Bunge Corp. v. Commissioner of Revenue*, 305 N.W.2d 779, 785 (Minn. 1981). If an agency's interpretation is longstanding, the agency is not deemed to have promulgated a new rule.

*Cable Communications Bd. v. Nor-West Cable Communications Partnership*, 356 N.W.2d 658, 667 (Minn. 1984).

In this case, PERA's interpretation that employer-paid deferred compensation is a fringe benefit rather than salary is not an unpromulgated rule because it is a longstanding agency interpretation that is consistent with the plain language of the applicable statute. PERA's Executive Director, Mary Most Vanek, made the determination that employer-paid deferred compensation and insurance supplemental payments were not "salary" under PERA's definition of salary as stated in Minn. Stat. § 353.01, subd. 10. Ms. Vanek's determination that these supplemental benefits are not statutory salary is consistent with PERA's determination dating prior to 1995. Vanek's First and Second Affidavits reference that PERA has been excluding employer-paid deferred compensation since prior to 1995.

Additionally, the Second Affidavit of David Bergstrom establishes that prior to 1995 MSRS was the only public pension plan that was not excluding employer-paid deferred compensation from the definition of salary. After 1995, all public pension plans, including MSRS, excluded employer-paid deferred compensation from pension salary, so that salary for pension calculation would not be artificially inflated. Furthermore, Cheryl Keating testified that PERA regularly advises other cities, and had specifically told the City of St. Paul in 1992 and 2004, that employer-paid deferred compensation is not salary under the PERA statute. Thus, there is substantial evidence in the record to support PERA's longstanding interpretation that for pension purposes salary does not include employer-paid deferred compensation and insurance supplemental payments.

PERA's longstanding interpretation of the PERA salary statute should be given deference in this proceeding. *In the Matter of Excess Surplus Status of Blue Cross and Blue Shield of Minnesota*, 624 N.W.2d 264, 278 (Minn. 2001). It is not an unenforceable unpromulgated interpretive rule. *See Mapleton Community Home, Inc. v. Minnesota Department of Human Services*, 391 N.W.2d 798 (Minn. 1986). Rather, PERA has applied the language of the statute excluding "employer paid fringe benefits" from PERA salary consistently even before the legislature examined this issue in 1995. *See Good Neighbor Care Centers, Inc. v. Minnesota Department of Human Services*, 428 N.W.2d 397, 402-03 (Minn. Ct. App. 1988) (If an interpretation is consistent with the plain meaning of the statute, the agency's action is authorized by the statute itself). Additionally, there is no need for PERA to adopt any rule to delineate every possible "employer paid fringe benefit" that could exist. *See Bunge Corp*, 305 N.W.2d at 804 (A case by case determination of policy may be made based on facts as applied to a specific party). Employer-paid deferred compensation is only one such example of that type of benefit which would be excluded based on the language of Minn. Stat. § 353.01, subd. 10(b).

It is a fundamental concept that decisions of an administrative agency, such as PERA, enjoy a presumption of correctness and that deference should be shown to that agency based on the agency's own special knowledge in its field, education, and experience. *In the Matter of Excess Surplus Status of Blue Cross and Blue Shield of Minnesota*, 624 N.W.2d at 278. The agency decision maker is presumed to have the expertise necessary to decide matters within the scope of the agency's authority. *Id.* This

judicial deference is rooted in the separation of powers doctrine and is extended to an agency decision maker in the interpretation of statutes that the agency is charged with administering and enforcing. *Id.*

Additionally, the Minnesota Supreme Court has stated that deference is required when the relevant regulatory language is unclear or susceptible to different reasonable interpretations. *In re Cities of Annandale and Maple Lake*, 731 N.W.2d 501, 515, 516 (Minn. 2007). Deference is also required when interpretation and application of the statute in question requires the agency to apply its own specialized training and expertise. *Id.* Since before 1995 PERA has been excluding employer-paid deferred compensation from the definition of salary under Minn. Stat. § 353.01, subd. 10. PERA has made this determination throughout the years and has consistently applied this interpretation to all other units of local government. Duluth was similarly treated to other local units of government, so that pension salaries are not artificially inflated.

Based on PERA's longstanding interpretation of the salary definition, PERA's exclusion of the employer-paid deferred compensation and the insurance supplemental payment should be granted deference in this proceeding. Accordingly, PERA's decision is not an error of law and does not qualify as an unpromulgated rule.

**B. Substantial Evidence In The Record As A Whole, Including The City Of Duluth's Payroll Records And Testimony Of The City Auditor, Rather Than Mere Estimates As Permitted By Minn. Stat. §353.27, Supports The Decision Of The PERA Board.**

**1. Burden of proof.**

The procedural rules for contested case hearings provide that a party proposing that an agency take a certain action bears the burden of proving the facts at issue by a preponderance of the evidence. Minn. R. 1400.7300, subp. 5 (2009); *Minn. Ctr. for Env't'l. Advoc. v. MPCA*, 696 N.W.2d 398, 404 (Minn. Ct. App. 2005) (where environmental advocacy group argued that proposed permit should include specific discharge standard, advocacy group had burden of proof at contested case hearing to show standard was required).

In this case, PERA Executive Director, Mary Most Vanek, made the initial decision that the benefits at issue in this case were not "salary" under the PERA statute, Minn. Stat. § 353.01; subd. 10. PERA has already acted and has reduced "salary," and thus benefits, as is PERA's statutory charge. See Minn. Stat. § 353.03, subd. 3, and 353.18. Relators challenged this action by PERA, and PERA granted the contested case proceeding. The burden of proof was therefore on the Relators to prove by a preponderance of the evidence that the benefits at issue should properly have been included as salary for PERA purposes. See Minn. R. 1400.7300, subp. 5; *Minn. Ctr. for Env't'l. Advoc. v. MPCA*, 696 N.W.2d at 404; *In The Matter of the Application of John Allers and Konrad Stroh for Ret. Benefits*, 533 N.W.2d 646, 652 (Minn. Ct. App. 1995); *Manteuffel v. City of North St. Paul*, 538 N.W.2d 727, 729 (Minn. Ct. App. 1995).

**2. Minn. Stat. § 353.01, subd. 10(b), controls what is excluded as salary for PERA pension purposes.**

Relators fail to cite or discuss the application of Minn. Stat. § 353.01, subd. 10(b), which provides what is excluded as salary for pension purposes. Rather, Relators only cite to Minn. Stat. § 353.01, subd. 10(a) which has the more general definition of what is salary. Under the rules of statutory construction, the more specific provision controls the more general provision. Minn. Stat. § 645.26, subd. 1. Accordingly, the specific definition of what is not to be included as salary under subd. 10(b) should control in this specific situation. Subd. 10(b) excludes employer-paid fringe benefits and employer-paid amounts used by employees towards the cost of insurance coverage. The two types of payments at issue in this case are excluded by Minn. Stat. § 353.01, subd. 10(b).

Relators argue that this Court should look at statutes and decisions relating to Minnesota's salary cap for public employees. Relators' argument is without merit. What qualifies as compensation when the legislature is trying to limit salary for public employees does not control what qualifies as salary for the pension fund. The legislature has recognized that employers and employees will want to artificially inflate a public employee's salary by giving that employee fringe benefits and let the public view the salary as a smaller amount than the true compensation paid to the employee. However employer-paid fringe benefits are expressly excluded from salary for PERA purposes.

**3. Tax treatment is irrelevant.**

The federal Internal Revenue Service ("IRS") guidance on fringe benefits also distinguishes between voluntary employee-paid deferred compensation and

employer-paid deferred compensation as is the case here. Whether the City of Duluth correctly followed federal IRS regulations in handling employer-paid deferred compensation and supplemental insurance payments is not controlling in a decision of whether the employer-paid deferred compensation and supplemental insurance payments are salary under Minnesota's PERA statute. Nor does the taxability of any benefit govern what is salary under PERA's statute.

The PERA Trustees are fiduciaries pursuant to Minn. Stat. ch. 356A and as fiduciaries, they are required to comply with the laws governing PERA. PERA is required by statute to correct employer contributions, to address benefits and overpayments, and to recover overpayments. Minn. Stat. §353.27. PERA must refund contributions made on amounts that are not PERA-eligible salary, reduce benefits and recover overpayments resulting from inclusion of "fringe benefits" such as the employer-paid deferred compensation and insurance supplement payments at issue in this case..  
Minn. Stat. 353.27

Under Minnesota law, governmental employers have an obligation to correctly report salary to PERA. The definition of salary for PERA purposes is controlled by Minn. Stat. § 353.01, subd. 10. Employer-paid fringe benefits, employer-paid amount used by employer towards the cost of insurance coverage are expressly excluded from that statutory definition of salary. Minn. Stat. § 353.01, subd. 10(b).

The tax treatment of the employer-paid deferred compensation and insurance supplement payments is not relevant to determining whether these amounts were "fringe benefits" excluded from PERA salary pursuant to Minn. Stat. § 353.01, subd. 10. Cheryl

Keating, Pat Kappelhoff, and Wayne Parson all testified that based on their experience and knowledge, the employer-paid deferred compensation and the insurance supplemental payments were not salary within the statutory definition. It is the obligation of employers to comply with the PERA law and the tax laws. However, even if a public employer did not comply with the tax law regarding its treatment of employer-paid benefits, such benefits that are specifically excluded from the statutory definition of salary cannot be included for salary purposes by PERA.

It is unrefuted that the City of Duluth and Duluth employees have the obligation to comply with IRS regulations and tax law. Tax consequences are not within PERA's purview. Mr. Parson, recognized that the City of Duluth has the obligation to comply with tax laws and with PERA requirements. He also testified that the City may not have been consistent in how it applied the tax law. He recognized that the City of Duluth has the obligation to comply with both tax laws and with PERA requirements. Mr. Parson was unwavering in his position that employer-paid deferred compensation and supplemental insurance payments are not to be considered salary for pension purposes.

Whether the City of Duluth improperly included deferred compensation payments in employees' taxable income so that employees did not receive a tax benefit is an issue to be resolved between the City and the unions that bargained for employer-paid deferred compensation payments. The City of Duluth has an obligation to comply with the IRS statutes and regulations and it is beyond the purview of the PERA Board determine compliance with IRS regulations. More importantly for this case, the tax treatment of

deferred compensation benefits under federal law does not control whether such payments qualify as salary under Minnesota's PERA statutes.

**4. Duluth payroll records are sufficient evidence to support PERA's decision.**

PERA may rely on a schedule of estimated earnings to calculate PERA benefits in the event payroll abstract records have been lost or destroyed. Minn. Stat. § 353.27, subd. 11(b). In this case, however, the PERA Board based its decision on significantly more detailed evidence. As demonstrated below, that evidence more than meets the "substantial evidence" test.

Unrefuted evidence in the record establishes that the City of Duluth had year end back up tapes of its payroll records for the years 1997-2004 and payroll records from its current accounting system for the years 2005-2007. The back up tapes and payroll records were the City of Duluth's official records. The payroll data submitted by the City of Duluth and relied upon by PERA goes far beyond the estimates PERA is authorized to rely upon.

It is important to note that the ALJ did not find that the City of Duluth's payroll records were inaccurate as to the amount of employer-paid deferred compensation. Instead, the ALJ found that the records were inaccurate because deferred compensation contributions and insurance supplement payments were in some instances included in taxable income. As discussed above, however, the tax treatment of the City of Duluth's deferred compensation payments is not relevant to determine whether the payments are salary for PERA purposes.

Wayne Parson testified that he provided PERA with official city records in determining over-statements of salary to the City of Duluth employees and retirees. Mr. Parson also testified that he could determine, based on his review, that the City of Duluth had a payroll procedure to properly comply with the tax laws and to exclude deferred compensation paid by an employer and insurance supplemental payments from extra taxes. Even if the City of Duluth did not consistently comply with the tax laws, those employer-paid benefits should still be excluded as salary for PERA purposes.

Based on Mr. Parson's testimony, it is a misnomer to say that the payroll records were re-created. Mr. Parson testified that he was able to pull back-up tapes in order to show payroll registries. The payroll registry and back-up tapes are official city records. The payroll evidence provided by the City of Duluth is not only used in good faith, but more than meets the minimal statutory requirement of estimates that may be furnished to PERA in order to make PERA determinations.

Based on the official city records provided by the City of Duluth PERA's executive director made a reasonable decision to exclude employer-paid deferred compensation and insurance supplemental payments from the salary calculation of the Duluth employees. PERA is authorized to determine salary under Minn. Stat. § 353.03. PERA is also allowed to use estimates to make these determinations pursuant to Minn. Stat. § 353.27, subd. 11(b).

PERA's recalculations of Petitioners' benefits and the obligations of the City of Duluth and its employees to PERA were accurate.

## 5. Substantial evidence conclusion.

Accordingly, there is substantial evidence in the record that the tax treatment by the City of Duluth is irrelevant for the purposes of salary determination by PERA. Additionally, there is substantial evidence in the record to support the deference to be given to PERA and its long-term interpretation of its statutory definition of salary. Finally, there is substantial evidence based on the City of Duluth's submittal after 2008 to support the calculation of benefits for current and former Duluth city employees. Even if PERA had the burden of proof in this hearing, there would be substantial evidence to make this decision and to reach these conclusions.

Relators' argument regarding the probative value of the City of Duluth's financial records amount to a request for this Court to re-weigh the evidence that was presented to the PERA Board. As noted above, under Minnesota law, courts reviewing agency decisions will not re-weigh the evidence as Relators request. *See In re Lakedale Telephone Company*, 561 N.W.2d at 554 (reviewing court will not substitute its judgment for agency's regarding persuasive weight of evidence presented to agency); *Billy Graham Evangelical Assoc. v. Minneapolis*, 667 N.W.2d at 124 (upon review courts should not attempt to weigh credibility of evidence but should instead review the record to ensure that decision was legally sufficient - i.e. had support in the record).

Based on the entire record, PERA's decision to exclude employer-paid deferred compensation and insurance supplemental payments from salary is reasonable and consistent with the law.

**C. The PERA Board's Decision Is Not Arbitrary and Capricious.**

Based on the statutory definition, the prior interpretation of the statute by PERA, and the testimony received by the PERA Board, PERA's determination to exclude the benefit payments at issue in this case from PERA salary is not arbitrary or capricious, but is instead reasonable and consistent with the law.

As noted above, an administrative decision is not arbitrary and capricious if the decision maker explained its decision with appropriate references to the record before it, even if the Court might have reached a different conclusion if it had been the fact finder. *First National Bank v. Department of Commerce*, 350 N.W.2d at 368. See also *In re Rochester Ambulance Service*, 500 N.W.2d at 499 (agency action not arbitrary or capricious if there is room for two opinions on matter); *In re Petition of Minn. Power*, 545 N.W.2d at 51 (same).

In this case, it is clear that the PERA Board's decision satisfies the arbitrary and capricious test. There was testimony that other public entities made the same error as Duluth, and they were treated in the same manner by PERA. However, those public entities adopted special legislation limiting repayment to three years. The City of Duluth did not avail itself, and thus its retirees, to this special legislation.

The PERA Board is not unmindful of the hardship that the error in reporting benefits to PERA has caused to individual retirees who may have relied on this amount in retiring. However, PERA has an obligation to treat all public employers and public employees in a similar manner. Accordingly, PERA would breach its fiduciary duty if it allowed these Duluth retirees to have higher benefits than permitted by statute, and higher

amounts than allowed to all other public employees in PERA's plan. Minn. Stat. § 356A.02 and Minn. Stat. § 356A.04 (2010).

Any hardships to the employees, although unfortunate, do not affect the determination of salary. Additionally, any improper tax treatment by the City of Duluth also does not affect the PERA determination, even if it may have negative affects on the City of Duluth or individual employees by the IRS. Rather, PERA has an obligation to treat all local units of government and their employees consistently in excluding employer-paid deferred compensation and insurance supplemental payments from salary for PERA purposes.

**II. PROMISSORY ESTOPPEL AND EQUITABLE ESTOPPEL DO NOT APPLY IN THIS CASE WHERE A PENSION FUND BOARD LACKS THE AUTHORITY TO ACT OUTSIDE THE BOUNDS OF ITS AUTHORITY.**

Relators argue that promissory and equitable estoppel should prevent PERA's collection of improperly calculated benefits. Relators' claim fails because Minnesota Courts have long held that estoppel cannot be applied against a public pension plan where the plan or its board of trustees lacks the authority to act outside the bounds of its authority. See *In the Matter of the Application for PERA Retirement Benefits of Michael M. McGuire*, 756 N.W.2d 517, 519-20 (Minn. Ct. App. 2008), rev. den. (Minn. Dec. 16, 2008) (estoppel cannot be applied when doing so would cause agency to act outside bounds of its authority); *Axelson v. Minneapolis Teachers Retirement Association*, 544 N.W.2d 297, 302 (Minn. 1996) (estoppel will does not apply to agency action which would be outside of agency's authority); *In the Matter of the Retirement Benefits of*

*Robert W. Larson*, No. C7-95-2512, 1996 WL 310344 (Minn. Ct. App. June 11, 1996) (unpublished decision at RA1-RA5) (same).

Nothing in PERA's governing laws allows PERA or its Board of Trustees the discretion to waive the mandatory provisions of the law. PERA has no authority to deviate from the statutory definition of what does and does not qualify as salary under Minn. Stat. § 353.01, subd. 10 (a) and (b) (2008). PERA's duty with respect to erroneous deductions/contributions and overpayments to members is set forth in Minn. Stat. § 353.27. PERA has a statutory obligation to correct employer contributions. Minn. Stat. § 353.27, subd. 7(2)(c). PERA also has a statutory obligation to address benefits and overpayments and to recover overpayments. Minn. Stat. § 353.27, subd. 7(b) and (d). Therefore, equitable remedies that may be available in some other forum are not available in this proceeding.

Although individual retirees will be receiving less benefits than anticipated, PERA has an obligation to comply with the law. *See Axelson 544 N.W.2d 297*. Minnesota Statutes Chapters 353 and 356A, require the PERA Board of Trustees, as fiduciaries, to follow the law and the terms of its pension plan. As noted above, Minnesota courts have consistently held that equitable or promissory estoppel cannot apply to compel the PERA Board of Trustees to act outside the bounds of its authority. Under the reasoning of the cases cited above, Relators' estoppel arguments fail as a matter of law.

In addition, even if common law equitable principles of estoppel could apply in this proceeding, the factors that would support application of the doctrine are lacking. A

party seeking to apply estoppel against a government agency has a heavy burden. *Brown v. Minnesota Dept. of Pub. Welfare*, 368 N.W.2d 906, 910 (Minn. 1985). A party seeking to invoke the doctrine of equitable or promissory estoppel has the burden of proving 1) that promises or inducements were made; 2) that the person reasonably relied upon the promises; and 3) that the person will be harmed if estoppel is not applied. *Heidbreder v. Carton*, 645 N.W.2d 355, 371 (Minn. 2002). When seeking to apply estoppel against a government agency, some element of wrongful conduct by the government agency is also required. *City of North Oaks v. Sarpal*, 797 N.W.2d 18 (Minn. 2011) (holding that wrongful conduct required to estop government and that simple mistake by government official not wrongful conduct which would allow for estoppel). For the reasons discussed below, Relators cannot establish a claim for estoppel against the PERA Board in this case.

First, PERA had no notice prior to 2008 of the nature of the compensation that the City of Duluth was claiming as salary. Testimony by Cheryl Keating, Pat Kappelhoff, and Wayne Parson all show that PERA relied on information provided by the City of Duluth. Thus, PERA did not act wrongfully and estoppel does not apply in this case.

Second, PERA made no misrepresentations or promises to Relators regarding what would constitute salary. PERA's information to retirees specifically states that the law controls, not information provided by PERA. Thus, PERA did not make any promises to Relators. Moreover, the only reasonable belief that Relators could have is that state law controls determination of benefits.

Finally, Relators have not been legally prejudiced because they will receive all that the law authorizes them to receive as benefits. *In re Larson*, 1996 WL 310344 at \*5 (reduction of benefits to amount retiree legally should have received did not qualify as legal harm). Even though the employees may suffer economically from reduced benefits, PERA has an obligation to provide only the benefit permitted under Minnesota law.

PERA does recognize the economic impact that may occur to the City of Duluth retirees. However, PERA also recognizes its fiduciary duty to all pension members, not just the City of Duluth retirees. Other public employees have not been allowed to have employer-paid fringe benefits included for PERA salary purposes. The City of Duluth employees should not be allowed to have a higher PERA salary than other public employees have been permitted, or than the law authorizes.

Therefore, PERA cannot be estopped from properly complying with the statutory definition of salary and from basing benefits solely on the proper salary amount.

**III. PERA'S ACTIONS ARE NOT BARRED BY THE STATUTE OF LIMITATIONS, WHERE THE CITY OF DULUTH FAILED TO ADOPT SPECIAL LEGISLATION THAT WOULD HAVE SPECIFICALLY ADOPTED A THREE YEAR STATUTE OF LIMITATIONS FOR THE CITY, ITS EMPLOYEES, AND RETIREES.**

Relators assert various statutes of limitations which they argue should apply in this action to prevent PERA from correcting overpayments made by a pension fund to pension beneficiaries. The PERA law that applies to this proceeding does not create a time limitation within which PERA is required to correct erroneous contributions and recover the overpaid benefits that result. *See* Minn. Stat. § 353.27, subd 7(b) (2008). Prior to 1990, section 353.27 contained a three year statute of limitations, but the statute

was amended to allow erroneously taken deductions to be refunded without limit, and also required the suspension of benefits until all outstanding money has been recovered by the fund. *Compare* Minn. Stat. § 353.27 (2008) with Minn. Stat. § 353.27 (1988). As Relators concede, the statute was amended in 2009 to again place a three year limitation on the correction of erroneous contributions and deductions and resulting overpayments, but the amendment was not effective for this action. *See* Relator's Brief, p. 39.

Rather, Duluth and other public entities were given the opportunity to adopt special legislation to apply a limitation on corrections to benefit calculations. As was established at the hearing on this matter, the City of Duluth never adopted any such legislation. As a result, PERA's actions in re-calculating benefits in this case is legally required and is not barred by any applicable statute of limitations.

While there was testimony that other public entities made the same error as Duluth in calculating salary for their employees, those public entities adopted special legislation limiting repayment to three years. The City of Duluth never enacted similar legislation. Special legislation was again adopted in the 2011 special session for the City of Duluth to place a limitation on corrections. To date, however, the City has not adopted this limitation. *See* 2011 Minn. Laws, 1st Special Session, Ch. 8, Art. 1, Sec. 4.

When the applicable law does not contain a time limitation on administrative action, the courts have not provided one. *Nicholson v. I.S.D.* 636, No. CO-91-1404, 1992 WL 48113 (Minn. Ct. App. 1992) (unpublished opinion at RA6-RA9). Minnesota courts have ruled that the time limitations in Minn. Stat. § 541.05 apply only to judicial proceedings. *Har-Mar, Inc. v. Thorsen & Thorson, Inc.*, 218 N.W.2d 751, 754 (Minn.

1974); *Lucas v. American Family Insurance Co.* 403 N.W.2d 646, 650 (Minn. 1987).

There is no legal basis to assert that the PERA Board should invent or borrow from the civil law a time limitation on its duty to correct the mistakes caused by erroneously reported compensation.

Clearly the legislature does not intend that section 541.07, or any other statute provides a limitation for PERA to make corrections in this matter. That is precisely why the legislature has given the City another opportunity to adopt a three year limitation when the legislature passed special legislation for the City of Duluth in 2011. There is no legal basis for the Court to apply a statute of limitations, unless Duluth adopts the special legislation which provides a three year limitation.

#### **IV. PERA'S CORRECTION OF BENEFITS IS NOT AN UNCONSTITUTIONAL IMPAIRMENT OF CONTRACT OR AN UNCONSTITUTIONAL TAKING.**

There is no unconstitutional impairment of contract or an unconstitutional taking when a pension fund corrects benefit overpayments, as was done in this case.

There is no express or implied contract that any public employee or retiree can collect and retain overpaid pension benefits. To the contrary, Minn. Stat. § 353.27 expressly authorizes PERA to collect overpayments. If there is no enforceable contract or promise, there is no basis for a contract impairment claim. *See AFSCME Councils 6, 14, 65 & 96 v. Sundquist*, 338 N.W.2d 560, 566 (Minn. 1983). Because Relators had no contractual right to retain overpayments, there is no unconstitutional impairment of contract in this case.

Additionally, the Contract Clause of the United States Constitution states: “No State shall . . . pass any . . . Law impairing the Obligation of Contracts.” U.S. Const. Art. I, § 10. Despite the broad language of this clause, not every impairment is a constitutional violation. A law is invalid under the Contracts Clause *only if* it substantially impairs a contractual relationship and is not reasonable and necessary to serve an important and legitimate public purpose. *See United States Trust Co. of New York v. New Jersey*, 431 U.S. 1, 17 (1977); *Christensen v. Minneapolis Municipal Retirement Bd.*, 331 N.W.2d 740, 750-51 (Minn. 1983).

Relators’ contract impairment claims fail because there has been no impairment, let alone a substantial impairment, of any reasonable contractual expectations. A contract impairment occurs when a state law substantially disrupts a party’s reasonable contractual expectations. *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 244-46, 98 S.Ct. 2716, 2722-23 (1978) (noting legislation cannot alter contract terms “by effectively imposing on one of the parties an obligation which it had not reasonably anticipated or relieving a party of a contractual obligation.”). A “technical” or minimal contract alteration is not a constitutional violation. *See Id.* at 245, 98 S.Ct. at 2723 (“Minimal alteration of contractual obligations may end the inquiry at its first stage.”); *Acton Const’n v. Comm’r of Revenue*, 391 N.W.2d 828, 833 (Minn. 1986) (legislation restricting party to gains reasonably expected from a contract is not an impairment).

In short, PERA actually fulfilled any contractual obligations it had in this case. Relators’ only reasonable contractual expectation is that they would be paid benefits to which they are lawfully entitled. That has happened. Relators did not and could not have

a reasonable contractual expectation that they would be permitted to keep overpayments in violation of Minnesota law. Therefore, Relators impairment of contract claim fails.

Likewise, Relators' unconstitutional takings claim also fails. The Taking Clauses restrict the ability of government to take private property without just compensation. U.S. CONST. AMEND. V ("nor shall private property be taken for public use, without just compensation"); Minn Const. art. 1, § 13 ("private property shall not be taken, destroyed or damaged for public use, without just compensation therefore first paid or secured"); *See also Wensmann Realty, Inc. v. City of Eagan*, 734 N.W.2d 623, 631-32 (Minn. 2007) (noting the Takings Clause ensures that government does not require some citizens to bear a burden that should be borne by the public as a whole).

Relators' claimed expectation in keeping incorrectly paid benefits not provided for by law is not a property right protected by the Takings Clauses. As the First Circuit said in *National Education Ass'n-Rhode Island v. Retirement Bd. of the Rhode Island Employees' Retirement Sys.*, 172 F.3d 22, 29 (1st Cir. 1999), "the Supreme Court has also made clear that the protection under the Takings Clause does not extend to mere 'unilateral expectations' even if they are entirely plausible expectations of economic benefit." Therefore, Relators Takings claim also fails.

**V. RELATORS ARE NOT ENTITLED TO ATTORNEYS FEES WHEN THEY ARE NOT PREVAILING PARTIES AND PERA'S POSITION IS SUBSTANTIALLY JUSTIFIED.**

Relators cite four statutes as the basis for the request for attorney fees. None of these statutes supports an award of attorney fees to relators.

First, Relators argues that that they are entitled to an award of fees under Minn. Stat. § 15.472 because Relators contend that the PERA's position in this matter was not substantially justified. Relators' argument on this point is without merit because Relators are not prevailing parties.

Minn. Stat. § 15.472 (a) (2010) provides that:

If a prevailing party other than the state, in a civil action or contested case proceeding other than a tort action, brought by or against the state, shows that the position of the state was not substantially justified, the court or administrative law judge shall award fees and other expenses to the party unless special circumstances make an award unjust.

Under the plain language of the statute, an award of fees would only be appropriate if Relators (a) were a prevailing parties; and (b) could show that the PERA's position was not substantially justified. In this case, the Relators cannot claim to have been a prevailing party. Relators did not prevail before the PERA Board and the ALJ recommendation was not adopted by PERA Board. Rather, the PERA staff position was adopted. As a result, the Relators were not a prevailing parties and are not entitled to an award of fees under Section 15.472(a).

Moreover, PERA's position in this case was clearly substantially justified. This Court has held that an award of fees under Section 15.472 is not appropriate even where an agency's decision is ultimately reversed if the agency's position is "not without some

justification.” *Mbong v. New Horizon Nursing*, 608 N.W.2d 890, 895 (Minn. Ct. App. 2000). In this case, PERA’s decision was clearly substantially justified. The evidence showed that PERA treated Duluth in the same manner as it had other public entities since 1992.

Second, Minn. Stat. § 8.31, subd 1 and subd. 3A do not grant attorney fees in a challenge to a PERA Board determination. Relators argue that a challenge to a pension board determination constitutes “violations of the law of this state respecting unfair, discriminatory, and other unlawful practices in business, commerce or trade.” There is no case law to support this assertion. The administration of public pension benefits is not “business, commerce or trade;” nor is the proper calculation of benefits “unfair, discriminatory, or other unlawful practices.”

Third, Minn. Stat. § 353.03, subd. 3, also does not apply in this situation. This section specifically provides that the PERA board has the authority to pay its administrative costs from the fund. Moreover, Petitioners cite no case law which would provide authority for their request for attorney fees under this statute.

Finally, PERA is not governed by ERISA, a federal law that applies to private pension funds. Rather, PERA is a state public pension fund governed by state law. Accordingly, the request for attorney fees should be denied.

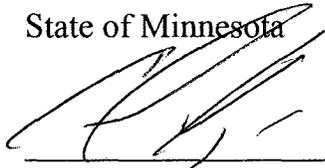
**CONCLUSION**

For the foregoing reasons, the Court should affirm the decision of the Public Employees Retirement Association Board of Trustees, finding that employer-paid deferred compensation and supplemental insurance payments must be excluded from the definition of "salary" under Minn. Stat. §353.03, subd. 10 (b), and in calculating proper benefits to the City of Duluth employees and retirees.

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Respectfully submitted,

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