

STATE OF MINNESOTA  
OFFICE OF ADMINISTRATIVE HEARINGS

FOR THE PUBLIC EMPLOYEES RETIREMENT ASSOCIATION

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

**PERA'S RESPONSE IN OPPOSITION TO  
PETITIONERS' MOTION FOR  
SUMMARY JUDGMENT**

Allen Johnson, et al., Petitioners.

OAH Docket No. 4-3600-2080902

**INTRODUCTION**

The Public Employees Retirement Association ("PERA") submits this Response Memorandum in opposition to Petitioners Paul Ostman, Douglas Michog, John Edwards, Mark Behning, Terry Purcell, Douglas Belanger, Dave Salvesson, Anne Peterson, L.J. Harvey, William L. Johnson, and David Wedin's ("Petitioners") Motion for Summary Judgment.

Petitioners agree with PERA: "The PERA salary status of the City of Duluth's deferred compensation and insurance supplements are questions of state law." Petitioners also agree that, "The status of the payments in question may be determined based upon the provisions of the collective bargaining agreements between the City of Duluth and its employees, the correspondence between the City of Duluth and PERA, and the statutory language." See Petitioners' Memorandum of Law, ("Pet. Mem.") page 1. Nevertheless, Petitioners devote the majority of their memorandum to: (1) Recollections of the bargaining process during which the parties agreed to employer deferred compensation contributions in lieu of salary increases; (2) Petitioners' claims to reliance on having those amounts treated as PERA salary; (3) An attempt to discredit the accuracy of the payroll records provided by the City of Duluth and

PERA's resulting determinations; (4) An attempt to avoid the restrictions of Minn. Stat. § 356.24 based upon vague internal audit notes of the State Auditor's Office dating back to 2002; (5) An irrelevant display of difficult-to-decipher pay check stubs; (6) Mischaracterizations of IRS qualified deferred compensation plans; and (7) Misstatements of applicable law.

PERA submitted numerous documents, affidavits, and a 29-page memorandum in support of its Motion for Summary Disposition. Petitioners submitted 18 affidavits and a 62-page memorandum in support of their Motion. Both PERA's and Petitioners' memorandums exceed the 25 page limitation set out in Minn. R. 1400.6600. Consequently, PERA's Reply Memorandum is intended to be brief and only address newly raised issues. In support of its opposition to Petitioners' Motion for Summary Judgment, incorporated by reference is PERA's Memorandum of Law in Support of PERA's Motion for Summary Disposition.

### **PETITIONERS' FACTUAL ASSERTIONS**

#### **1. The Collective Bargaining Process.**

PERA challenges Petitioners' self-serving recollections of what occurred fifteen years ago in the course of the bargaining process. Their claim that PERA was contacted and that PERA advised them to include the new form of compensation as "salary" lacks foundation as to when, how, and who they claimed to have contacted at PERA. Moreover, none of the Petitioners set forth what they claim they asked PERA. The nature of a response to a question all too often depends upon the question asked. Petitioners provide no specifics regarding how they may have characterized the employer contributions to PERA, or for that matter, to the State Auditor in 2002.

In 1994, PERA declared before the legislature that employer contributions to deferred compensation plans ("DCPs") were not salary. *See* Affidavit of David Bergstrom. In 1995, the

law generally prohibited governmental subdivisions from contributing to supplemental pension plans. An exception existed for an employer “match” to the State DCP plan, which could not exceed \$2,000 per year. *See* Act of May 10, 1995, ch. 141, art. 3, § 16, 1996 Minn. Laws at 378-79 (Minn. Stat. § 356.24 (1995)), copy attached. Petitioners’ claims to PERA’s approval lack credibility when considered against the backdrop of applicable law and PERA’s public explanations of how it interpreted its salary definition. PERA challenges Petitioners’ claims as to what was said fifteen years ago during contract negotiations and the unsubstantiated claim that someone contacted someone at PERA regarding the status of employer contributions.

At best, the bargaining process reflects that the City was unwilling to increase salaries and instead of salary increases, proposed an employer contribution to the employees’ deferred compensation accounts.

## **2. Availability of Deferred Compensation Funds.**

Petitioners’ collective bargaining agreements do not set the terms regarding the availability of their DCP accounts. The bargaining agreements require that contributions be made to tax-qualified “457” plans. Federal tax law sets the terms for distributions from those plans.

The purpose of a 457 plan is to delay the “constructive receipt” of income. Section 457 and related regulations limit “in-service” distributions. 29 U.S.C. § 457 (2006). For convenience, attached to this Memorandum are several pages from the “*457 Pension Answer Book*, (5th Ed. 2007) and a copy of section 457 of the Code that explain permissible distributions. “In-service” distributions are strictly limited and result in a taxable event. A 457 plan may choose whether loans are available. The State DCP administered by MSRS does not allow for loans. *See* Second Affidavit of David Bergstrom.

In recent years, the IRS law has changed to allow for tax-deferred “roll-overs” of deferred compensation to tax-qualified pension plans. Since the funds stay in a tax-qualified pension plan, subject to early distribution limitations, a roll-over does not result in the constructive receipt of income.

Both employer and employee contributions to DCPs are subject to FICA taxes, but this requirement does not apply to those Petitioners who are police or fire employees. They are not subject to Minnesota’s 218 Agreement and do not participate in the social security system. *See* Minn. Stat. §§ 355.091, .07(d) (2008). That is why special benefits are provided under the Police and Fire Fund, including higher employer and employee contributions than other employees with correspondingly higher benefits.

Unlike wages and other forms of salary, there are strict limitations on the “availability” of deferred compensation under a 457 plan.

### **3. The City of Duluth’s Self-Insured Medical Plan.**

Petitioners seek to avoid the salary exclusion for “employer paid amounts used by an employee toward the cost of insurance coverage,” Minn. Stat. § 353.01, subd. (1)(b), by claiming that the City never offered insurance coverage since it had not contracted with an insurance company for such coverage. *See* Pet. Mem. at 6-7 and 36. Petitioners ignore the fact that the City is providing insurance coverage through a self-insured benefit plan. Its benefit plans provide insurance to its employees and retirees. The Fire Fighters, the Police and the AFSCME CBAs make numerous references to Hospital-Medical Insurance. *See, e.g.,* Article 18, 2007-2009 Local 101 CBA). The City of Duluth’s Employee Benefits Handbook (2009) opens with Duluth’s promise: “The City of Duluth expects to continue its health insurance program indefinitely.” The manual makes many references to Health, Dental, and Life Insurance plans

and the benefit plans are subject to federal “COBRA” continuation requirements. *See* Second Affidavit of Mary Most Vanek, Ex. 1.

The City provides its employees medical insurance through a self-insured plan and when the City contributes amounts used by its employees towards the cost of that insurance, those amounts are excluded from salary under Minn. Stat. § 353.01, subd. 10(b)(2).<sup>1</sup>

#### **4. Petitioners’ Salary Stubs.**

Petitioners’ pay stubs confirm that the City of Duluth treated the employer contributions (“deferred wages” or “deferred comp allowance”) and “insurance supplements” as “gross earnings.” Deductions were made for “flexible benefits,” “health plan premiums” or “health insurance,” and “Deferred Compensation.” *See* Charbonneau Aff., Ex. 7; Johnson Aff., attached pay stubs. From some of the pay stubs, it appears that where the employee was making voluntary deferred compensation contributions, the employer’s contribution was simply added to the amount contributed by the employee. Some of the listed deductions, such as “FRINGE BEN - PENSION-EMPR” (*see* Johnson Aff.) are not explained. If Petitioners claim the pay stubs show that deferred compensation was a “deduction from” other compensation, thereby falling under the general definition of salary in Minn. Stat. § 353.01, subd. 10(a)(1), the pay stubs do little to show what the amounts were deducted from.<sup>2</sup>

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<sup>1</sup> In a recent case, *Savela v. City of Duluth*, the St. Louis County District Court discussed the City’s “insurance” program and “benefit plan” without distinction. *See Savela v. City of Duluth*, File No. 69DU-CV-08-1973 (Minn. Dist. Ct. Sept. 10, 2009) (copy attached).

<sup>2</sup> PERA submits that the best evidence of how the employer contributions were treated for tax purposes are Petitioners’ annual W-2 statements which provide boxes in which an employer is to report both employee elective deferrals and employer contributions. A blank W-2 form with applicable instructions is attached. For their own reasons, Petitioners have chosen not to rely upon their W-2 statements.

## 5. The State Auditor's Internal Working Papers.

Petitioners claim that the State Auditor raised issues regarding the legality of the City's deferred compensation contributions in 2001. Since a note on those papers by an unidentified author states, "issue resolved," Petitioners claim that the State Auditor approved the contributions and "determined it to be legal and in compliance with PERA and the law." Pet. Mem. at 15-17. The State Auditor's notes cannot trump state law. Moreover, the State Auditor made no findings relating to the contributions' status under PERA. Further, Petitioners' claim that the auditors were satisfied when city representatives explained to them that the contributions were declared as income and that no matching payments were ever required," (Pet. Mem. at 11) makes no sense.

Petitioners apparently believe that since the employer contributions were not an "employer match," the provisions of Minn. Stat. §§ 356.24-25 do not apply. This is simply wrong. In 2001 and until 2008, Minn. Stat. § 356.24 prohibited governmental subdivisions from contributing anything *but* an employer match and this match was limited to \$2,000. Minn. Stat. § 356.24, subd. 1(a)(5)(i), (iii) (2006).<sup>3</sup> The restrictions of Minn. Stat. § 356.24 apply to the City of Duluth's DCP contributions. First, they were not a matching contribution and second, for the years 2001 to 2008, they exceeded the \$2,000 limitation. For the auditors to walk away from this issue makes a reasonable person query how the contributions were actually explained to the auditors. The Auditor specifically referenced section 356.24 and recommended that Duluth's City Attorney review the statute to determine the legality of the City contributions. *See* Storaasli

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<sup>3</sup> In 2008, the allowable contribution was changed to allow for a matching contribution of up to one-half of the elective deferral allowed by the IRS. Minn. Stat. § 356.24, subd. 1(a)(5) (2008).

Affidavit, Ex. B. No evidence has been presented showing that the City Attorney ever reviewed the statute as recommended.<sup>4</sup>

Finally, it must be questioned whether the wrongful contribution of public funds and their resulting increase in pension benefits is consistent with sound public policy. First, Petitioners claim they can use unauthorized employer contributions to increase their average salaries for PERA purposes. Rolling over those contributions to the PERA plan and purchasing additional service credits result in a further increase in benefits. There is something inherently wrong in this unusual form of “double dipping.”

From a sound public pension policy, Petitioners should not be able to increase their public pensions based upon unlawful contributions.

**6. The City of Duluth’s Payroll Records and PERA’s Reliance on Those Records.**

Section 353.27, subd. 11(b) provides:

In the event payroll abstract records have been lost or destroyed, for whatever reason or in whatever manner, so that such schedules of salaries cannot be furnished therefrom, the employing governmental subdivision, in lieu thereof, shall furnish to the association an estimate of the earnings of any employee or former employee for any period as may be requested by the executive director. If the association is provided a schedule of estimated earnings, the executive director is authorized to use the same as a basis for making whatever computations might be necessary for determining obligations of the employee and employer to the retirement fund. If estimates are not furnished by the employer at the request of the executive director, the executive director may estimate the obligations of the employee and employer to the retirement fund based upon those records that are in its possession.

Minn. Stat. § 353.27, subd. 11(b) (2008).

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<sup>4</sup> The auditors advised the City of Duluth to seek the advice of its City Attorney on the issue. Although Petitioner Brown served as the City of Duluth’s attorney during the time in question, the record does not reflect if the City sought his advice or what that advice might have been.

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. PERA believes the City made a good faith effort to re-create payroll data and PERA, as required by Minn. Stat. § 353.27, and utilized that data in good faith. At the pre-trial conference in this matter, the City of Duluth’s representative stated that any individuals who wished to review their own payroll records could visit the City’s offices in order to review their records. In addition, Petitioners were fully informed that if they disagreed with the figures they received from PERA, that they should contact the City of Duluth. Only one Petitioner contacted the City and only one Petitioner contacted PERA. *See* Second Affidavit of Mary Most Vanek. The other Petitioners simply chose to agitate amongst themselves.

PERA submits that the City’s efforts to accurately report contributions by re-creating payroll records could have been avoided. The CBAs set out the monthly amounts provided for deferred compensation and insurance supplements. No one disputes those numbers. Moreover, it is reasonable to assume that Petitioners received the amounts set out in the CBAs and those amounts were reported as salary to PERA. None of the Petitioners claims that PERA seeks to exclude contributions in excess of the amounts set out in the CBAs. The dollar amounts contributed for each Petitioner can be easily determined through the CBAs. Once the legal issues in this proceeding are decided, PERA stands willing to meet and assist any of the Petitioners, employees or retirees with a review of the records and bargaining agreements. *See* Second Affidavit of Mary Most Vanek.

## PETITIONERS' ERRONEOUS LEGAL ARGUMENTS

### 1. The PERA Board's Fiduciary Duty.

PERA's Board members and its Executive Director are fiduciaries. Minn. Stat. § 356A.02, subd. 1 (2008). Its fiduciary duty extends beyond the interests of the Petitioners. It owes the same duty to the taxpayers of the state, the City of Duluth, and to the State of Minnesota. *Id.* § 356A.04, subd. 1 (2008).

Without question, the PERA Board's foremost duty is to maintain the federal tax-qualified status of its pension plans. To do so, it must strictly follow the terms of its plans and remedy all operational failures. *See* Memorandum in Support of PERA's Motion, p. 5.

In fulfilling its fiduciary duty, the PERA Board is held to the standard of a "prudent person," not the "prudent expert" standard claimed by Petitioners. *Compare* Minn. Stat. § 356A.04, subd. 2 (2008) *with* Petitioners' claim to a higher standard, Pet. Mem. at 25.

Petitioners' characterization of *Application of Allers'* charge to PERA to "police" salary reports merits mention. In that case the court found:

Whereas PERA can accord deference to the salary of a member because the member is employed by a public agency, *see* Minn. Stat. § 43A.17, subd. 1 (1992) . . . no statutory ceiling on salaries applies to private employees. Because the legislature endowed the PERA Board with broad powers to "allow or disallow claims for withdrawals, pensions, or benefits payable from the fund," we hold that the fiduciary duty of the PERA Board owes its members, the taxpayers of the state, and the state requires PERA to be even more diligent in policing the *salary reports of the limited number of private employees* within its purview.

*Application of Allers*, 533 N.W.2d 646, 651-52 (Minn. 1995) (emphasis added). Petitioners apparently claim that PERA has the fiduciary duty to "police," through field audits, the payroll records of the 4,000 governmental subdivisions that participate in PERA. Such a duty would, of course, come with a high price tag in personnel and administrative costs. The federal and state "exclusive benefit rule" that applies to PERA does allow for the expenditure of reasonable and

necessary costs from the PERA Fund. However, PERA questions whether the employees of the state's 4,000 governmental subdivisions would agree with Petitioners' claim that their benefit fund should bear the expenses "policing" would require. *See generally*, Second Affidavit of Mary Most Vanek.

**2. The PERA Salary Definition and PERA's Past Practice.**

Petitioners admit that PERA has historically interpreted its salary definition as excluding non-employee contributions. Pet. Mem. at 28. Doing so is consistent with Minn. Stat. § 353.01, subd. 10 (1)(a). Salary is determined before deduction for, "deferred compensation, supplemental retirement plans, or *other voluntary salary reduction programs . . . .*" *Id.* (emphasis added).

Petitioners ignore the impact of the emphasized language. Employee paid deferred compensation is a voluntary salary reduction program. Employer paid deferred compensation is not a voluntary salary reduction. It is in addition to the salaries provided under the terms of the bargaining agreements.

**3. Petitioners' Claim that the Legislature Refused to Exclude Employer Paid Deferred Compensation is Wrong.**

This claim stretches the boundaries of reasonable advocacy. It is simply false. It is quite clear from the 1995 Legislative Salary Report that the only statewide fund that did not exclude employer matching contributions from salary was MSRS.<sup>5</sup> There is no support for the claim that in 1994 the legislature rejected a bill providing for the exclusion.

Petitioners are apparently confused over the extensive amendments made to PERA's definition of salary in 1993 and 1994, and the MSRS legislation proposed in 1995.

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<sup>5</sup> The reason the exclusion was expressed as a "matching contributions" is because that was the only employer contribution authorized under Minn. Stat. § 356.24.

The Murphy Affidavit did not address the 1995 legislation at all. The proposed legislation quoted by Petitioners (Pet. Mem. at 28) was the result of the 1995 Salary Committee's recommendation that the pension funds' definitions of salary be consistent. It therefore proposed legislation that applied *only* to MSRS. *See* Second Affidavit of David Bergstrom. In 1995, an amendment was adopted fulfilling the Committee's recommendation. *See id.*

Whether intentional or not, Petitioners' presentation of the bill claimed to have been rejected by the legislature in 1994 is deceptive. *See* Pet. Mem. at 28. Their quote of the bill excludes the bill's caption: "Section 1. Minnesota Statutes 1994, section 352.01, subdivision 13, is amended to read:" A copy of the legislation as proposed in 1995 is included in the Second Affidavit of David Bergstrom. The legislation was proposed in 1995, related only to MSRS, as Chapter 352 relates only to MSRS, and was approved, not rejected, by the legislature. *Id.*

**4. The 1984 Attorney General's Opinion Did Not Find That Employer Contributions Were Salary for PERA Purposes. The Opinion Did Recognize the Distinction Between a Payroll Deferral and an Employer Contribution.**

Petitioners' reliance upon Attorney General Opinion 59-A-41, February 22, 1984 is misplaced for a number of reasons. Foremost, of course, is that the opinion was issued prior to the changes in PERA's definition of salary which occurred ten years later, and prior to the changes in other pension laws relating to a governmental subdivision's authority to contribute to supplemental pension plans.

The Attorney General's Opinion did not opine that employer-paid deferred compensation is "salary" for PERA purposes. It recognized the limitations Minn. Stat. § 356.24 placed on employer contributions to supplemental pension plans. In commenting upon the 1984 version of Minn. Stat. §§ 356.24 and 356.25, the opinion stated "thus subject to the exceptions named in those sections, payment of public funds (i.e., employer contributions) to pension or deferred

compensation funds in addition to the primary program provided for such employees is not authorized.” Op. Atty. Gen., Feb. 22, 1984 at 4. Because of those limitations, the Attorney General opined that any payments for deferred compensation must come from the employee’s salary. In reviewing the allowable contributions to the State’s DCP, the opinion stated:

This section (352.96) also expresses the plain distinction between direct contribution of public funds (“employer contributions”) and voluntary allocation of employee compensation (payroll deduction).

*Id.* at 7.<sup>6</sup> Nothing in the opinion suggests that employer contributions are part of an employee’s salary. The opinion stands for the proposition that in 1984, if a governmental subdivision wanted to pay additional compensation through deferred compensation, it must be taken from the employee’s salary.

PERA’s statute defining salary has changed since 1984. The provisions of Minn. Stat. §§ 356.24 and 356.25 now allow for limited employer contributions to 457 plans and serve to change the result of the 1984 opinion. From 1995 through 2008, a governmental subdivision could make employer contributions to a 457 plan in an amount *matching* the employee’s contributions with a maximum amount of \$2,000. The 1984 Attorney General Opinion supports PERA’s position, not Petitioners’ position.

**5. Neither *Allegrezza* Nor *Christensen* Support Petitioners’ Claims to Estoppel.**

The 1983 *Christensen* case cited throughout Petitioners’ Memorandum addressed a legislative amendment that changed the statutory terms of a pension plan resulting in the

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<sup>6</sup> Not discussed in the opinion but presumably of concern to the City of Mankato and its City Manager was Minn. Stat. §43A.17, subd. 9, which limits public employee salaries to 95 percent of the Governor’s salary. This section served to encourage the payment of additional compensation in forms that would not be considered to be “salary.” The facts in the opinion show that Mankato and its City Manager agreed to a reduction of salary in return for an equivalent employer DCP contribution. In contrast, Petitioners’ did not agree to a reduction in salary. They bargained for “salary” in the amounts set forth in the CBAs and, in addition, an employer DCP contribution.

termination of a retiree's pension. The Court applied estoppel principles to determine whether a contract right existed and the extent to which those terms could be changed. In contrast, this proceeding seeks to enforce the terms of the pension plan, not change them.

Administrative Law Judge George Beck's decision in *Allegrezza* was issued on March 1, 1995. Judge Beck relied upon *Christensen* to find that PERA was estopped from changing the benefits Allegrezza relied upon when he retired. On June 6, 1995, the Court of Appeals issued its decision in *Axelson v. Mpls. Teachers' Retirement Fund Association*, 532 N.W.2d 594 (Minn. Ct. App. 1995). The Court of Appeals also relied upon *Christensen* to find that the MTRFA was estopped from denying Axelson a promised benefit. See *Axelson*, 532 N.W.2d at 596-97. On March 8, 1996, the Supreme Court reversed the Court of Appeals and rejected the Court of Appeals' reliance on *Christensen*, finding that estoppel did not apply where an agency lacked the authority to act. *Axelson v. Mpls. Teachers' Retirement Fund Association*, 544 N.W.2d 297, 299-300 (Minn 1996). A number of subsequent Court of Appeals' decisions and the current Supreme Court have followed the Supreme Court's *Axelson* decision against claims to estoppel based upon *Christensen*. See PERA's Memorandum in Support of PERA's Motion for Summary Disposition, at 22-25.

Estoppel cannot be claimed to prevent the PERA Board from applying the terms of the PERA pension plans.

#### **6. Petitioners' Constitutional Claims.**

Since neither the Office of Administrative Hearings nor the PERA Board of Trustees has the authority to decide Petitioners' Constitutional claims, they will not be addressed in this Memorandum.

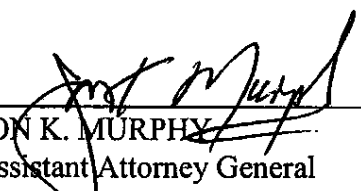
## SUMMARY

Employer paid contributions to tax-qualified deferred compensation plans and employer-paid insurance supplements do not fall within the definition of "salary" for PERA purposes. In addition, they fall within several of the specific exclusions in Minn. Stat. § 353.01, subd. 2(b)(2) and (b)(5) (2008). For the reasons set forth in PERA's Memorandum of Law In Support of PERA's Motion for Summary Disposition, neither laches nor the time limitations for civil actions applies to this proceeding. Petitioners' Motion for Summary Judgment should be denied and PERA's Motion for Summary Disposition should be granted.

Dated: *March 15, 2010*

Respectfully submitted,

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State of Minnesota

  
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AG: #2603180-v1

Act of May 10, 1995

(vi) the period in which the unfunded actuarial accrued liability amount determined in item (iii) is amortized by the total level annual dollar or level percentage amortization contribution computed under item (v) must be calculated using the interest assumption specified in subdivision 4d in effect after any applicable change, rounded to the nearest integral number of years, but not to exceed 30 years from the end of the plan year in which the determination of the established date for full funding using the procedure set forth in this clause is made and not to be less than the period of years beginning in the plan year in which the determination of the established date for full funding using the procedure set forth in this clause is made and ending by the date for full funding in effect before the change; and

(vii) the period determined under item (vi) must be added to the date as of which the actuarial valuation was prepared and the date obtained is the new established date for full funding.

(d) For the Minneapolis employees retirement fund, the established date for full funding is June 30, 2020.

(e) For the public employees retirement association police and fire fund, an excess of valuation assets over actuarial accrued liability will be amortized in the same manner over the same period as an unfunded actuarial accrued liability but will serve to reduce the required contribution instead of increasing it.

Sec. 16. Minnesota Statutes 1994, section 356.24, subdivision 1, is amended to read:

Subdivision 1. **RESTRICTION; EXCEPTIONS.** (a) It is unlawful for a school district or other governmental subdivision or state agency to levy taxes for, or contribute public funds to a supplemental pension or deferred compensation plan that is established, maintained, and operated in addition to a primary pension program for the benefit of the governmental subdivision employees other than:

(1) to a supplemental pension plan that was established, maintained, and operated before May 6, 1971;

(2) to a plan that provides solely for group health, hospital, disability, or death benefits;

(3) to the individual retirement account plan established by sections 354B.01 to 354B.05;

(4) to a plan that provides solely for severance pay under section 465.72 to a retiring or terminating employee;

(5) for employees other than personnel employed by the state university board or the community college board and covered by section 354B.07, subdivision 1, to:

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of

(ii) payment of the applicat  
annuity contract qualified under  
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\$2,000 a year per employee;

(i) to the state of Minnesc  
352.96; or

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Code with respect to the tax-shel  
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354B.07 to 354B.09, if provide  
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(b) A qualified insurance co

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applicant insurance companies  
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made on or before January 1,  
state board of investment may  
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establish a budget for its costs  
cesses. The state board of inv

~~(i) the state of Minnesota deferred compensation plan under section 352.96;~~  
or

~~(ii) payment of the applicable portion of the premium on a tax sheltered annuity contract qualified under section 403(b) of the federal Internal Revenue Code, purchased from a qualified insurance company; if provided for in a personnel policy of the public employer or in the collective bargaining agreement of between the public employer with and the exclusive representative of public employees in an appropriate unit, in an amount matching employee contributions on a dollar for dollar basis, but not to exceed an employer contribution of \$2,000 a year per employee;~~

~~(i) to the state of Minnesota deferred compensation plan under section 352.96; or~~

~~(ii) in payment of the applicable portion of the premium on a tax-sheltered annuity contract qualified under section 403(b) of the Internal Revenue Code, if purchased from a qualified insurance company, and if the employing unit has complied with any applicable pension plan provisions of the Internal Revenue Code with respect to the tax-sheltered annuity program during the preceding calendar year; or~~

~~(5) (6) for personnel employed by the state university board or the community college board and covered by sections 352D.02, subdivision 1a, and 354B.07, subdivision 1, to the supplemental retirement plan under sections 354B.07 to 354B.09, if provided for in a personnel policy or in the collective bargaining agreement of the public employer with the exclusive representative of the covered employees in an appropriate unit, in an amount matching employee contributions on a dollar for dollar basis, but not to exceed an employer contribution of \$2,000 a year for each employee.~~

(b) A qualified insurance company is a company that:

(1) meets the definition in section 60A.02, subdivision 4;

(2) is licensed to engage in life insurance or annuity business in the state;

(3) is determined by the commissioner of commerce to have a rating within the top two rating categories by a recognized national rating agency or organization that regularly rates insurance companies; and

(4) is determined by the state board of investment to be among the ten applicant insurance companies with competitive options and investment returns on annuity products. The state board of investment determination must be made on or before January 1, 1993, and must be reviewed periodically. The state board of investment may retain actuarial services to assist it in this determination and in its periodic review. The state board of investment may annually establish a budget for its costs in any determination and periodic review processes. The state board of investment may charge a proportional share of all

satisfies the other requirements of Treasury Regulations Section 1.408-2(e)(2) and (e)(6), the IRS may apply the requirements in a manner that is consistent with the applicant's status as a governmental unit. [Treas. Reg. § 1.408-2T(3)(8)(i)]

## Distributions and Related Issues

### Q 2:204 Must an eligible 457(b) plan specify when benefits are payable from the plan?

Yes. In general, an eligible plan must specify a fixed or determinable time of payment by reference to the occurrence of an event (e.g., retirement) that triggers the individual's right to receive or commence receiving amount deferred under the plan. The individual can be given the right to make a deferral election as to that time or event (see Qs 2:205, 2:219).

### Q 2:205 When can distributions be made from an eligible 457(b) plan?

Benefits cannot be made available to participants before the earliest of the following:

1. The occurrence of an unforeseeable emergency; [I.R.C. § 457(d)(1)(A)(iii); TAMRA § 1011(e)]
2. The participant's separation (severance after 2001) (see Qs 1:17, 7:13 from service with the sponsoring employer;
3. Retirement in accordance with the terms of any retirement plan maintained by the sponsoring entity;
4. The participant's attainment of age 70; or
5. The participant's death.

[I.R.C. § 457(d)(1)]

In addition, minimum distribution requirements apply to eligible plans. (The minimum distribution requirements are more fully discussed in chapter 3. See Q 2:233 for a general discussion of basic minimum distribution concepts.)

### Q 2:206 Can an employer offset plan benefits by the amount due from the participant?

Possibly in the case of a nongovernmental 457(b) plan, to the extent that a plan (or applicable law) does not contain a prohibition against alienation or assignment. There is an economic benefit issue raised by an offset; that is, whether the amount of the offset is taxable under the cash equivalency theory (Press and Patchell 1996). As a result of the exclusive benefit rule, a governmental 457(g) trust is not subject to offset, except perhaps for expenses (e.g., administrative, legal) properly chargeable against it as specified in the trust document.

ulations Section 1.408-2(e)(2) to a manner that is consistent with Treas. Reg. § 1.408-2T(3)(8)(i)]

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seeable emergency; [I.R.C.

e after 2001) (see Qs 1:17, 7:13) yer;

ns of any retirement plan main-

or

ments apply to eligible plans. (The fully discussed in chapter 3. See num distribution concepts.)

efits by the amount due

l 457(b) plan, to the extent that a prohibition against alienation or ssue raised by an offset; that is, nder the cash equivalency theory exclusive benefit rule, a govern- et, except perhaps for expenses ble against it as specified in the

**Q 2:207 Can a secured creditor of the employer make a claim on 457 plan assets?**

A secured creditor of the employer cannot make a claim on 457 plan assets if the plan is funded, that is, if the plan is a governmental 457 trust. In other cases, it would depend on the status of a secured creditor under applicable law.

**Q 2:208 Are plan distributions excludable from the bankruptcy estate?**

Contradictory federal court rulings left this issue unresolved for some time. Creditors' rights and bankruptcy protection are more fully discussed in chapter 9.

One U.S. district court determined that an eligible 457(b) plan is excluded from the bankruptcy estate. [*In re Wheat*, 149 B.R. 1003 (Bankr. S.D. Fla. 1992)] A different federal court determined that an eligible 457(b) plan is not excluded from the bankruptcy estate. [*Pederson v. Public Employees Benefit Services Corp.*, No. 91-91194 (S.D. Iowa June 16, 1993)] However, for bankruptcies beginning after October 16, 2005, a 457(b) trust or custodial account would generally be exempt from the estate of a bankrupt participant under U.S. Code Section 522(b)(12) (see Q 2:47).

**In-Service Withdrawals**

**Q 2:209 Under what conditions may a participant receive a distribution while employed?**

Except for cash-outs of accounts of less than \$5,000 where there have been no contributions for the two years prior to the distribution (see Q 2:228), there are only two conditions under which a participant may request a distribution prior to separation from service with the employer:

1. For an unforeseeable emergency (the plan must contain provisions for allowing such distributions, and the term *unforeseeable emergency* must be defined in the plan documents); or
2. On attainment of age 70.

The need to pay funeral expenses of a spouse or a dependent may also constitute an unforeseen emergency. [Treas. Reg. § 1.457-6(c)(2)(i)]

Special rules apply to terminated plans (see Q 2:264).

**Q 2:210 Can rollovers be ignored for cash-outs?**

For years after 2001, a plan will be permitted to ignore amounts attributable to rollover contributions when determining the cash-out amount. [I.R.C. § 457(e)(9)(A)(ii), amended by EGTRRA § 648(b)]

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I.R.C. § 457

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Effective: June 17, 2008

United States Code Annotated Currentness

Title 26. Internal Revenue Code (Refs &amp; Annos)

Subtitle A. Income Taxes (Refs &amp; Annos)

Chapter 1. Normal Taxes and Surtaxes (Refs &amp; Annos)

Subchapter E. Accounting Periods and Methods of Accounting

☑ Part II. Methods of Accounting

☑ Subpart B. Taxable Year for Which Items of Gross Income Included (Refs &amp; Annos)

→ § 457. Deferred compensation plans of State and local governments and tax-exempt organiza- tions

(a) Year of inclusion in gross income.--

(1) **In general.**--Any amount of compensation deferred under an eligible deferred compensation plan, and any income attributable to the amounts so deferred, shall be includible in gross income only for the taxable year in which such compensation or other income--

(A) is paid to the participant or other beneficiary, in the case of a plan of an eligible employer described in subsection (e)(1)(A), and

(B) is paid or otherwise made available to the participant or other beneficiary, in the case of a plan of an eligible employer described in subsection (e)(1)(B).

(2) **Special rule for rollover amounts.**--To the extent provided in section 72(t)(9), section 72(t) shall apply to any amount includible in gross income under this subsection.

(3) **Special rule for health and long-term care insurance.**--In the case of a plan of an eligible employer described in subsection (e)(1)(A), to the extent provided in section 402(l), paragraph (1) shall not apply to amounts otherwise includible in gross income under this subsection.

(b) **Eligible deferred compensation plan defined.**--For purposes of this section, the term "eligible deferred compensation plan" means a plan established and maintained by an eligible employer--

(1) in which only individuals who perform service for the employer may be participants,

(2) which provides that (except as provided in paragraph (3)) the maximum amount which may be deferred under the plan for the taxable year (other than rollover amounts) shall not exceed the lesser of--

(A) the applicable dollar amount, or

(B) 100 percent of the participant's includible compensation,

(3) which may provide that, for 1 or more of the participant's last 3 taxable years ending before he attains normal retirement age under the plan, the ceiling set forth in paragraph (2) shall be the lesser of--

(A) twice the dollar amount in effect under subsection (b)(2)(A), or

(B) the sum of--

(i) the plan ceiling established for purposes of paragraph (2) for the taxable year (determined without regard to this paragraph), plus

(ii) so much of the plan ceiling established for purposes of paragraph (2) for taxable years before the taxable year as has not previously been used under paragraph (2) or this paragraph,

(4) which provides that compensation will be deferred for any calendar month only if an agreement providing for such deferral has been entered into before the beginning of such month,

(5) which meets the distribution requirements of subsection (d), and

(6) except as provided in subsection (g), which provides that--

(A) all amounts of compensation deferred under the plan,

(B) all property and rights purchased with such amounts, and

(C) all income attributable to such amounts, property, or rights,

shall remain (until made available to the participant or other beneficiary) solely the property and rights of the employer (without being restricted to the provision of benefits under the plan), subject only to the claims of the employer's general creditors.

A plan which is established and maintained by an employer which is described in subsection (e)(1)(A) and which is administered in a manner which is inconsistent with the requirements of any of the preceding paragraphs shall be treated as not meeting the requirements of such paragraph as of the 1st plan year beginning more than 180 days after the date of notification by the Secretary of the inconsistency unless the employer corrects the inconsistency before the 1st day of such plan year.

(c) **Limitation.**--The maximum amount of the compensation of any one individual which may be deferred under subsection (a) during any taxable year shall not exceed the amount in effect under subsection (b)(2)(A) (as modified by any adjustment provided under subsection (b)(3)).

(d) **Distribution requirements.**--

(1) **In general.**--For purposes of subsection (b)(5), a plan meets the distribution requirements of this subsection if--

(A) under the plan amounts will not be made available to participants or beneficiaries earlier than--

- (i) the calendar year in which the participant attains age 70 1/2,
- (ii) when the participant has a severance from employment with the employer, or
- (iii) when the participant is faced with an unforeseeable emergency (determined in the manner prescribed by the Secretary in regulations),

(B) the plan meets the minimum distribution requirements of paragraph (2), and

(C) in the case of a plan maintained by an employer described in subsection (e)(1)(A), the plan meets requirements similar to the requirements of section 401(a)(31).

Any amount transferred in a direct trustee-to-trustee transfer in accordance with section 401(a)(31) shall not be includible in gross income for the taxable year of transfer.

(2) **Minimum distribution requirements.**--A plan meets the minimum distribution requirements of this paragraph if such plan meets the requirements of section 401(a)(9).

(3) **Special rule for Government plan.**--An eligible deferred compensation plan of an employer described in subsection (e)(1)(A) shall not be treated as failing to meet the requirements of this subsection solely by reason of making a distribution described in subsection (e)(9)(A).

(e) **Other definitions and special rules.**--For purposes of this section--

(1) **Eligible employer.**--The term "eligible employer" means--

(A) a State, political subdivision of a State, and any agency or instrumentality of a State or political subdivision of a State, and

(B) any other organization (other than a governmental unit) exempt from tax under this subtitle.

(2) **Performance of service.**--The performance of service includes performance of service as an independent contractor and the person (or governmental unit) for whom such services are performed shall be treated as the employer.

(3) **Participant.**--The term "participant" means an individual who is eligible to defer compensation under the plan.

(4) **Beneficiary.**--The term "beneficiary" means a beneficiary of the participant, his estate, or any other person whose interest in the plan is derived from the participant.

(5) **Includible compensation.**--The term "includible compensation" has the meaning given to the term "participant's compensation" by section 415(c)(3).

(6) **Compensation taken into account at present value.**--Compensation shall be taken into account at its present value.

(7) **Community property laws.**--The amount of includible compensation shall be determined without regard to any community property laws.

(8) **Income attributable.**--Gains from the disposition of property shall be treated as income attributable to such prop-

erty.

**(9) Benefits of tax exempt organization plans not treated as made available by reason of certain elections, etc.--**In the case of an eligible deferred compensation plan of an employer described in subsection (e)(1)(B)--

**(A) Total amount payable is dollar limit or less.--**The total amount payable to a participant under the plan shall not be treated as made available merely because the participant may elect to receive such amount (or the plan may distribute such amount without the participant's consent) if--

(i) the portion of such amount which is not attributable to rollover contributions (as defined in section 411(a)(11)(D)) does not exceed the dollar limit under section 411(a)(11)(A), and

(ii) such amount may be distributed only if--

**(I)** no amount has been deferred under the plan with respect to such participant during the 2-year period ending on the date of the distribution, and

**(II)** there has been no prior distribution under the plan to such participant to which this subparagraph applied.

A plan shall not be treated as failing to meet the distribution requirements of subsection (d) by reason of a distribution to which this subparagraph applies.

**(B) Election to defer commencement of distributions.--**The total amount payable to a participant under the plan shall not be treated as made available merely because the participant may elect to defer commencement of distributions under the plan if--

(i) such election is made after amounts may be available under the plan in accordance with subsection (d)(1)(A) and before commencement of such distributions, and

(ii) the participant may make only 1 such election.

**(10) Transfers between plans.--**A participant shall not be required to include in gross income any portion of the entire amount payable to such participant solely by reason of the transfer of such portion from 1 eligible deferred compensation plan to another eligible deferred compensation plan.

**(11) Certain plans excluded.--**

**(A) In general.--**The following plans shall be treated as not providing for the deferral of compensation:

(i) Any bona fide vacation leave, sick leave, compensatory time, severance pay, disability pay, or death benefit plan.

(ii) Any plan paying solely length of service awards to bona fide volunteers (or their beneficiaries) on account of qualified services performed by such volunteers.

**(B) Special rules applicable to length of service award plans.--**

(i) **Bona fide volunteer.--**An individual shall be treated as a bona fide volunteer for purposes of subparagraph (A)(ii) if the only compensation received by such individual for performing qualified services is in the form of--

(I) reimbursement for (or a reasonable allowance for) reasonable expenses incurred in the performance of such services, or

(II) reasonable benefits (including length of service awards), and nominal fees for such services, customarily paid by eligible employers in connection with the performance of such services by-volunteers.

(ii) **Limitation on accruals.**--A plan shall not be treated as described in subparagraph (A)(ii) if the aggregate amount of length of service awards accruing with respect to any year of service for any bona fide volunteer exceeds \$3,000.

(C) **Qualified services.**--For purposes of this paragraph, the term "qualified services" means fire fighting and prevention services, emergency medical services, and ambulance services.

(D) **Certain voluntary early retirement incentive plans.**--

(i) **In general.**--If an applicable voluntary early retirement incentive plan--

(I) makes payments or supplements as an early retirement benefit, a retirement-type subsidy, or a benefit described in the last sentence of section 411(a)(9), and

(II) such payments or supplements are made in coordination with a defined benefit plan which is described in section 401(a) and includes a trust exempt from tax under section 501(a) and which is maintained by an eligible employer described in paragraph (1)(A) or by an education association described in clause (ii)(II),

such applicable plan shall be treated for purposes of subparagraph (A)(i) as a bona fide severance pay plan with respect to such payments or supplements to the extent such payments or supplements could otherwise have been provided under such defined benefit plan (determined as if section 411 applied to such defined benefit plan).

(ii) **Applicable voluntary early retirement incentive plan.**--For purposes of this subparagraph, the term "applicable voluntary early retirement incentive plan" means a voluntary early retirement incentive plan maintained by--

(I) a local educational agency (as defined in section 9101 of the Elementary and Secondary Education Act of 1965 (20 U.S.C. 7801)), or

(II) an education association which principally represents employees of 1 or more agencies described in subclause (I) and which is described in section 501(c) (5) or (6) and exempt from tax under section 501(a).

(12) **Exception for nonelective deferred compensation of nonemployees.**--

(A) **In general.**--This section shall not apply to nonelective deferred compensation attributable to services not performed as an employee.

(B) **Nonelective deferred compensation.**--For purposes of subparagraph (A), deferred compensation shall be treated as nonelective only if all individuals (other than those who have not satisfied any applicable initial service requirement) with the same relationship to the payor are covered under the same plan with no individual variations or options under the plan.

(13) **Special rule for churches.**--The term "eligible employer" shall not include a church (as defined in section

3121(w)(3)(A) or qualified church-controlled organization (as defined in section 3121(w)(3)(B)).

**(14) Treatment of qualified governmental excess benefit arrangements.**--Subsections (b)(2) and (c)(1) shall not apply to any qualified governmental excess benefit arrangement (as defined in section 415(m)(3)), and benefits provided under such an arrangement shall not be taken into account in determining whether any other plan is an eligible deferred compensation plan.

**(15) Applicable dollar amount.**--

**(A) In general.**--The applicable dollar amount shall be the amount determined in accordance with the following table:

For taxable years beginning in calendar year:	The applicable dollar amount:
2002	\$11,000
2003	\$12,000
2004	\$13,000
2005	\$14,000
2006 or thereafter	\$15,000.

**(B) Cost-of-living adjustments.**--In the case of taxable years beginning after December 31, 2006, the Secretary shall adjust the \$15,000 amount under subparagraph (A) at the same time and in the same manner as under section 415(d), except that the base period shall be the calendar quarter beginning July 1, 2005, and any increase under this paragraph which is not a multiple of \$500 shall be rounded to the next lowest multiple of \$500.

**(16) Rollover amounts.**--

**(A) General rule.**--In the case of an eligible deferred compensation plan established and maintained by an employer described in subsection (e)(1)(A), if--

- (i) any portion of the balance to the credit of an employee in such plan is paid to such employee in an eligible rollover distribution (within the meaning of section 402(c)(4)),
- (ii) the employee transfers any portion of the property such employee receives in such distribution to an eligible retirement plan described in section 402(c)(8)(B), and
- (iii) in the case of a distribution of property other than money, the amount so transferred consists of the property distributed,

then such distribution (to the extent so transferred) shall not be includible in gross income for the taxable year in which paid.

**(B) Certain rules made applicable.**--The rules of paragraphs (2) through (7), (9), and (11) of section 402(c) and

(i) a local educational agency (as defined in section 9101 of the Elementary and Secondary Education Act of 1965 (20 U.S.C. 7801), or

(ii) an education association which principally represents employees of 1 or more agencies described in clause (i) and which is described in section 501(c) (5) or (6) and exempt from taxation under section 501(a).

**(D) Employment retention plan.**--The term "employment retention plan" means a plan to pay, upon termination of employment, compensation to an employee of a local educational agency or education association described in subparagraph (C) for purposes of--

(i) retaining the services of the employee, or

(ii) rewarding such employee for the employee's service with 1 or more such agencies or associations.

**(g) Governmental plans must maintain set-asides for exclusive benefit of participants.**--

**(1) In general.**--A plan maintained by an eligible employer described in subsection (e)(1)(A) shall not be treated as an eligible deferred compensation plan unless all assets and income of the plan described in subsection (b)(6) are held in trust for the exclusive benefit of participants and their beneficiaries.

**(2) Taxability of trusts and participants.**--For purposes of this title--

**(A)** a trust described in paragraph (1) shall be treated as an organization exempt from taxation under section 501(a), and

**(B)** notwithstanding any other provision of this title, amounts in the trust shall be includible in the gross income of participants and beneficiaries only to the extent, and at the time, provided in this section.

**(3) Custodial accounts and contracts.**--For purposes of this subsection, custodial accounts and contracts described in section 401(f) shall be treated as trusts under rules similar to the rules under section 401(f).

**(4) Death benefits under USERRA-qualified active military service.**--A plan described in paragraph (1) shall not be treated as an eligible deferred compensation plan unless such plan meets the requirements of section 401(a)(37).

#### CREDIT(S)

(Added Pub.L. 95-600, Title I, § 131(a), Nov. 6, 1978, 92 Stat. 2779, and amended Pub.L. 96-222, Title I, § 101(a) (4), Apr. 1, 1980, 94 Stat. 196; Pub.L. 98-369, Title IV, § 491(d)(33), July 18, 1984, 98 Stat. 851; Pub.L. 99-514, Title XI, § 1107(a), Oct. 22, 1986, 100 Stat. 2426; Pub.L. 100-647, Title I, § 1011(e)(1), (2), (9), (10), Title VI, §§ 6064(a) to (c), 6071(c), Nov. 10, 1988, 102 Stat. 3460, 3461, 3700, 3701, 3705; Pub.L. 101-239, Title VII, §§ 7811(g)(4), (5), 7816(j),

STATE OF MINNESOTA

DISTRICT COURT

COUNTY OF ST. LOUIS

SIXTH JUDICIAL DISTRICT

---

Paula Savela,

Plaintiff,

vs.

City of Duluth,

Defendant.

**FINDINGS OF FACT,  
CONCLUSIONS OF LAW,  
ORDER AND MEMORANDUM**

File No. 69DU-CV-08-1793

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The above entitled matter came before the Honorable Kenneth A. Sandvik, Judge of District Court, on August 8, 2009 at the St. Louis County Courthouse, Duluth, Minnesota for the purpose of a hearing on the parties' cross motions for summary judgment. Paula Savela, the Class Representative, appeared personally and through counsel, Don L. Bye and Shelly M. Marquardt of Duluth, Minnesota. The City of Duluth was represented by attorney John M. LeFevre, Jr. of Minneapolis, Minnesota. Duluth Mayor Don Ness and Gunnar Johnson, the Duluth City Attorney, were also present on behalf of the City of Duluth.

The Court, having taken this matter under advisement, makes the following:

**FINDINGS OF FACT:**

For purposes of this Order, the Court finds the following facts to be true:

1. Three (3) individual Plaintiffs commenced this action in April of 2008, alleging that the City of Duluth had breached contractual obligations that were set forth in the Collective Bargaining Agreements (hereinafter "CBAs") between the City and the collective bargaining units.

2. On May 12, 2009, this Court approved and signed, pursuant to the parties' stipulation, an Order for Class Certification and Amended Scheduling Order.
3. The Class Definition is "all Duluth retirees who are former bargaining unit members and who retired from January 1, 1983 through December 31, 2006, and their spouses/dependents who are presently entitled to the retiree health care benefits, under the collective bargaining agreements ("CBAs") for the following bargaining units: Local 101 International Association of Fire Fighters; Duluth Police Union, Local 807; Confidential Employees; City of Duluth Supervisory Association; and Local 66 of A.F.S.C.M.E., Council 5 (formerly Council 96) for Basic Unit Employees."
4. The Class satisfied the prerequisites of Minn.R.Civ.P. 23.01 and was certified under Minn.R.Civ.P 23.02(a)(1) and (a)(2).
5. The Class was not certified under Minn.R.Civ.P. 23.02(c).
6. On or about May 26, 2009, Plaintiffs' Amended Complaint was filed with this Court.
7. In the Amended Complaint, the Class Representative and class members (hereinafter "Plaintiffs") allege that they have been damaged or are threatened with damage as a result of the City's breach of its contractual obligations.
8. Plaintiffs seek damages arising from and proximately caused by the City's alleged breach of its contractual obligations.
9. Plaintiffs seek declaratory and injunctive relief.
10. The controversy between the parties concerns the meaning of the CBA language ("to the same extent as active employees") on the following issue:

As a matter of contract, are the Class members' (Plaintiffs') health benefits fixed and governed by the plan in place on the date of their retirement or may the City of Duluth modify the benefits whenever and however benefits for current employees are modified?

11. The CBAs all the contain the following language with respect to retired employees' hospital-medical insurance coverage:

Any employee who retires from employment with the City...shall receive hospital-medical insurance coverage to the same extent as active employees, subject to the following conditions and exceptions...

12. Plaintiffs claim that their health benefits, their share of the costs thereof including co-pays and deductibles, are fixed and governed by the plan in place on the date of their retirement.

13. Plaintiffs claim the City promised it would pay insurance benefits in effect at the time of the employees' retirement for the retired employee, the retiree's spouse and dependents for the lifetime of the retiree, the retiree's spouse and dependents, which ever was latest.

14. Plaintiffs seek enforcement of these alleged promises.

15. The City of Duluth claims that Plaintiffs' health benefits may be modified to the same extent that benefits for current employees are modified.

16. The City seeks a determination that it may modify the retiree's benefits, including the costs therefore and the co-pays and deductibles, whenever and however benefits for active employees are modified.

17. The City does not dispute that it is obligated to provide health benefits to Plaintiffs.

18. The City does not dispute that it agreed to pay health-care premiums for Plaintiffs, subject to conditions in the CBAs.

19. The contract language does not vest the Class members' health insurance benefits under the plans existing at the time of retirement but instead provides that coverage shall be "for the life of the retiree" but "to the same extent as active employees."

20. On May 26, 2009, the City of Duluth filed a Notice of Motion and Motion for Summary Judgment, a Memorandum in Support of City's Motion for Summary Judgment, and a Proposed Order.
21. On July 10, 2009, Plaintiffs filed a Notice of Motion and Answer and Counter Motion for Summary Judgment, a Memorandum in Support of Summary Judgment, Affidavits of Paula Savela, Patricia Turchi, Patrick Alexander and Eli Miletich and a Proposed Order.
22. In their Affidavits, Paula Savela and Patricia Turchi state that they changed the dates of their retirement with the "knowledge and belief that whatever coverage [they] had on [the] date of retirement would be the coverage provided by the City without cost to [them] for the rest of [their] li[ves]." Both Affiants state that this belief was "in large part strengthened when [they] retired by verbal assurances of city officials, supervisors and co-employees."
23. Affiants Paula Savela and Patricia Turchi also maintain that they received assurances in writing from the Benefits Plan Administrator that they would be provided the same coverage for life as retirees as they had when they retired. However, the attachment provided as support for her claim does not appear to indicate what Ms. Savela purports.
24. Affiant Paula Savela further claims that after attending many meetings and listening to city officials and retirees, she was "firmly convinced that the retiree insurance provision that was negotiated meant that City retirees were to keep the same coverage..."
25. Affiant Patrick Alexander makes similar assertions in his Affidavit and provides attachments in support of those assertions. One of the attachments to his Affidavit is a document that Mr. Alexander purports was used by the City Administration during the

1990's and given out to people who contemplated retirement or retired from employment.

The document provides:

Retirees and disabled employees who are receiving a pension may retain health insurance coverage as provided under the terms of the current labor agreement under which he/she resigned or retired (see current labor agreement for your bargaining unit).

26. This Court reads the above to mean that Mr. Alexander could receive coverage subject to the terms of the labor agreement under which he retired. The terms of the agreement under which Mr. Alexander retired provided that retirees shall receive hospital-medical insurance coverage to the same extent as active employees.

27. Affiant Eli Miletich states that it was his understanding that "retirees got and kept the same insurance and coverage through life as they had when they retired." He provided the following example:

For example initially the co-pay for prescription drugs was only \$.50 cents. As that co-pay was gradually increased to \$3.00 or \$5.00 or \$7.00 or \$12.00 and \$20.00 that only applied to new retirees and the older ones stayed at the level they retired under.

28. The July 23, 2009 hearing date for the cross motions for summary judgment was continued until August 7, 2009 per Plaintiffs' request.

29. On August 4, 2009, the City of Duluth filed a Memorandum in Response to Plaintiffs' Motion for Summary Judgment.

30. On August 6, 2009, Plaintiffs filed a Reply to Defendant's Answer to Plaintiffs' Memorandum Regarding Summary Judgment.

31. On August 6, 2009, Plaintiffs filed several Response Affidavits, Supplemental Affidavits and Affidavits.

32. The City objected to the Court's consideration of the Affidavits arguing that the Affidavits were untimely. The City also argued two affidavits which were attached to the Affidavit of Mr. Hall were from the former City Attorney and appeared to be protected by the attorney-client privilege.
33. A hearing on the cross motions for summary judgment was held on August 7, 2009.
34. At the hearing, the Court accepted the Affidavits but allowed the City one week in which to submit in writing its objection to the Affidavit of Mr. Hall based on the attorney-client privilege.
35. On August 14, 2009, the City withdrew its objection based on the attorney-client privilege but continued to object to the Affidavits based on the timeliness of their submissions.
36. The Affidavits provide information regarding the Affiants' understanding of the negotiations concerning the retiree insurance provisions, Affiants' understanding of the intent behind the negotiations, Affiants' understanding of the application of the retiree health insurance provisions and Affiants' reliance on what they believed the insurance provision meant.
37. The Court took into consideration the Affidavits submitted by Plaintiffs on August 6, 2009, in deciding this motion. The Court considers the Affidavits extrinsic evidence, and as such, may not be used to vary the terms of the CBAs because the contract is neither incomplete nor ambiguous. The Affidavits however, give information relevant to the retirees' claims for health benefits under a promissory estoppel theory.

38. While the parties agree that Plaintiffs' claim is a straight contract claim, this Court finds it reasonable and appropriate to analyze the matter under a promissory estoppel theory as well.

39. The parties agree that there is no genuine issue as to any material fact.

#### CONCLUSIONS OF LAW:

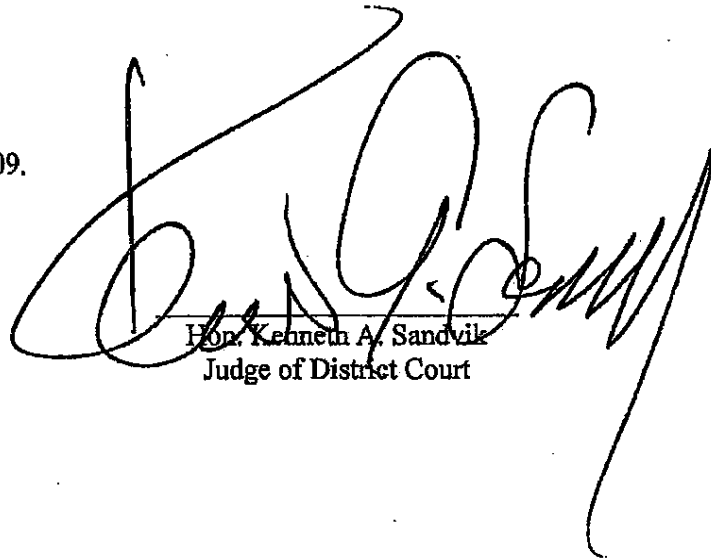
1. The evidence in the record demonstrates that there is no genuine issue as to any material fact and the City of Duluth is entitled to a judgment as a matter of law.
2. The Collective Bargaining Agreements are not ambiguous and the contract language shall be given its plain and ordinary meaning.
3. The Collective Bargaining Agreements require the City of Duluth to provide the same coverage to retirees that it provides to active employees.
4. The Plaintiffs' health benefits are not fixed and governed by the plan in place on the dates of their retirements. The CBAs, in effect on the retirements dates, do not prohibit the City from changing or modifying the health insurance plan provided to the Plaintiffs.
5. To support a promissory estoppel claim, the Plaintiffs would have to show that any promise or promises made to them by the City of Duluth must be enforced to prevent injustice. Judicial determinations of injustice involve a number of considerations, including the reasonableness of a promisee's reliance. The record does not contain facts that would support the conclusion that reliance was reasonable, and therefore the City of Duluth is entitled to summary judgment.

**ORDER:**

1. Plaintiffs' Motion for Summary Judgment and Request for Declaratory Relief is hereby DENIED.
2. The City's Motion for Summary Judgment and Request for Declaratory Relief is hereby GRANTED.
3. The City may modify the Plaintiffs' benefits whenever and however benefits for active employees are modified.
4. The attached memorandum is incorporated herein.

**IT IS FURTHER ORDERED** that copies of the Order and Memorandum should be directed by mail to counsel of record for the parties, as such are more fully identified in the files and records herein.

Dated this 13<sup>th</sup> day of October, 2009.



Hon. Kenneth A. Sandvik  
Judge of District Court

## MEMORANDUM

The parties in this matter have made cross motions seeking summary judgment. Both parties assert that the language in the Collective Bargaining Agreements (CBAs) which relate to the retirees' health benefits is unambiguous as a matter of law and that summary judgment should be awarded in their favor.

Summary judgment is appropriate and shall be granted if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact, and that either party is entitled to a judgment as a matter of law. Minnesota Rules of Civil Procedure Rule 56.03. In the present case, there are no issues of material fact. A CBA is a contract, and as such, this Court will interpret and enforce the CBAs as other contracts. *Housing and Redevelopment Authority of Chisholm v. Norman*, 696 N.W.2d 329 (Minn. 2005). "Generally, construction of a written contract is a question of law for the district court and therefore summary judgment is particularly appropriate." *Knudsen v. Transp. Leasing/Contract, Inc.*, 672 N.W.2d 221, 223 (Minn.App.2003), *review denied* (Minn. Feb. 25, 2004). Interpretation of an unambiguous contract is also a question of law on which summary judgment may be granted. *Iowa Kemper Ins. Co. v. Stone*, 269 N.W.2d 885, 887 (Minn. 1978).

"The construction and effect of a contract is [ ] a question of law unless the contract is ambiguous." *Denelsbeck v. Wells Fargo & Co.*, 666 N.W.2d 339, 346 (Minn.2003) (quoting *Turner v. Alpha Phi Sorority House*, 276 N.W.2d 63, 66 (Minn.1979)). If the contract is ambiguous, its interpretation is a question of fact for the fact-finder. *Id.* A contract is ambiguous if, based upon its language alone, it is reasonably susceptible of more than one interpretation. *Housing and Redevelopment Authority of Chisholm v. Norman*, 696 N.W.2d 329 (Minn. 2005).

"Absent ambiguity, the terms of a contract will be given their plain and ordinary meaning and will not be considered ambiguous solely because the parties dispute the proper interpretation of the terms." *Knudsen v. Transp. Leasing/Contract, Inc.*, 672 N.W.2d 221, 223 (Minn.App.2003), review denied (Minn. Feb. 25, 2004). "[W]hen a contract is unambiguous, a court gives effect to the parties' intentions as expressed in the four corners of the instrument, and clear, plain, and unambiguous terms are conclusive of that intent." *Id.* When a contract is unambiguous, the "contract language must be given its plain and ordinary meaning, and shall be enforced by courts even if the result is harsh." *Minneapolis Pub. Hous. Auth. v. Lor*, 591 N.W.2d 700, 704 (Minn.1999)

When "a written agreement is ambiguous or incomplete, evidence of oral agreements tending to establish the intent of the parties is admissible." *Alpha Real Estate Co. of Rochester v. Delta Dental Plan of Minn.*, 664 N.W.2d 303, 312 (Minn.2003). Only when a contract is ambiguous *on its face*, will courts examine intrinsic evidence of intent. *Norman*, 696 N.W. 2d 329 at 337 (emphasis added). Extrinsic evidence may not be used to vary the terms of a written contract when the contract is neither incomplete nor ambiguous. *Alpha Real Estate Co. of Rochester v. Delta Dental Plan of Minn.*, 664 N.W.2d 303, 312. As the Court finds that the contract is neither incomplete nor ambiguous, the Affidavits submitted by Plaintiffs, which provide information concerning contract negotiations and the City's alleged intent when negotiating the health benefits provisions, cannot be used to vary the terms of contract.

Pursuant to the parties' stipulation and the Court's Order for Class Certification and Amended Scheduling Order, the controversy between the parties concerns the meaning of the CBA language ("to the same extent as active employees") on the following issue:

As a matter of contract, are the Class members' health benefits fixed and governed by the plan in place on the date of their retirement or may the City of Duluth modify the benefits whenever and however benefits for current employees are modified?

Plaintiffs contend that the language in dispute should be read to mean that the Class members' health benefits are fixed and governed by the plan in place on the date of their retirement. The City asserts that Class members' health benefits are the same benefits that current employees have.

Plaintiffs rely on *Housing and Redevelopment Authority of Chisholm v. Norman*, 696 N.W.2d 329 (Minn. 2005) and *Adams v. Independent School Dist. No. 316*, 2008 WL 2573660 (Minn. App. 2008) in support of their argument that the City is obligated to continue to provide health benefits at the level in effect under the CBAs at the time of Plaintiffs' respective retirement. In *Norman*, the Minnesota Supreme Court reviewed the question of whether Chisholm Housing and Redevelopment Authority (CHRA) was obligated to continue to pay health insurance premiums for the benefit of Carolee E. Norman, a retired former employee, beyond the expiration of the collective bargaining agreement after CHRA had terminated Norman's health insurance coverage altogether, including payment of the premiums.

CHRA argued that Minn. Stat. §179A.20, subd. 2a, enacted in 1988, deprived a public employer of authority to contract to pay retiree healthcare benefits beyond the term of the CBA that contained those benefits relying on the language "[a] contract may not obligate an employer to fund all or part of the cost of health care benefits for a former employee beyond the duration of the contract." Norman countered that the limitations set forth in §179A.20, subd. 2a, were overridden by Minn. Stat. §471.61 which was enacted four years later. The applicable provisions of §471.61 provide:

Subd. 2b. A unit of local government must allow a former employee and the employee's dependents to continue to participate indefinitely in the employer-

sponsored hospital, medical, and dental insurance group that the employee participated in immediately before retirement, under the following conditions:

(e) The former employee must pay the entire premium for continuation coverage, except as otherwise provided in a collective bargaining agreement or personnel policy. A unit of local government may discontinue coverage if a former employee fails to pay the premium within the deadline provided for payment of premiums under federal law governing insurance continuation.

(k) Notwithstanding section 179A.20, subdivision 2a, insurance continuation under this subdivision may be provided for in a collective bargaining agreement or personnel policy.

The Court in *Norman* read §179A.20, subd. 2a to have a much more narrow purpose than what CHRA argued and concluded that the subdivision “was intended only to relieve public employers from any obligation to appropriate or set aside current resources to ‘fund’ these future liabilities to retirees.” The purpose of 2a, the Court went on to say, was to relieve the employer from any obligation to set aside current resources to secure this future liability beyond the duration of the CBA.” The Court also stated that Minn. Stat. §471.61, subd.2b(e) authorizes public employers to contract in a CBA to pay insurance premiums on behalf of retirees as it provides that “[t]he former employee must pay the entire premium for continuation coverage, except as otherwise provided in a collective bargaining agreement or personnel policy.”

The Court held that CHRA was authorized to include retiree healthcare benefits in the CBA since a public employer is statutorily authorized to obligate itself in a collective bargaining agreement to pay retiree healthcare premiums indefinitely beyond the term of the agreement. It then considered what rights accrued to Norman when the CHRA included healthcare benefits in the CBA.

In *Norman*, the parties, the District Court and the Court of Appeals analyzed the case under a promissory estoppel theory, relying on the Minnesota Supreme Court’s decision in *Christensen v. Minneapolis Municipal Employees Retirement Board*, 331 N.W2d 740 (Minn.

1983). In *Christensen*, the Supreme Court followed the principles of promissory estoppel, rejecting a conventional contract approach because “with its strict rules of offer and acceptance, (it) tends to deprive the analysis of the relationship between the state and its employees of a needed flexibility.” *Christensen* at 747. In the later *Norman* decision, the Supreme Court analyzed the matter under both a promissory estoppel theory and a traditional contract theory. The Supreme Court noted that *Christensen* had been decided before the Public Employment Labor Relations Act (PERLA) was amended, at a time when public employers had no authority to include any pension benefits in a CBA. Furthermore, the Court stated “the employee in *Christensen* did not rely on a CBA, but rather on a statutory pension that the legislature attempted to reduce by amendment after the employee retired” and thus the case could not proceed under conventional contract law. Noting that “[a]lthough promissory estoppel may remain proper for analyzing noncontractual promises of retirement benefits to public employees, the statutory authority granted to a public employer to contract in a CBA to pay retiree health insurance premiums obviates the need to resort to promissory estoppel when a CBA includes this benefit,” the Court held that “a promise by a public employer, embodied in a CBA, to pay health insurance premiums for an employee who retires during the term of the CBA is enforceable on contract grounds.” Notwithstanding the *Norman* decision, this Court finds it reasonable and appropriate to analyze the matter under a promissory estoppel theory as well as under a contract theory in light of the affidavits submitted by Plaintiffs. While the parties assured the Court that Plaintiffs’ claim is a straight contract claim, the affidavits submitted by Plaintiff tend to provide information relevant to a promissory estoppel and reliance argument.

In *Norman*, the collective bargaining agreement in place when Norman retired provided that all qualified retirees who had at least 10 years of service “shall continue to be covered

under... the existing hospital medical, surgical, drug and dental programs covering employees of the CHRA ...” and CHRA “shall pay all insurance premiums in full, to include single coverage and disability retirement.” The language did not limit the promise to pay the premiums to the duration of the CBAs and the language did not provide that coverage would be only “to the same extent as active employees.” The Court held that Norman's right to the payment of health insurance premiums vested at the time she retired and CHRA could not later unilaterally terminate those benefits.

The language in the collective bargaining agreements in this case differs significantly from that found in *Norman*. In *Norman*, the CBA provided that qualified retirees shall be covered under “the *existing* hospital medical, surgical, drug and dental programs...” The plain and ordinary meaning of that language is that the retirees’ insurance coverage would continue as it existed at the time the employee retired. No similar language is found in the CBAs in this case. In fact, the language used in the CBA’s here limits the retirees’ coverage “to the same extent as active employees.”

Following *Norman*, the Minnesota Court of Appeals in *Adams v. Independent School Dist. No. 316*, 2008 WL 2573660 (Minn. App. 2008), again examined the terms of CBAs in effect at the time of retirees' retirement to determine their entitlement to healthcare benefits. The applicable CBA language in *Adams* provided that the retirees “shall continue to be insured under the then existing hospital and medical insurance program covering teachers of Independent School District No. 316...” In *Adams*, the Court held:

We conclude, as did the court in *Norman*, that, in particular, the use of the term “*then existing* medical and hospital insurance program” in the CBAs is unambiguous and expresses the parties' intent that appellant would continue to provide healthcare benefits to a retiring teacher under the provision expressed in the CBA at the time of that teacher's retirement, including the level of coverage and the percent of coverage paid by appellant.

Again, no comparable language is found in the CBAs in this case which would entitle Plaintiffs to coverage under the same health plan that was in place at the time of their retirements.

This Court has examined the terms of the CBAs in effect at the time of Plaintiffs' retirement in order to determine their entitlement to healthcare benefits and finds that the language "to the same extent as active employees," is unambiguous and therefore must be given its plain and ordinary meaning. This Court finds that the plain and ordinary meaning of that language is that Plaintiffs' health benefits are not fixed by the plan in place of the date of their retirement and that the City of Duluth may modify the benefits to the same extent that benefits for active employees are modified.

For the foregoing reasons, Plaintiffs' motion for summary judgment is denied and the City's motion for summary judgment is granted.

As previously noted, this Court finds it reasonable and necessary to analyze the matter under a promissory estoppel theory as well. To support a promissory estoppel claim, the party seeking relief must show (1) a clear and definite promise, (2) intended to induce reliance, (3) on which the promisee relied to his or her detriment, and (4) that must be enforced to prevent injustice. *Housing and Redevelopment Authority of Chisholm v. Norman*, 696 N.W.2d 329 (Minn. 2005); *Cohen v. Cowles Media Co.*, 479 N.W.2d 387, 391 (Minn.1992). This Court takes issue with the fourth prong.

Judicial determinations of injustice involve a number of considerations, "including the reasonableness of a promisee's reliance." *Faimon v. Winona State Univ.*, 540 N.W.2d 879, 883 (Minn.App.1995), *review denied* (Minn. Feb. 9, 1996). "[E]stablishing the reasonableness of the reliance is essential to any cause of action in which detrimental reliance is an element." *Nicollet Restoration, Inc. v. City of St. Paul*, 533 N.W.2d 845, 848 (Minn.1995). If the record does not

contain facts that would support the conclusion that reliance was reasonable, the promisor is entitled to summary judgment. *Id.*

This Court finds the record does not contain facts that would support the conclusion that Plaintiffs' reliance on the alleged assurances of city officials, supervisors and co-employees that whatever coverage they had on the date of retirement would be provided to them by the City, without cost, for the rest of their lives, was reasonable in light of the contract language and in light of rising healthcare costs.

The contract language provides that retirees "shall receive hospital-medical insurance coverage to the same extent as active employees." As former employees of the City, the retirees were aware, at the time of their respective retirement dates, that the City often modified the healthcare benefits of active employees. Under the included language in the hospital-medical insurance coverage provisions in the CBAs, it is not reasonable for the retirees to assume that their benefits were fixed by the plans in place on the dates of their retirements. Furthermore, healthcare costs have been consistently increasing since before the earliest dates of Plaintiffs' retirements. Using the figures provided by affiant Eli Miletich as an example, promises of lifetime .50 cents co-pays for prescription medications, are not reasonable to rely on. For these reasons, the City of Duluth is also entitled to a summary judgment under a promissory estoppel theory.

9/10/2009

KAS/taw

# Instructions for Forms W-2 and W-3

## Wage and Tax Statement and Transmittal of Wage and Tax Statements

Section references are to the Internal Revenue Code unless otherwise noted.

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### What's New

**Military differential pay.** Employers paying their employees while they are on active duty in United States uniformed services should treat these payments as wages subject to income tax withholding. See *Military differential pay* on page 3.

### Reminders

**Reporting for nonqualified deferred compensation plans.** You are not required to complete box 12 with code Y (deferrals under nonqualified plans subject to section 409A).

**Distributions from governmental section 457(b) plans of state and local agencies.** Generally, report distributions from section 457(b) plans of state and local agencies on Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc. See Notice 2003-20 for details. You can find Notice 2003-20 on page 894 of Internal Revenue Bulletin 2003-19 at [www.irs.gov/pub/irs-irbs/irb03-19.pdf](http://www.irs.gov/pub/irs-irbs/irb03-19.pdf).

**Earned income credit (EIC) notice.** You must notify employees who have no income tax withheld that they may be able to claim an income tax refund because of the EIC. You can do this by using the official IRS Form W-2 with the EIC notice on the back of Copy B or a substitute Form W-2 with the same statement. You must give your employee Notice 797, Possible Federal Tax Refund Due to the Earned Income Credit (EIC), or your own statement that contains the same wording if (a) you use a substitute Form W-2 that does not contain the EIC notice, (b) you are not required to furnish Form W-2, or (c) you do not furnish a timely Form W-2 to your employee. For more information, see section 10 in Pub. 15 (Circular E), Employer's Tax Guide.

**Electronic payee statements.** If your employees give their consent, you may be able to furnish Copies B, C, and 2 of Forms W-2 to your employees electronically. See Pub. 15-A, Employer's Supplemental Tax Guide, for additional information.

**Extended due date for electronic filers.** If you file your 2010 Forms W-2 with the Social Security Administration (SSA) electronically, the due date is extended to March 31, 2011. For information on how to file electronically, see *Online filing of Forms W-2 and W-3* below and *Electronic reporting* on page 3.

**Form 944.** Use the "944" checkbox in box b of Form W-3 if you filed Form 944, Employer's ANNUAL Federal Tax Return. Also use the "944" checkbox if you filed Formulario 944(SP), the Spanish version of Form 944.

**Nonqualified deferred compensation plans.** Section 409A provides that all amounts deferred under a nonqualified deferred compensation (NQDC) plan for all taxable years are includible in gross income unless certain requirements are satisfied. See *Nonqualified deferred compensation plans* on page 6.

**Online filing of Forms W-2 and W-3.** You may file Forms W-2 and W-3 electronically by visiting the SSA's website at [www.socialsecurity.gov/employer](http://www.socialsecurity.gov/employer), and selecting "Business Services Online (BSO)." Once registered, you can upload electronic wage files or use the SSA's "Create Forms W-2 Online" to send electronic information to Social Security. W-2 Online allows you to create "fill-in" versions of Forms W-2 to file with the SSA and to print copies of the forms to file with state or local governments, distribute to your employees, and keep for your records. Form W-3 will be figured for you based on your Forms W-2, excluding state and local totals. For more information, see *Online wage reporting* below.

**Substitute forms.** If you are not using the official IRS form to furnish Form W-2 to employees or to file with the SSA, you may use an acceptable substitute form that complies with the rules in Pub. 1141, General Rules and Specifications for Substitute Forms W-2 and W-3. Pub. 1141, which is revised annually, is a revenue procedure that explains the requirements for format and content of substitute Forms W-2 and W-3. Your substitute forms must comply with the requirements in Pub. 1141.

### Need Help?

**Information reporting customer service site.** The IRS operates a centralized customer service site to answer questions about reporting on Forms W-2, W-3, 1099, and other information returns. If you have questions about reporting on these forms, call 1-866-455-7438 (toll free). The hours of operation are Monday through Friday from 8:30 a.m. to 4:30 p.m., Eastern time. If you have questions about electronic filing of Forms W-2, contact the SSA at 1-800-772-6270 or visit the SSA website at [www.socialsecurity.gov/employer](http://www.socialsecurity.gov/employer).

**Hearing impaired TTY/TDD.** Telephone help is available using TTY/TDD equipment. If you have questions about reporting on information returns (Forms 1096, 1098, 1099, 3921, 3922, 5498, W-2, W-2G, and W-3) you may call 1-304-579-4827. For any other tax information, call 1-800-829-4059.

**Online wage reporting.** Using a personal computer, you can access SSA's Business Services Online (BSO) to electronically report wage data. To obtain information regarding filing wage data electronically with the SSA or to access BSO, visit the SSA's Employer W-2 Filing Instructions and Information website

government plans). Instead, use box 14 for these items and any other information that you wish to give to your employee. For example, union dues and uniform payments may be reported in box 14.

**TIP** *On Copy A (Form W-2), do not enter more than four items in box 12. If more than four items need to be reported in box 12, use a separate Form W-2 to report the additional items (but enter no more than four items on each Copy A (Form W-2)). On all other copies of Form W-2 (Copies B, C, etc.), you may enter more than four items in box 12 when using an approved substitute Form W-2. See Multiple forms on page 8.*

Use the IRS code designated below for the item you are entering, followed by the dollar amount for that item. Even if only one item is entered, you must use the IRS code designated for that item. Enter the code using a capital letter. Use decimal points but not dollar signs or commas. For example, if you are reporting \$5,300.00 in elective deferrals under a section 401(k) plan, the entry would be D 5300.00 (not A 5300.00 even though it is the first or only entry in this box). Report the IRS code to the left of the vertical line in boxes 12a through 12d and the money amount to the right of the vertical line.

See the *Form W-2 Reference Guide for Box 12 Codes* on page 15. See also the detailed instructions below for each code.

**Code A—Uncollected social security or RRTA tax on tips.** Show the employee social security or Railroad Retirement Tax Act (RRTA) tax on all of the employee's tips that you could not collect because the employee did not have enough funds from which to deduct it. Do not include this amount in box 4.

**Code B—Uncollected Medicare tax on tips.** Show the employee Medicare tax or RRTA Medicare tax on tips that you could not collect because the employee did not have enough funds from which to deduct it. Do not include this amount in box 6.

**Code C—Taxable cost of group-term life insurance over \$50,000.** Show the taxable cost of group-term life insurance coverage over \$50,000 provided to your employee (including a former employee). See *Group-term life insurance* on page 6. Also include this amount in boxes 1, 3 (up to the social security wage base), and 5.

**Codes D through H, S, Y, AA, and BB.** Use these codes to show elective deferrals and designated Roth contributions made to the plans listed. Do not report amounts for other types of plans. See the example for reporting elective deferrals under a section 401(k) plan, later.

The amount reported as elective deferrals and designated Roth contributions is only the part of the employee's salary (or other compensation) that he or she did not receive because of the deferrals or designated Roth contributions. Only elective deferrals and designated Roth contributions should be reported in box 12 for all coded plans; except, when using code G for section 457(b) plans, include both elective and nonelective deferrals.

For employees who were 50 years of age or older at any time during the year and made elective deferral and/or designated Roth "catch-up" contributions, report the elective deferrals and the elective deferral "catch-up" contributions as a single sum in box 12 using the appropriate code, and the designated Roth contributions and designated Roth "catch-up" contributions as a single sum in box 12 using the appropriate code.

**TIP** *If any elective deferrals, salary reduction amounts, or nonelective contributions under a section 457(b) plan during the year are makeup amounts under the Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA) for a prior year, you must enter the prior year contributions separately. Beginning with the earliest year, enter the code, the year, and the amount. For example, elective deferrals of \$2,250 for 2008 and \$1,250 for 2009 under*

*USERRA under a section 401(k) plan are reported in box 12 as follows:*

*D 08 2250.00, D 09 1250.00. A 2010 contribution of \$7,000 does not require a year designation; enter it as D 7000.00. Report the code (and year for prior year USERRA contributions) to the left of the vertical line in boxes 12a through 12d.*

The following are not elective deferrals and may be reported in box 14, but not in box 12.

- Nonelective employer contributions made on behalf of an employee.
- After-tax contributions that are not designated Roth contributions, such as voluntary contributions to a pension plan that are deducted from an employee's pay. See the instructions in codes AA and BB for reporting designated Roth contributions on page 12.
- Required employee contributions.
- Employer matching contributions.

**Code D—Elective deferrals under section 401(k) cash or deferred arrangement (plan).** Also show deferrals under a SIMPLE retirement account that is part of a section 401(k) arrangement.

**Example of reporting excess elective deferrals and designated Roth contributions under a section 401(k) plan.** For 2010, Employee A (age 45) elected to defer \$18,300 under a section 401(k) plan. The employee also made a designated Roth contribution to the plan of \$1,000, and made a voluntary (non-Roth) after-tax contribution of \$600. In addition, the employer, on A's behalf, made a qualified nonelective contribution of \$2,000 to the plan and a nonelective profit-sharing employer contribution of \$3,000.

Even though the 2010 limit for elective deferrals and designated Roth contributions is \$16,500, the employee's total elective deferral amount of \$18,300 is reported in box 12 with code D (D 18300.00). The designated Roth contribution is reported in box 12 with code AA (AA 1000.00). The employer must separately report the actual amounts of \$18,300 and \$1,000 in box 12 with the appropriate codes. The amount deferred in excess of the limit is not reported in box 1. The return of excess salary deferrals and excess designated contributions, including earnings on both, is reported on Form 1099-R.

The \$600 voluntary after-tax contribution may be reported in box 14 (this is optional) but not in box 12. The \$2,000 nonelective contribution and the \$3,000 nonelective profit-sharing employer contribution are not required to be reported on Form W-2, but may be reported in box 14.

Check the "Retirement plan" box in box 13.

**Code E—Elective deferrals under a section 403(b) salary reduction agreement.**

**Code F—Elective deferrals under a section 408(k)(6) salary reduction SEP.**

**Code G—Elective deferrals and employer contributions (including nonelective deferrals) to any governmental or nongovernmental section 457(b) deferred compensation plan.** Do not report either section 457(b) or section 457(f) amounts that are subject to a substantial risk of forfeiture.

**Code H—Elective deferrals under section 501(c)(18)(D) tax-exempt organization plan.** Be sure to include this amount in box 1 as wages. The employee will deduct the amount on his or her Form 1040.

**Code J—Nontaxable sick pay.** Show any sick pay that was paid by a third-party and was not includible in income (and not shown in boxes 1, 3, and 5) because the employee contributed to the sick pay plan. Do not include nontaxable disability payments made directly by a state.

**Code K—20% excise tax on excess golden parachute payments.** If you made excess "golden parachute" payments to certain key corporate employees, report the 20% excise tax on these payments. If the excess payments are considered to be wages, report the 20% excise tax withheld as income tax withheld in box 2.

**Instructions for Employee** (continued from back of Copy C)

**F**—Elective deferrals under a section 408(k)(6) salary reduction SEP

**G**—Elective deferrals and employer contributions (including nonelective deferrals) to a section 457(b) deferred compensation plan

**H**—Elective deferrals to a section 501(c)(18)(D) tax-exempt organization plan. See "Adjusted Gross Income" in the Form 1040 instructions for how to deduct.

**J**—Nontaxable sick pay (information only, not included in boxes 1, 3, or 5)

**K**—20% excise tax on excess golden parachute payments. See "Total Tax" in the Form 1040 instructions.

**L**—Substantiated employee business expense reimbursements (nontaxable)

**M**—Uncollected social security or RRTA tax on taxable cost of group-term life insurance over \$50,000 (former employees only). See "Total Tax" in the Form 1040 instructions.

**N**—Uncollected Medicare tax on taxable cost of group-term life insurance over \$50,000 (former employees only). See "Total Tax" in the Form 1040 instructions.

**P**—Excludable moving expense reimbursements paid directly to employee (not included in boxes 1, 3, or 5)

**Q**—Nontaxable combat pay. See the instructions for Form 1040 or Form 1040A for details on reporting this amount.

**R**—Employer contributions to your Archer MSA. Report on Form 8853, Archer MSAs and Long-Term Care Insurance Contracts.

**S**—Employee salary reduction contributions under a section 408(p) SIMPLE (not included in box 1)

**T**—Adoption benefits (not included in box 1). You **must** complete Form 8839, Qualified Adoption Expenses, to compute any taxable and nontaxable amounts.

**V**—Income from exercise of nonstatutory stock option(s) (included in boxes 1, 3 (up to social security wage base), and 5)

**W**—Employer contributions to your Health Savings Account. Report on Form 8889, Health Savings Accounts (HSAs).

**Y**—Deferrals under a section 409A nonqualified deferred compensation plan.

**Z**—Income under section 409A on a nonqualified deferred compensation plan. This amount is also included in box 1. It is subject to an additional 20% tax plus interest. See "Total Tax" in the Form 1040 instructions.

**AA**—Designated Roth contributions under a section 401(k) plan.

**BB**—Designated Roth contributions under a section 403(b) plan.

**Box 13.** If the "Retirement plan" box is checked, special limits may apply to the amount of traditional IRA contributions that you may deduct.

**Note.** Keep **Copy C** of Form W-2 for at least 3 years after the due date for filing your income tax return. However, to help **protect your social security benefits**, keep Copy C until you begin receiving social security benefits, just in case there is a question about your work record and/or earnings in a particular year. Compare the Social Security wages and the Medicare wages to the information shown on your annual (for workers over 25) Social Security Statement.

		a Employee's social security number		OMB No. 1545-0008			
b Employer identification number (EIN)			1 Wages, tips, other compensation		2 Federal income tax withheld		
c Employer's name, address, and ZIP code			3 Social security wages		4 Social security tax withheld		
			5 Medicare wages and tips		6 Medicare tax withheld		
			7 Social security tips		8 Allocated tips		
d Control number			9 Advance EIC payment		10 Dependent care benefits		
e Employee's first name and initial      Last name      Suff.			11 Nonqualified plans		12a		
			13 Statutory employee      Retirement plan      Third-party sick pay <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>		12b		
			14 Other		12c		
					12d		
f Employee's address and ZIP code							
15 State	Employer's state ID number	16 State wages, tips, etc.	17 State income tax	18 Local wages, tips, etc.	19 Local income tax	20 Locality name	
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Form **W-2** Wage and Tax Statement

2009

Department of the Treasury—Internal Revenue Service

Copy 2—To Be Filed With Employee's State, City, or Local Income Tax Return.



# STATE OF MINNESOTA

OFFICE OF THE ATTORNEY GENERAL

LORI SWANSON  
ATTORNEY GENERAL

December 15, 2009

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**Re: In the Matter of the PERA Salary Determinations Affecting Retired and Active Employees of the City of Duluth  
OAH Dkt. No. 4-3600-20809-2**

Dear Ms. Storaasli and Mr. Andrew:

Enclosed please find copies of e-mail correspondence which PERA Staff discovered during preparation of the stipulation in this matter. I do not believe these two documents were previously disclosed. Also enclosed please find the cover memorandum that Lawrence A. Martin sent to me regarding legislative history. The documents are rather repetitive, particularly the various summaries that were included. However, if there are particular documents that you would like copies of, please advise me accordingly. I have also enclosed several memos which I believe were submitted to the PERA Board of Trustees. I am not certain whether these were previously disclosed.

Should you have any questions, please contact me.

Very truly yours,

  
JON K. MURPHY  
Assistant Attorney General  
(651) 757-1385 (Voice)  
(651) 297-4139 (Fax)

Enclosures

AG: #2556206-v1

STATE OF MINNESOTA

OFFICE OF THE ATTORNEY GENERAL

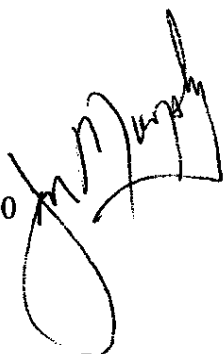
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TO: LARRY MARTIN  
Executive Director  
Legislative Commission on Pensions and Retirement  
Room 55, State Office Building  
St. Paul, MN 55155

DATE: September 17, 2009

FROM: JON K. MURPHY  
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SUBJECT: **Duluth Salary Issues**

PERA is involved in a contested case litigation with a number of Duluth's active and retired employees concerning certain PERA salary determinations. At issue is whether certain amounts, such as employer paid deferred compensation, the cash out of unused personal leave days, and payments made in lieu of insurance premiums were improperly reported by Duluth to PERA as "salary."

At the initial pre-trial conference, the Administrative Law Judge suggested interest in any legislative history that might relate to the statutory definition of salary. It is my understanding that the primary changes to the statutory language may have been in 1993 and 1994. In 1993, Minn. Laws ch. 307, art. 4, secs. 1-15, rewrote Minn. Stat. § 353.01, subd. 10. An additional rewrite was done in 1994 under Minn. Laws 1994, ch. 528, art. 2, secs. 1-4.

It is also my understanding that during the course of 1994, a salary review advisory committee had been established to review the salary definitions of the various funds. I have been able to find only limited information on this, which includes a memorandum from you to Senator Phil Riveness dated August 12, 1994.

I would like to know if you maintain records which might include legislative history regarding PERA salary definition stemming back to at least 1994. If such records or materials are available, I would be happy to visit your office in order to review them. Please advise if you can assist in this matter.



TO: Jon K. Murphy, Assistant Attorney General  
 FROM: Lawrence A. Martin, Executive Director *JLM*  
 RE: Duluth Salary Issues  
 DATE: November 3, 2009

Introduction

The attached documents are in response to your request for any Commission records, including legislative history, regarding the Public Employees Retirement Association (PERA) salary definition and the 1994-1995 Salary Study Advisory Committee.

Because the task force was not a purely legislative body, the Commission made no sound recordings and kept no minutes of the Salary Study Advisory Committee meetings, although there are copies of the meeting agendas for the August 17, 1994 and November 29, 1994, advisory committee meetings. The administrators of the major statewide retirement plans, as the initiators of the creation of the advisory committee, may have minutes, recordings, or other materials from those advisory committee meetings.

Attachments

<i>Date</i>	<i>Source</i>	<i>Subject</i>
<b>File: Legislative Commission on Pensions and Retirement Meeting Agendas</b>		
8/17/1994	Agendas	August 17, 1994, Covered Salary Review Advisory Committee Initial Meeting Notice
11/29/1994	Agendas	November 29, 1994, Covered Salary Review Advisory Committee Initial Meeting Agenda
<b>File: Covered Salary Definitions Advisory Committee</b>		
9/24/1991	L. Martin	Practice of Other Jurisdictions on Interest and Salary Actuarial Assumptions
4/1/1992	L. Martin	Policy Considerations Present in Proposed Change in Salary Increase Assumption
Undated	Laws 1994	Laws 1994, Ch. 528, Page 10; Salary Study Advisory Committee
7/26/1994	L. Hacking	Requesting that Mary Vanek serve on the Advisory Committee in Ms. Hacking's absence
8/4/1994	D. Bergstrom	Fund directors' compilation of the various plans' salary for pension purposes
8/12/1994	L. Martin	Issues Related to Minnesota Public Pension Plan Covered Salary
11/1994	L. Martin	Compilation of various states' included and excluded salary items
7/18/1994	D. Bergstrom	Appointment to Advisory Committee on Public Pension Plan Covered Salary Definitions
2/8/1994	Star Tribune	Minneapolis goes to court over pension plan increases
2/22/1995	Salary Study Adv. Comm.	Salary Study Advisory Committee Report
2/23/95	D. Bergstrom	Revised salary study committee report
5/4/1995	L. Martin	Potential Amendment Disallowing Local Relief Associations From Redefining Covered Salary Without Municipal Approval
7/2/1996	Minn. Court of Appeals	Minnesota Court of Appeals: CX-96-344; Krollman vs. City of Hibbing Decision
10/2/1996	L. Martin	Definition Of Covered Salary For Local Police And Salaried Firefighter Relief Associations And Consolidation Accounts: Extent of Potential Problem and Options for Potential Resolution
<b>File: Session Summaries</b>		
8/16/1993	E. Burek	Summary of 1993 Pension Legislation
6/10/1994	E. Burek	Summary of 1994 Pension Legislation
<b>File: Bill File; Laws 1993, Chapter 307: H.F. 574 (Reding); S.F. 519 (Stumpf)</b>		
2/2/1993	Unknown	1993 PERA Administrative Bill Summary
3/9/1993	E. Burek	H.F. 574 (Reding); S.F. 519 (Stumpf): MSRS, PERA, TRA: Administrative Provisions and Age Discrimination Act Compliance
3/10/1993	E. Burek	S.F. 519 (Stumpf); H.F. 574 (Reding): Policy Issues
<b>File: Bill File; Laws 1994, Chapter 528: S.F. 2288 (Stumpf); H.F. 2405 (Reding)</b>		
3/15/1994	E. Burek	S.F. 2288 (Stumpf); H.F. 2405 (Reding): MSRS, PERA, TRA: Administrative and Other Changes
Undated	Minn. Senate	Senate Committee on Governmental Operations and Reform Committee report on S.F. 2288

Conclusion

I hope that this information is responsive to your request. If you need additional information or require clarification for any item, please contact me (651-296-2750).