

BEFORE AN ADMINISTRATIVE LAW JUDGE
FOR THE PUBLIC EMPLOYEES' RETIREMENT FUND

PUBLIC EMPLOYEES' RETIREMENT
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IN THE MATTER OF) PUBLIC EMPLOYEES'
WOODARD SMITH,) RETIREMENT FUND
)
)
Petitioner.)

FINAL DECISION ON SUMMARY JUDGMENT MOTIONS

In the decision of August 21, 2007, on the parties' summary judgment motions, I granted partial summary judgment in favor of the PERF Board on the questions of whether PERF is authorized to collect its overpayment of benefits to Smith and whether the actuarial tables utilized by PERF correctly resulted in a reduction of Smith's benefit. Summary judgment was deferred on the question of the actual amount of the benefit overpayment made to Smith from June 2003 through December 2006. The parties were invited to submit supplemental materials on that question.

The PERF Board filed a Response to Order mailed on September 7, 2007, including PERF Exhibit A, a version of PERF Exhibit 13 with helpful colored highlighting, and an explanation of some of the gaps or inconsistencies in the previously filed evidence. Smith's time to file a response to this supplemental information has expired.

The Decision on Motions for Summary Judgment dated August 21, 2007, is fully incorporated herein except as amended and clarified as follows.

Amended Findings of Undisputed Fact

The supplemental materials submitted by PERF call for the following amendments to the Findings of Undisputed Fact.

21. Smith actually began receiving a pension benefit in 2003 at a monthly rate of [REDACTED] (PERF Ex. 5; PERF Supp. Ex. A.)

23. Smith's annuity payout was also apparently miscalculated, but the evidence does not provide an explanation. According to a letter later sent to Smith, PERF used an incorrect "annuity factor" in calculating the base payout, and then repeated its error in applying the wrong survivor benefit conversion factor. According to PERF, this resulted in Smith receiving monthly payments of \$ [REDACTED] when he should have been receiving [REDACTED] (PERF Ex. 7, 13, Supp. Ex. A.)
[Footnote 2 is deleted.]

25 [REDACTED] By December 2006, Smith was receiving total monthly payments of [REDACTED] (PERF Ex. 6, 13.)

32. PERF Exhibit 13 shows the calculation of the net overpayment including COLAs. Exhibit 13 shows a total pension benefit overpayment of [REDACTED] and a "13th check" overpayment of [REDACTED] for a total overpayment of [REDACTED]. Exhibit 13 shows an annuity payout underpayment of [REDACTED] and credits Smith with [REDACTED] of interest on the underpayment, for a total underpayment of \$ [REDACTED]. The result is a net overpayment of \$ [REDACTED].

33. The letter of January 5, 2007 (PERF Ex. 6), showed a higher overpayment figure of [REDACTED] because, at that time, PERF was adjusting to withhold federal tax on annuity underpayments. (PERF Response to Order at 2-3.) This policy was later reversed, so the correct amount of net overpayment from 2003 through December 2006 was [REDACTED].

34. The PERF Board had already begun deducting \$ [REDACTED] a month based on the earlier calculation of the overpayment to be [REDACTED]. When the amount of the overpayment was adjusted to [REDACTED] the monthly payback amount was not adjusted downward for reasons of administrative convenience. Instead, the PERF Board intends to continue collecting [REDACTED] a month until the overpayment is satisfied, which will occur in 55 months rather than a full five years.

Supplemental Analysis

Genuine disputes of material fact

With the PERF Board's clarification, which Smith does not oppose, there are now no genuine issues of material fact on the question of the amount of the overpayment.

Calculation of benefit

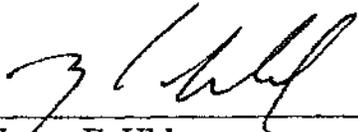
PERF's multiple recalculations of the net amount of the overpayment have now been explained. PERF initially notified Smith that his net overpayment was [REDACTED] (PERF Ex. 6), but that amount reflected tax withholding. PERF later decided against tax withholding, resulting in a net overpayment of [REDACTED] (PERF Ex. 13).

It is true that PERF continues to deduct [REDACTED] a month based on first calculation, which will result in collection of the overpayment over 55 months rather than 60. The difference of \$ [REDACTED] a month is insignificant. Presumably, PERF has systems in place to make sure that a deduction of only [REDACTED] is made in the 55th month, and the deductions end thereafter. There is no basis for concluding that PERF's decision to continue to collect \$ [REDACTED] a month is unreasonable.

Final Order

There is no genuine dispute of material fact and PERF is entitled to judgment as a matter of law on all questions presented. PERF's motion for summary judgment is GRANTED and Smith's motion for summary judgment is DENIED.

DATED: October 4, 2007.



Wayne E. Uhl
Administrative Law Judge
8710 North Meridian Street, Suite 200
Indianapolis, Indiana 46260-5388
(317) 844-3830

STATEMENT OF AVAILABLE PROCEDURES FOR REVIEW

The undersigned administrative law judge is not the ultimate authority, but was designated by the PERF Board to hear this matter pursuant to I.C. § 4-21.5-3-9(a). Under I.C. § 4-21.5-3-27(a), this order becomes a final order when affirmed under I.C. § 4-21.5-3-29, which provides, in pertinent part:

(b) After an administrative law judge issues an order under section 27 of this chapter, the ultimate authority or its designee shall issue a final order:

- (1) affirming;
- (2) modifying; or
- (3) dissolving;

the administrative law judge's order. The ultimate authority or its designee may remand the matter, with or without instructions, to an administrative law judge for further proceedings.

(c) In the absence of an objection or notice under subsection (d) or (e), the ultimate authority or its designee shall affirm the order.

(d) To preserve an objection to an order of an administrative law judge for judicial review, a party must not be in default under this chapter and must object to the order in a writing that:

(1) identifies the basis of the objection with reasonable particularity; and

(2) is filed with the ultimate authority responsible for reviewing the order within fifteen (15) days (or any longer period set by statute) after the order is served on the petitioner.

(e) Without an objection under subsection (d), the ultimate authority or its designee may serve written notice of its intent to review any issue related to the order. The notice shall be served on all parties and all other persons described by section 5(d) of this chapter. The notice must identify the issues that the ultimate authority or its designee intends to review.

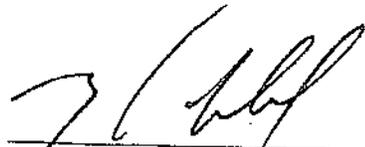
CERTIFICATE OF SERVICE

I hereby certify that I served a copy of this document on the following persons, by U.S. Postal Service first-class mail, certified mail, return receipt requested, postage prepaid, on October 4, 2007:

Woodard Smith



Linda I. Villegas, Staff Counsel
PERF
143 W. Market St.
Indianapolis IN 46204



Wayne E. Uhl
Administrative Law Judge

BEFORE AN ADMINISTRATIVE LAW JUDGE
FOR THE PUBLIC EMPLOYEES' RETIREMENT FUND

IN THE MATTER OF) PUBLIC EMPLOYEES'
WOODARD SMITH,) RETIREMENT FUND
)
Petitioner.)

**DECISION ON MOTIONS FOR SUMMARY JUDGMENT
AND ORDER TO SUPPLEMENT EVIDENCE**

Introduction

Woodard Smith appeals from the PERF Board's determination that his retirement benefit was miscalculated and that he was overpaid a total of [REDACTED] from his retirement in June 2003 through December 2006. PERF determined that it would reduce his benefit to the correct amount, and reduce it further to collect the overpayment over five years, without interest.

In accordance with the schedule set by agreement of the parties, Smith filed materials on April 30, 2007, that are construed as a motion for summary judgment, and PERF likewise filed a motion for summary judgment with supporting evidentiary materials on April 30, 2007. Each party filed a response to the other's motion on May 11, 2007. The motions are now fully briefed and ready for decision.

Findings of Undisputed Fact

1. Woodard Smith was employed on March 1, 1967, by the Indiana State Board of Health. He immediately and automatically became a member of PERF. (PERF Ex. 1.)

2. Smith did not report any prior PERF-eligible service in his initial membership record. (PERF Ex. 1.) However, a PERF document indicates prior service from November 28, 1959 through February 28, 1967, for what is now called the Indiana Department of Environmental Management (IDEM). (PERF Ex. 2.) The same record shows that Smith served at IDEM from April 6, 1986 through May 30, 2003. (*Id.*) There is no evidence of a break in service.

3. Smith was born on September 18, 1937. (PERF Ex. 4.)

4. In early 2003, PERF gave Smith a benefit estimate. (Petitioner's Ex. C.) The estimate was based on a presumed retirement date of June 1, 2003, and 36 years and 3 months of service. It also presumed that an additional 7 years and 3 months of service would be purchased, for a total of 43 years and 6 months. It

presumed an annuity savings account balance of \$ [REDACTED] and average annual compensation of \$ [REDACTED] (Pet. Ex. C.)

5. The document estimated benefits under several scenarios. Relevant here, it estimated that if Smith elected Option 30 (full survivor benefit with no withdrawal of annuity savings account), Smith would receive a monthly pension benefit of \$ [REDACTED] and annuity payout of \$ [REDACTED] for a total monthly benefit of \$ [REDACTED]. Upon his death, his beneficiary would receive the same for his or her lifetime. (Pet. Ex. C.)

6. The benefit estimate stated that it was based on unverified service data. It also stated: "All information shown is an estimate only. Actual benefits will be computed based on certified data using the laws in effect at retirement." (Pet. Ex. C.)

7. Smith applied for retirement benefits on May 30, 2003, anticipating that his last day in pay status would be May 30, 2003, and the effective date of retirement benefit would be June 1, 2003. (PERF Ex. 3.)

8. Smith selected benefit Option 30, which was described as follows:

OPTION 30 – JOINT WITH FULL SURVIVOR BENEFITS. You will be paid a monthly benefit for life. After your death, the same monthly benefit will be paid to your beneficiary for his/his life.

(PERF Ex. 3.)

9. With respect to his annuity savings account, Smith elected Choice 1, described as follows:

Choice Number 1: I elect to receive the total amount of my Annuity Savings Account paid as a monthly benefit. I understand that I will not receive any distribution from my Annuity Savings Account other than this monthly benefit.

(PERF Ex. 3.)

10. Smith designated his wife, Louise Smith, as his beneficiary. (PERF Ex. 3.) Louise was born on February 27, 1938. (PERF Ex. 3, 4.)

11. The application indicated that Smith was applying under a State Retirement Incentive Plan. (PERF Ex. 3.) Such early retirement incentives are authorized by Ind. Code § 5-10.2-3-1.2, which permits a member to purchase one year of service credit for every five completed years of service, and permits the State to purchase that credit for the member.

12. Smith was given credit for 43 years and 6 months of creditable service. (PERF Ex. 7, 12.)¹

13. Woodard Smith's age at retirement was 65 years, 8 months and 13 days. Louise Smith's age on the same date was 65 years, 3 months and 4 days.

14. The calculation of the retirement benefit is controlled by Ind. Code §§ 5-10.2-4-4 (retirement benefit calculation), -5 (early retirement percent reduction) and -7 (retirement benefit payment options). Some of these calculations are based on actuarial tables and an interest rate adopted by the PERF Board.

15. PERF miscalculated both Smith's retirement benefit and his annuity payout.

16. The base annual retirement benefit was correctly calculated following the formula prescribed by Ind. Code § 5-10.2-4-4(a), as follows:

Average annual compensation	[REDACTED]
Multiplied by 1.1%	x .011
Multiplied by total creditable service	x 43.5
Annual benefit	[REDACTED]

17. The error was made in adjusting the benefit to account for Smith's election of the full survivor option authorized by Ind. Code § 5-10.2-4-7(b)(1)(A), which must be the "actuarial equivalent" of the full benefit calculated above.

18. The PERF Board adopted mortality and actuarial factors for PERF in 1981. (PERF Ex. 9, 10, 11.) Those tables provide a conversion factor based on the ages of the member and the beneficiary. (PERF Ex. 11.) The ages are determined by the person's nearest birthday.

19. When Smith's benefit was originally calculated, his age was miscalculated to be 65. However, because he was 65 years and 8 months old, his nearest birthday was his 66th. Louise's age was correctly calculated to be 65.

20. Based on the mistaken age of 65, PERF used the conversion factor for Option 30 where the member is 65 and the beneficiary is 65, 0.831253 (rounded to 0.8313). (PERF Ex. 11, p. 166.) PERF contends that application of this conversion factor to the retirement benefit above mistakenly resulted in an annual benefit of [REDACTED] x 0.8313 [REDACTED] / 12 = [REDACTED]

¹ It is not clear, but immaterial, whether this is based on (1) a start date of March 1, 1967, and the State's purchase of 7 years and 3 months of service, or (b) a start date of November 28, 1959, and no purchase of additional service.

21. Smith actually began receiving a pension benefit in 2003 at a monthly rate of [REDACTED] (PERF Ex. 5.) The fact that this amount is higher than the calculation set forth above is unexplained.

22. The Option 30 conversion factor for a member who is 66 (Smith's correct age) with a beneficiary who is 65 is 0.820271 (rounded to 0.8203). (PERF Ex. 11, p. 169.) If this factor had been used, Smith's monthly benefit would have been \$ [REDACTED] x 0.8203 = [REDACTED] / 12 = [REDACTED]

23. Smith's annuity payout was also apparently miscalculated, but the evidence does not provide an explanation. According to a letter later sent to Smith, PERF used an incorrect "annuity factor" in calculating the base payout, and then repeated its error in applying the wrong survivor benefit conversion factor. According to PERF, this resulted in Smith receiving monthly payments of \$ [REDACTED] when he should have been receiving \$ [REDACTED] (PERF Ex. 7.)²

24. Cost-of-living adjustments (COLAs) increased the pension benefit by two percent effective January 2005, and 1.5 percent effective January 2006.³

25. PERF asserts that by December 2006, Smith was receiving monthly payments of [REDACTED] by December 2006. (PERF Ex. 6.) This number cannot be verified from the evidence presented.

26. On December 27 or 28, 2006, Smith received a phone call from PERF notifying him of the situation. (Smith MSJ at 2.)

27. On January 13, 2007, Smith received a letter from PERF dated January 5, 2007, and postmarked January 11, 2007. The letter informed him that the State Board of Accounts had identified the incorrect calculation of "a number of benefit payments since 2002." The letter stated that Smith's benefit had been recalculated and PERF determined that his pension benefit was overpaid and his annuity payout was underpaid, with a net overpayment of [REDACTED]. The letter stated that the overpayment would be collected through deductions from future payments over a period of five years without interest. (PERF Ex. 6.)

28. According to the letter, Smith's recalculated future monthly benefit would be [REDACTED]. For five years (60 months), his monthly benefit would be reduced by \$ [REDACTED] resulting in a temporary monthly benefit of [REDACTED] (PERF Ex. 6.)

² PERF has not submitted evidence of the actual amount paid to Smith from his annuity savings account.

³ These percentages are derived from PERF Exhibit 13.

29. Smith spoke to a PERF representative on January 17, 2007, and was promised a more detailed accounting. (PERF Ex. 8.)

30. PERF sent Smith a letter dated February 5, 2007, explaining the calculation errors in more detail, and notifying him of his right to seek administrative review. (PERF Ex. 7.)

31. The February 5 letter explained that Smith's original monthly payment benefit had been incorrectly calculated to be [REDACTED] + [REDACTED] and it should have been \$ [REDACTED]. It further explained that the subsequent COLAs were necessarily miscalculated as well.

32. PERF Exhibit 13 purports to show the calculation of the overpayment including COLAs. Exhibit 13 shows a total pension benefit overpayment of [REDACTED] a "13th check" overpayment of [REDACTED] for a total overpayment of [REDACTED]. Exhibit 13 shows an annuity payout underpayment of [REDACTED] and credits Smith with [REDACTED] in the underpayment, for a total underpayment of [REDACTED]. The result is a net overpayment of [REDACTED].

33. The accuracy of Exhibit 13 is dubious because it conflicts with PERF Exhibit 5. Specifically, Exhibit 13 assumes that Smith's first 19 pension benefit payments were [REDACTED] a month, with later COLAs based on that amount, while Exhibit 5 shows that he actually received initial payments of [REDACTED]. Exhibit 13 also shows two "13th check" payments that are unexplained.

34. Moreover, the \$ [REDACTED] net overpayment shown by Exhibit 13 is [REDACTED] less than the [REDACTED] overpayment claimed by PERF in its letter of January 5, 2007. (PERF Ex. 6.) If the correct amount is \$ [REDACTED] the correct monthly reduction to repay it over five years would have been [REDACTED].

35. Smith states that PERF has continued to deduct [REDACTED] from his monthly payment rather than [REDACTED]. (Smith MSJ Response at 1.)

36. Smith submitted a petition for review dated February 20, 2007, and received by PERF on February 21, 2007. (PERF Ex. 8.)

37. PERF concedes that Smith's appeal is timely. (Assignment letter to ALJ Uhl, 2/28/07.)

38. Any legal conclusion stated below that should be designated as a finding of fact is incorporated by reference.

Analysis

Legal standard

Summary judgment "shall be rendered immediately if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits and testimony, if any, show that a genuine issue as to any material fact does not exist and that the moving party is entitled to a judgment as a matter of law." Ind. Code § 4-21.5-3-23(b). This mirrors Ind. Trial R. 56(C). The standard for summary judgment under that rule is well-established:

A party seeking summary judgment bears the burden to make a prima facie showing that there are no genuine issues of material fact and that the party is entitled to judgment as a matter of law. Once the moving party satisfies this burden through evidence designated to the trial court pursuant to Trial Rule 56, the nonmoving party may not rest on its pleadings, but must designate specific facts demonstrating the existence of a genuine issue for trial. The court must accept as true those facts alleged by the nonmoving party, construe the evidence in favor of the nonmovant, and resolve all doubts against the moving party. . . . A genuine issue of material fact exists where facts concerning an issue that would dispose of the litigation are in dispute or where the undisputed material facts are capable of supporting conflicting inferences on such an issue.

McDonald v. Lattire, 844 N.E.2d 206, 210 (Ind. App. 2006).

Evidence

Neither party has objected to any of the evidence submitted by the opposing party. Therefore, all of the evidence is deemed admissible.

Genuine disputes of material fact

Neither party has argued that there are disputes of material fact. However, the evidence shows discrepancies in PERF's calculation of the overpayment. As explained below, these discrepancies prevent summary judgment on the question of the amount of the overpayment.

Issues

Taking together his petition for review (PERF Ex. 8) and his summary judgment materials, Smith raises the following issues.

First, Smith questions PERF's decision to recover the overpayment. He argues that (1) the errors were a breach of PERF's fiduciary responsibility and were made solely made by PERF, so PERF should be required to reimburse the fund for

the overpayment, and (2) the application for retirement benefits creates a contract that cannot be unilaterally modified by PERF. In the alternative, even if the overpayment could lawfully be recouped, Smith understands that PERF forgave overpayments of [REDACTED] or less, and reimbursed underpayments at [REDACTED] interest. He contends that it would therefore be fair to forgive \$ [REDACTED] of his overpayment, and pay him [REDACTED] % interest on the amount that he was underpaid from his annuity savings account.

Second, Smith raises questions about the calculations themselves. He questions why the benefit of an older retiree would be less than the benefit for a younger retiree. He also questions why his five-year repayment has not been reduced in accordance with the new overpayment amount of [REDACTED]

PERF argues in support of summary judgment that PERF is both authorized and required to collect overpayments, and that Smith's new payment and overpayment amounts were correctly recalculated.

PERF's authority to collect overpayment

1. Statutory authority

The first question is whether PERF is authorized to collect overpayments by deducting installments from future benefit payments. The PERF Board is granted broad authority to "[e]xercise all powers necessary, convenient, or appropriate to carry out and effectuate its public and corporate purposes and to conduct its business." Ind. Code § 5-10.3-3-8(a)(10). The board's powers shall be interpreted broadly to effectuate the purposes of the PERF law and not as a limitation of powers. Ind. Code § 5-10.3-3-8(c).

With one exception, the statutes governing PERF do not directly address the question of erroneous overpayments of benefits paid to a member or survivor.⁴ The exception is Ind. Code § 5-10.2-4-1.5, which authorizes PERF to pay an estimated benefit to a member who has retired but whose membership records are incomplete or not yet certified. After the records have been submitted and certified and the actual retirement benefit has been determined, PERF must temporarily adjust the benefit to reconcile any underpayment or overpayment. This adjustment may be done "over a reasonable time, as determined by the board." Ind. Code § 5-10.2-4-

⁴ At least two other states statutorily authorize recovery of overpayments. Sola v. Roselle Police Pension Bd., 794 N.E.2d 1055, 1058 (Ill. App. 2003) (interpreting Ill. Comp. Stat. § 5/3-144.2); State ex rel. Public Employees Retirement Ass'n v. Longacre, 59 P.3d 500 (N.M. 2002) (upholding constitutionality of New Mex. Stat. Ann. § 10-11-4.2(A), which authorizes collection of overpayment but only back to one year before it was discovered).

1.5(c). This statute does not apply here because this case does not involve payment of estimated benefits, but the statute endorses the concept of collecting an overpayment by deductions from future benefits over a reasonable period of time.

Implicit authority to collect overpayments may also be found in Ind. Code § 5-10.3-8-12, which authorizes the board to stop a member's payment if, among other things, the member "[r]efuses to repay an overpayment of benefits." This statute is not limited to overpayments of estimated benefits under Ind. Code § 5-10.2-4-1.5, and should be read to include overpayments made for any reason, including simple calculation errors.

PERF argues that further support for authority and a mandate to collect overpayments is found in Ind. Code § 5-10.2-2-1.5, which requires the fund to "satisfy the qualification requirements of Section 401 of the Internal Revenue Code." In order to meet those requirements, § 5-10.2-2-1.5 further requires the fund to meet several conditions, including (1) the corpus and income shall be distributed to members and their beneficiaries "in accordance with the retirement fund law," (2) no part of the corpus or income of the fund may be used for or diverted to any purpose other than the exclusive benefit of the members and their beneficiaries, and (5) all benefits paid from the fund shall be distributed in accordance with the requirements of § 401(a)(9) of the Internal Revenue Code (IRC) and the regulations under that section.

Section 401 of the IRC, 26 U.S.C. § 401, provides favorable tax treatment to qualified plans, including deferred income taxation of employer contributions and income, and exemption from employment taxes on employer contributions. In order to be qualified, contributions to the plan must be made "for the purpose of distributing to such employees or their beneficiaries the corpus and income of the fund accumulated by the trust in accordance with such plan." 26 U.S.C. § 401(a)(1) (emphasis added). The plan must also make it impossible to use the corpus and income for purposes other than for "the exclusive benefit of [the] employees or their beneficiaries." 26 U.S.C. § 401(a)(2).

Regulations promulgated by the United States Treasury Department repeat and refine the qualification requirements of § 401. A qualified pension plan must be "a definite written program." 26 C.F.R. § 1.401-1(a)(2). The plan must be established by an employer "for the exclusive benefit of his employees or their beneficiaries." 26 C.F.R. § 1.401-1(a)(3)(ii) and (iv). It must also be formed for the purpose of distributing the fund's corpus and income "in accordance with the plan." 26 C.F.R. § 1.401-1(a)(3)(iii).⁵

⁵ PERF also cites "26 C.F.R. § 1.401-126." I could not find a provision of the Code of Federal Regulations with that citation.

These provisions do not expressly state that an overpayment of benefits to a member or beneficiary who is entitled to benefits necessarily violates the exclusive benefit requirement or constitutes operation not "in accordance with the plan," but that conclusion is reasonable.

In further support, PERF cites IRS Revenue Procedure 2006-27 (May 1, 2006, published in Internal Revenue Bulletin 2006-22, May 30, 2006) (PERF Ex. 14), which is the IRS's system of correction programs for retirement plans that are intended to satisfy § 401(a) but have not met those requirements for a period of time. (§ 1.01, Ex. 14 at 1.) If the plan corrects a failure using these procedures, the IRS will not treat the plan as failing to meet § 401(a). (§3.01, Ex. 14 at 5.)

PERF contends that the failure to collect overpayments like the one in this case is a "qualification failure," which is defined as "any failure that adversely impacts the qualification of a plan." (§ 5.01(2), Ex. 14 at 8.) Of the four types of qualification failures, PERF contends that overpayment is an "operational failure," defined as a qualification failure that "arises solely from the failure to follow plan provisions." (§5.01(2)(b), Ex. 14 at 8.)

The Revenue Procedure specifically defines an "overpayment" as "a distribution to an employee or beneficiary that exceeds the employee's or beneficiary's benefit under the terms of the plan . . ." (§ 5.01(6), Ex. 14 at 10.) The Procedure clearly contemplates that overpayments are failures that require correction. This can be seen from Section 6, which sets forth the principles for correction of failures. While it does not specifically state that overpayments are failures, it creates an exception to the general requirement of full correction by stating that a plan is not required to seek return of an overpayment of \$100 or less. (§ 6.02(5)(c), Ex. 14 at 15.) Section 6 also states generally that full correction may not be required "because it is unreasonable or not feasible," and that "the correction method adopted must be one that does not have significant adverse effects on participants and beneficiaries of the plan . . ." (§ 6.02(5), Ex. 14 at 15.) It further appears that overpayments may be corrected by the procedure used by PERF in this case, reduction of future benefits to both correct the error and recoup the overpayment on an actuarially adjusted basis. (Appendix B, Correction Methods and Examples, § 2.05, Ex. 14 at 62, which incorporates § 2.04(1) (correction of § 415(b) excesses), Ex. 14 at 57-60.)

A revenue procedure is directory, not mandatory, and does not have the force of a promulgated rule. Estate of Shapiro v. Commissioner, 111 F.3d 1010, 1017-18 (2nd Cir. 1997), citing cases. Nevertheless, Procedure 2006-27 clearly indicates the IRS view that the overpayment in this case would be considered a failure that would threaten PERF's qualification under IRC § 401.

PERF has cited no cases holding that a pension plan risks losing its status as a qualified plan under the IRC if it fails to recover overpayments, or that the risk justifies collection of overpayments. Nor has PERF provided evidence that the IRS has taken action to revoke a plan's qualified status under circumstances such as those presented here.

My own research disclosed very little discussion of the possibility, and then only where a non-employee was provided benefits. In Flynn v. Hach, 138 F.Supp.2d 334 (E.D. N.Y. 2001), for example, the court found that trustees of a pension plan did not act arbitrarily in refusing to deem the plaintiff an employee covered by the plan. As partial support for the trustees' position, the court accepted their argument that the plan would risk losing its qualified status under § 401 if it included non-employees.

The court cited Thomas v. Bd. of Trustees of Intern. Union of Operating Engineers, 1998 WL 334627 (E.D. Pa. 1998), in which the union made pension fund contributions for Thomas for 14 years when he was not the union's employee. The IRS audited the pension funds and, upon learning that contributions had been received for non-employees, threatened the funds with loss of their status as qualified trusts under § 401. To avoid this result, the funds refunded the contributions and Thomas sued. The court granted summary judgment to the union, holding that the funds had properly refunded the contributions in the face of the threatened loss of their tax-exempt status. The court cited two older decisions for the proposition that plans providing coverage to non-employees are not qualified under § 401. Professional & Executive Leasing, Inc. v. Commissioner, 862 F.2d 751, 752-54 (9th Cir. 1988); Stochastic Decisions, Inc. v. Wagner, 34 F.3d 75, 82 (2d Cir. 1994) (profit-sharing plan providing benefits to non-employee was not qualified under § 401, and therefore not exempt from claims of creditors).

Finally, in Redall Industries, Inc. v. Wiegand, 870 F.Supp. 175, 179 (E.D. Mich. 1994), trustees of a pension plan seeking restitution of overpayments argued that the plan would lose its qualified status if restitution was not ordered. Based on an expert's testimony that the plan's qualification would merely be "in question," the court found a dispute of material fact and denied summary judgment.

Against this are dozens of cases, some of them cited later in this decision, that considered whether to permit recoupment or not without reference to the prospect that the plan would lose its § 401 qualification, some of which denied recoupment.

2. Court decisions, common law restitution

Apart from statutory provisions, court decisions must be examined to determine whether and to what extent a public pension plan is authorized to recoup mistaken overpayments. Such decisions are important because, while PERF is a

creature of statute, it is also subject to the constitution and common law of Indiana. To that extent, when determining whether PERF has acted "in accordance with the retirement fund law," Ind. Code § 5-10.2-2-1.5(1), or "in accordance with such plan," 26 U.S.C. § 401(a), the "plan" includes principles of Indiana law beyond PERF's statutory terms. ⁶

For example, Article 11, § 12 of the Indiana Constitution, before its amendment in 1996, prohibited PERF from investing in equity securities or stocks of private corporations. Bd. of Trustees of Public Employees' Retirement Fund v. Pearson, 459 N.E.2d 715 (Ind. 1984). Constitutional and contractual principles have been held to prevent retroactive amendment to pension terms, if a vested interest has been found. Bd. of Trustees of Public Employees' Retirement Fund v. Hill, 472 N.E.2d 204 (Ind. 1985) (judges' retirement fund). Because PERF is a trust, Ind. Code § 5-10.3-2-1(b), it is presumably also subject to the common law of trusts. And with respect to the possible application of equitable estoppel to this case, PERF does not argue that estoppel is absolutely prohibited, but only that it does not apply on the facts of this case. (PERF Memorandum in Support of Motion for Summary Judgment at 13-14.)

No Indiana court appears to have specifically decided the circumstances under which a pension or other trust can recover mistaken overpayments. There are many such cases from other jurisdictions that reach a wide variety of conclusions based on each case's particular facts. A strong theme in these cases, however, is the application of equitable principles to determine whether, depending on the standard of review involved, it is unreasonable, arbitrary or capricious for a pension to obtain recovery of overpayments.

The overwhelming majority of these are decided under the Employment Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. §§ 1001 *et seq.* ERISA does not apply to plans established by states or their political subdivisions. 29 U.S.C. §§ 1002(32), 1003(b)(1). Nevertheless, in an action under ERISA, courts apply common law principles of equitable relief. See, e.g., Johnson v. Retirement Program Plan, 2007 WL 649280 (E.D. Tenn. 2007) (summary judgment granted for pension plan on challenge to collection of mistaken overpayments, based on ERISA, trust law and equitable estoppel); Phillips v. Maritime Association-I.L.A. Local Pension Plan, 194 F.Supp.2d 549 (E.D. Tex. 2001) (using equitable common law principles, pension plan cannot reduce benefits or recoup overpayments); Kaliszewski v. Sheet Metal Workers' Nat'l Pension, 2005 WL 2297309 (W.D. Pa. 2005) (recommending denial of summary judgment on disputed question of whether pension could reduce overpayments resulting from miscalculation).

⁶ Cf. Ogden v. Michigan Bell Telephone Co., 595 F.Supp. 961, 970 (E.D. Mich. 1984) (state law concepts which extend beyond the terms of a pension plan may be a proper reference in an action to enforce plan).

Guidance as to how Indiana courts would address the question is found in cases discussing a party's right to restitution of a payment made by mistake. Indiana accepts the general rule that "if one party pays money to another party under a mistake of fact that a contract or other obligation required such payment, the payor is entitled to restitution." St. Mary's Medical Center, Inc. v. United Farm Bureau Family Life Ins. Co., 624 N.E.2d 939, 941 (Ind. App. 1993), citing Restatement of Restitution § 18 (1937). This rule applies "even though the [payor] may have been careless and had failed to employ the means of knowledge which would have disclosed the mistake." Century Bldg. Partnership, L.P. v. SerVaas, 697 N.E.2d 971, 974 (Ind. App. 1998), citing Monroe Financial Corp. v. DiSilvestro, 529 N.E.2d 379, 383 (Ind. App. 1988), trans. denied (Ind. 1989).⁷

But this rule is subject to the limitation that "the party receiving the money must not have so changed his position so as to make it inequitable to require him to make repayment." Monroe Financial, id. In that case, the court held that investing the proceeds or using the proceeds as a down payment to incur new debt based on the proceeds are not sufficient to demonstrate a change of position that would bar restitution. Id. at 384-85.

These equitable principles of restitution have been applied in ERISA cases of mistaken overpayments:

The Fund correctly points out that, generally speaking, "[w]hen a trustee overpays a beneficiary the trustee is entitled to recover the excess payment, even when it was the product of unilateral mistake on the part of the trustee." Hoffa v. Fitzsimmons, 673 F.2d 1345, 1354 (D.C. Cir. 1982). But, as Regan [the overpaid person] notes, "such recovery may not be permitted where the beneficiary has changed his position in detrimental reliance on the correctness of the overpayment; in such cases the beneficiary is entitled to retain part or all of the overpayment to the extent necessary to avoid injustice." Id. at 1354 n. 27. There appears to be no dispute that Regan changed his position in reliance on the correctness of what turned out to be a series of overpayments. The outcome of this motion thus turns on whether Regan reasonably believed that he was entitled to the payments he received.

⁷ The 1937 Restatement of Restitution and many cases draw a distinction between mistakes of fact and mistakes of law, holding that a payor is not entitled to restitution of overpayments induced solely by mistakes of law. Restatement § 45. Our Supreme Court, however, has expressed approval of the contemporary view that this distinction is "artificial" and restitution is available regardless of whether the mistake was one of fact or law. Time Warner Entertainment Co., L.P. v. Whiteman, 802 N.E.2d 886, 891 (Ind. 2004).

Laborer's Dist. Council Pension Fund for Baltimore and Vicinity v. Regan, 474 F.Supp.2d 279, 281 (D. N.H. 2007) (denying summary judgment because of factual disputes over whether Regan's reliance on the overpayments was reasonable). See also Lumenite Control Technology, Inc. v. Jarvis, 252 F.Supp.2d 700, 706-07 (N.D. Ill. 2003) (using three-part test, pension fund is entitled to restitution of overpayment if (1) it has a reasonable expectation of repayment, (2) member should reasonably have expected to repay, and (3) society's reasonable expectations of person and property would be defeated by nonpayment, citing Harris Trust & Sav. Bank v. Provident Life & Accident Ins. Co., 57 F.3d 608, 615 (7th Cir. 1995)).

Another line of authority uses a very similar analysis based on the law of trusts. See Ind. Code § 5-10.3-2-1(b) (PERF "is a trust"). The court in Johnson, *supra*, summarizing Sixth Circuit law, noted that if a trustee has made a payment out of trust property to a beneficiary who was not entitled to the payment, the beneficiary is subject to repayment unless doing so will result in hardship. In pension overpayment cases, therefore, the court must consider "the possible inequitable impact recoupment may have on individual retirees," including the beneficiary's disposition of the money, the amount of the overpayment, the nature of the mistake made by the trustee, the amount of time that has passed since overpayment was made, and the beneficiary's total income and effect recoupment would have on that income. Johnson, 2007 WL 649280 at *6-*7, citing cases and Restatement of Trusts (Second) § 250 (1959).

Finally, in the case of a pension fund, equitable considerations must include the obligation of the fund to all of its beneficiaries to maintain the integrity of the fund. "Forcing . . . a plan to pay benefits [that] are not part of the written terms of the program disrupts the actuarial balance of the Plan and potentially jeopardizes the pension rights of others legitimately entitled to receive them." Central States, Southeast & Southwest Areas Health & Welfare Fund v. Neurobehavioral Associates, P.C., 53 F.3d 172, 175 (7th Cir. 1995) (reversing and remanding dismissal of action in which plan sought restitution of overpayment after clerical error resulted in \$10,000 payment when only \$100 owed). See also Black v. TIC Investment Corp., 900 F.2d 112, 115 (7th Cir. 1990).

Because of this overriding obligation to protect other members and the actuarial soundness of the plan, some courts have held that erroneous statements of a plan representative will be enforced against the plan only where the statements interpreted an ambiguous provision of the plan, not where the statements were contrary to its clear provisions. E.g., Slice v. Sons of Norway, 866 F.Supp. 397, 405-06 (D. Minn. 1993), *aff'd*, 34 F.3d 630 (8th Cir. 1994); Strong v. State ex rel. Oklahoma Police Pension and Retirement Bd., 115 P.3d 889 (Okla. 2005) (including long list of cases on both sides of question at 895, n. 23); Borkey v. Township of Centre, 847 A.2d 807 (Pa. Cmwlth. 2004) (estoppel will not be applied to forbid plan from reducing benefit where plan's erroneous statements were contrary to "positive

law," but recoupment of past overpayment barred as "unconscionable"); Romano v. Retirement Bd. of Employees' Retirement System of Rhode Island, 767 A.2d 35 (R.I. 2001); Law v. Ernst & Young, 956 F.2d 364 (1st Cir. 1992) (estoppel applies only where the representations were interpretations of the terms of the plan about which reasonable persons could disagree, not modifications of the terms of the plan).

The application of equitable principles may not be a significant restriction of PERF's statutory authority to collect overpayments. As noted above, the IRS procedure upon which PERF relies so heavily does not require full correction where full correction would be "unreasonable or not feasible," and further provides that the correction method must "not have significant adverse effects on participants and beneficiaries of the plan . . ." (IRS Revenue Procedure 2006-27, § 6.02(5), PERF Ex. 14 at 15.) Apparently, therefore, PERF could decline to collect an overpayment where collection would have a "significant adverse effect" on a member who unwittingly came to rely heavily on the overpayment.

3. Equitable estoppel

Smith suggests reliance on an estimate of benefits provided to him before he retired. (Pet. Ex. C.) That estimate projected a monthly pension benefit of [REDACTED] which was remarkably close to the [REDACTED] Smith should have received, and an annuity payout of \$[REDACTED] significantly less than the \$1,077.24 Smith should have received and the [REDACTED] he apparently did receive. The estimate made it very clear that it was subject to final verification.

Smith has not argued that he relied on the miscalculated payment itself, and he would be hard-pressed to do so. During the first 19 months of his retirement, the Smith actually received a pension benefit of \$[REDACTED] a month, only [REDACTED] or [REDACTED] % more than what he should have received ([REDACTED]). This difference was cushioned somewhat by the underpayment of the annuity payout. Smith has not implied that he took any action to his detriment based on the expectation of the higher benefit.

Based on the relatively small differences between the estimates, the amounts Smith actually received, and the amounts he should have received, there is no basis for a claim of detrimental reliance. Equitable estoppel could not possibly apply on the facts of this case. See Wabash Grain, Inc. v. Smith, 700 N.E.2d 234, 237 (Ind. App. 1998) (equitable estoppel requires showing of (1) a representation or concealment of a material fact, (2) made by a person with knowledge of the fact and with the intention that the other party act upon it, (3) to a party ignorant of the fact, (4) which induces the other party to rely or act upon it to his detriment). Therefore, the extent to which equitable estoppel can be applied against a governmental entity such as PERF need not be decided. Compare City of Crown Point v. Lake County, 510 N.E.2d 684, 687 (Ind. 1987) (equitable estoppel cannot ordinarily be applied against governmental entities); with Equicor Development, Inc. v. Westfield-Washington Township Plan Commission, 758 N.E.2d 34, 39 (Ind.

2001) (estoppel against a governmental entity "may be appropriate where the party asserting estoppel has detrimentally relied on the governmental entity's affirmative assertion or on its silence where there was a duty to speak."); see also U.S. Outdoor Advertising Co., Inc. v. Indiana Department of Transportation, 714 N.E.2d 1244, 1259-60 (Ind. App. 1999); Samplawski v. City of Portage, 512 N.E.2d 456, 459 (Ind. App. 1987).

4. Conclusion

In summary, the PERF Board has the discretion and authority to correct unilateral errors and change payments to a member or beneficiary to the correct amount. The board also has the discretion and authority to collect overpayments by reducing the member or beneficiary's future payments until the overpayment is recovered.

Whether reduction of the benefit is appropriate in a particular case, however, is subject to equitable principles of Indiana law that are inherently part of the terms of the PERF pension plan. Because these principles are incorporated into the plan as a matter of law, their application does not threaten disqualification of the plan under § 401 of the IRC. The cases cited above provide a kaleidoscope of equitable considerations that courts have considered in circumstances similar or analogous to this case. Most important are the Indiana cases on restitution, which supply the most relevant source of authority on how Indiana courts would view this case. Furthermore, even IRS procedures permit consideration of adverse effects on members when determining whether to correct overpayments.

In this case, the equities weigh strongly in favor of permitting PERF to recover the overpayments. The overpayments were clearly contrary to law and modified the terms of the plan. There is no evidence that Smith relied to his detriment on the overpayments, or will suffer significant adverse effects from repaying them. While fault for the overpayments lies solely with PERF, Indiana law allows restitution even for careless mistakes. The overpayment to Smith alone does not represent a significant proportion of the overall assets of PERF.⁸ But Smith was not the only member who was overpaid, and PERF was required to take a global view of the potential impact of all the overpayments on the integrity of the fund.

Smith argues that PERF breached a contract formed by his application. Indiana cases speak of pensions giving rise to contractual rights where (1) the employee voluntarily chooses to participate or (2) where retirement conditions of the

⁸ According to its web site, PERF's assets at the end of 2006 were approximately \$16.1 billion. Press release, "PERF Assets Top \$16 billion," <http://www.in.gov/perf/agency/20070112.html> (last viewed 8/15/07).

plan have been met. Bd. of Trustees of Indiana Public Employees' Retirement Fund v. Grannan, 578 N.E.2d 371, 376 n. 1 (Ind. App. 1991); Haverstock v. State Public Employees Retirement Fund, 490 N.E.2d 357, 360-61 (Ind. App. 1986). But the vested rights are the terms of the plan as set forth by statute, not the application and certainly not an erroneous estimate or payment. Smith had no contractual right to the payment of a benefit more than dictated by statute.

Smith also argues that the first \$ [REDACTED] of his overpayment should have been forgiven because PERF did not seek repayment from any member who was overpaid [REDACTED] or less. As explained above, this is because the IRS does not require collection of such overpayments. IRS Revenue Procedure 2006-27, § 6.02(5)(c) (PERF Ex. 14 at 15.)

Finally, Smith argues that he should receive [REDACTED] % interest on the amounts that were underpaid because other retirees who received net underpayments received interest at that rate. He has not provided any evidence to support that claim. As explained above, PERF has credited him with \$56.98 of interest on his underpayment of [REDACTED] a month). The rate and method of calculation are not explained, but this appears to represent an effective annual interest rate of about [REDACTED], well within market rates over that period of time.

Calculation of benefit

Smith's benefit was reduced when it was realized that he was 66 years old at retirement, not 65. He questions why an older retiree would receive a smaller benefit, based on his intuition that an older retiree should have fewer years to live and his beneficiary was the same age in both calculations. He has not submitted evidence challenging the accuracy of the actuarial tables and conversion factors used by PERF. In the absence of such evidence, there is no basis for reversal where it appears that the tables were properly adopted by the PERF Board.

PERF has submitted an explanation from its actuary. (PERF Response at 2-3.) This explanation is that the present total value of the benefit increases when the member is older, because it is more likely that the member will die before the beneficiary, and therefore more likely that benefits will have to be paid to the beneficiary. The monthly benefit is reduced to account for this added value.

Smith also questions PERF's multiple recalculations of the net amount of the overpayment. As noted in the findings of undisputed fact above, PERF initially notified Smith that his net overpayment was [REDACTED] (PERF Ex. 6), but has submitted a document showing the net overpayment to be [REDACTED] (PERF Ex. 13). He states that PERF continues to deduct [REDACTED] a month based on the higher amount. Compounding the discrepancy is the fact that Exhibit 13 appears to be based on an initial monthly pension benefit of \$ [REDACTED], when Exhibit 5 shows that

Smith actually received [REDACTED] Unfortunately for Mr. Smith, these numbers suggest that PERF's overpayment figure is too low.

The undersigned ALJ has spent considerable time attempting—and failing—to reconcile these numbers to ascertain the correct amounts. More information is needed. Therefore, both summary judgment motions will be held under advisement subject to supplementation with a more complete and accurate explanation of the amount of the overpayment.

Order

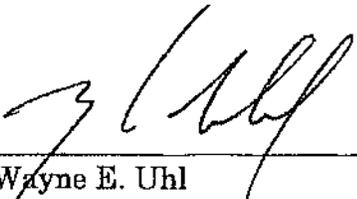
Summary judgment is granted in part and deferred in part. See Ind. Code § 4-21.5-3-23(c).

There is no genuine dispute of material fact and PERF is entitled to judgment as a matter of law on the questions of whether PERF is authorized to collect its overpayment of benefits to Smith and whether the actuarial tables utilized by PERF correctly resulted in a reduction of Smith's benefit. PERF's motion for summary judgment is GRANTED and Smith's motion for summary judgment is DENIED on these issues.

There remains a genuine issue of material fact as to the actual amount of the benefit overpayment made to Smith from June 2003 through December 2006. Both parties' motions for summary judgment on this issue are HELD UNDER ADVISEMENT.

PERF may submit supplemental evidence explaining or revising its calculation of the overpayment, and setting forth its intent as to the future collection of the overpayment, no later than **September 7, 2007**. Smith may file a response challenging the supplemental evidence no later than **September 17, 2007**. PERF may file a reply no later than **September 24, 2007**.

DATED: August 21, 2007.



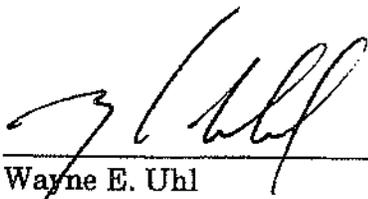
Wayne E. Uhl
Administrative Law Judge
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CERTIFICATE OF SERVICE

I hereby certify that I served a copy of this document on the following persons, by U.S. Postal Service first-class mail, postage prepaid, on August 21, 2007:

Woodard Smith


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PERF
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Indianapolis IN 46204



Wayne E. Uhl
Administrative Law Judge