

**BEFORE THE ALASKA OFFICE OF ADMINISTRATIVE HEARINGS**

In the Matter of	)	
	)	
U L. C	)	OAH No. 15-1480-PER
<hr style="width: 40%; margin-left: 0;"/>	)	Agency No. 2015-009

**DECISION**

**I. Introduction**

In 1981-83, U C worked off and on in state service in temporary positions. Later, she obtained permanent employment. When she vested in the Alaska Public Employees Retirement System in 1988, she was not told that she could elect to have her temporary service credited toward her retirement by paying the cost of service for those years. When she eventually retired in 2015, her cost to repay the indebtedness was substantially increased by the accrued interest. She asked the Division of Retirement and Benefits to waive the interest. When it denied her request, she appealed.

The Division’s denial of Ms. C’s request is affirmed. Having to pay interest is not prejudicial to Ms. C because she had use of the money during the time period for which interest would be charged. Furthermore, Ms. C has not proved that the interest rate charged by the Division is punitive or that the interest of justice would be served by waiving the interest.

**II. Facts**

U C retired from the Alaska Court System in 2015 after many years of service as the magistrate in No Name. When she first worked for the court system, Ms. C twice served as a temporary employee, from July-September 1981, and again from May 1982-February 1983. She became a permanent employee in February 1983. After five years of permanent service, Ms. C became vested in the Public Employees Retirement System in 1988.<sup>1</sup>

Temporary service does not automatically result in creditable service toward retirement. No contributions toward retirement are made by or on behalf of a temporary employee. An employee may, however, elect to claim temporary service toward retirement.<sup>2</sup> When an employee makes this election, the employee must pay an indebtedness to the system to compensate for the absence of contributions to the system.<sup>3</sup>

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<sup>1</sup> Admin. Rec. at 4.  
<sup>2</sup> AS 39.35.345.  
<sup>3</sup> *Id.* at (b).

In 1988, when she became vested, Ms. C and her employer made several inquiries to the Division about her service credits.<sup>4</sup> They identified errors made by the system in counting her time, which the system corrected. Much of the correspondence with the system related to her temporary service and distinguishing between her temporary and her permanent employment. The system did not advise or counsel Ms. C that she could elect to claim her temporary service. The parties agree that she did not ask whether she could be credited for her temporary service.<sup>5</sup>

If Ms. C had claimed her temporary service as creditable service in 1988, her indebtedness to the system at that time would have been \$2,542.<sup>6</sup> At the time she retired, however, she would have had to pay \$16,643.65.<sup>7</sup> The increase is due to the interest that accrued on the indebtedness, as required by statute.<sup>8</sup>

On August 25, 2015, Ms. C filed a grievance with the system, asking that she “not be penalized with the interest accumulation over the years.”<sup>9</sup> On September 8, 2015, the Division denied the request. On September 28, 2015, Ms. C appealed the denial to the Office of Administrative Hearings.

At a case-planning conference on January 7, 2016, the parties agreed that no facts were in dispute and that the appeal could be determined by summary adjudication with no evidentiary hearing. Both parties submitted briefs requesting summary adjudication. Neither party requested oral argument. The record closed on March 7, 2016.

### III. Discussion

Ms. C asks that the interest portion of her indebtedness be forgiven under the doctrine of equitable estoppel.<sup>10</sup> In some retirement cases, equitable estoppel will prevent the Division from applying a requirement to a retiree, even if the retiree is technically covered by the requirement. For example, in a 1997 case called *Crum v. Stalnakar*, the Alaska Supreme Court estopped the retirement system from denying a retired teacher the opportunity to claim credit for sick leave.<sup>11</sup> The court explained that:

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<sup>4</sup> See, e.g., Exhibits to Division Motion for Summary Judgment; Exhibits to C Response to Motion for Summary Judgment.

<sup>5</sup> C Response to Motion for Summary Judgment at 1.

<sup>6</sup> Division Exhibits 2, 3. The parties agree that \$2,542 is correct.

<sup>7</sup> Admin. Rec. at 4.

<sup>8</sup> AS 39.35.345(b).

<sup>9</sup> Admin. Rec. at 2.

<sup>10</sup> C Response to Motion for Summary Judgment at 2.

<sup>11</sup> *Crum v. Stalnakar*, 936 P.2d1254, 1258 (Alaska 1997). See also *In re LR.H.*, OAH No. 12-0094-TRS at 8-18 (OAH 2012) (estopping retirement system from denying teacher opportunity to claim credit for sick leave when retirement counselor told teacher upon submission of retirement papers that application was finished even though application for sick leave credit was not filled out).

estoppel may apply against the government and in favor of a private party if four elements are present: (1) the governmental body asserts a position by conduct or words; (2) the private party acts in reasonable reliance thereon; (3) the private party suffers resulting prejudice; and (4) the estoppel serves the interest of justice so as to limit public injury.<sup>12</sup>

The court determined that because the Division had an obligation to provide the teacher with the proper form for claiming the credit, its failure to do so was an assertion of a wrongful position that the teacher could not make the claim.<sup>13</sup> Because all four elements of estoppel were present, the teacher was allowed to file the claim for creditable service even though the time for making that claim had run.

In Ms. C's view, her case is equivalent to *Crum*. She believes that the Division's failure to inform her that she could claim credit for her temporary service was an assertion by the Division that she could not claim credit for that service. She also believes that she relied on that assertion to her detriment because she now would have to pay an additional \$14,102 that she would not have had to pay had she been notified of the opportunity to pay the indebtedness in 1988.

In the alternative, Ms. C asserts that the statutory interest rate is too high. She believes that if her indebtedness has to be increased to compensate for the time value of money, it should be increased only at the rate of inflation. Anything else would be a penalty.<sup>14</sup>

The Division does not address the argument that its failure to advise Ms. C of the opportunity to make the election in 1988 could be taken as an assertion that Ms. C could not make the election. Instead, the Division focuses on the third prong of the *Crum* test for estoppel: prejudice to the private party. In the Division's view, interest payments are required by statute to compensate the retirement system for not having use of the money during the years.<sup>15</sup> It concludes that Ms. C is not prejudiced because she had use of the money during this time period. These arguments are discussed below.

#### **A. Is having to pay reasonable interest prejudicial?**

First, with regard to interest generally, the Division is correct that having to pay interest on a debt is not prejudicial to Ms. C. As the Alaska Supreme Court explained, payment of interest on a debt is entirely neutral between the debtor and creditor: "Since an award of interest is not a

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<sup>12</sup> *Crum*, 936 P.2d at 1256.

<sup>13</sup> *Id.* at 1257-58.

<sup>14</sup> C Response at 3.

<sup>15</sup> Division's Motion for Summary Judgment at 2.

penalty but compensation, fault for the delay between the injuring event and payment of consequential damages is irrelevant.”<sup>16</sup> Therefore, requiring a debtor to pay interest is not prejudice to the debtor. Even if the retirement system were at fault, the Division may require Ms. C to pay compensatory interest on her indebtedness.

**B. Is the interest rate charged by the Division punitive?**

Ms. C is correct that charging an unduly high rate of interest could be punitive, and thus, prejudicial to her. In *Pyramid Printing Company v. Alaska State Commission for Human Rights*, for example, the Alaska Supreme Court invalidated an award of prejudgment interest set at the rate of 10.5 percent.<sup>17</sup> Although the court acknowledged that reasonable interest is not punitive, it advised that “any award that provides disproportionate monetary compensation may rightfully be considered punitive in nature.”<sup>18</sup>

I disagree with Ms. C’s assertion, however, that the only reasonable interest would be interest that reflects the rate of inflation. Interest is intended to compensate for the time value of money. The person who has use of the money is able to invest that money and earn a rate of return. The entire point of investing money is to earn a return above the rate of inflation. Therefore, merely charging the rate of inflation would undercompensate the creditor for the cost of money. Instead, at a minimum, the interest rate should reflect a reasonable rate that compensates for the time value of money.

The first step in determining whether the interest rate charged to Ms. C was reasonable or punitive is to determine what rate she was actually charged. Ms. C alleges that it was “the statutory” interest rate, but does not explain what that rate was or why she considers it to be a punitive rate. The current regulation that sets the rate of interest on a retirement system indebtedness, adopted in 2006, provides that interest on an indebtedness is seven percent compounded semiannually.<sup>19</sup> Based on my own calculation, it appears that the retirement system charged this rate to Ms. C for the entire time period. The question, then, is whether seven percent is a punitive interest rate or a compensatory interest rate.

*Pyramid Printing* did not provide much guidance on how to determine an appropriate rate of interest. It suggests, however, that a floating rate of three percent above the federal reserve rate

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<sup>16</sup> *Farnsworth v. Steiner*, 638 P.2d 181, 184 (Alaska 1981). See also, e.g., *Cool Homes, Inc. v. Fairbanks North Star Borough*, 860 P.2d 1248, 1257 (Alaska 1993) (“Interest, however, is not punitive. Rather, it is intended to compensate the party to whom the sum is owed for the period of non-payment.”).

<sup>17</sup> 153 P.3d 994, 1002 (Alaska 2007).

<sup>18</sup> *Id.*

<sup>19</sup> 2 AAC 35.400.

would always be appropriate.<sup>20</sup> For at least some of the years in question, seven percent would be higher than that rate.

The situation here, however, is different than that in *Pyramid Printing*. In *Pyramid*, the Human Rights Commission was applying prejudgment interest based on its authority to compensate a judgment debtor. Here, in contrast, the retirement system is required by statute to make “an actuarial adjustment” to repay an indebtedness, with interest to run based on a rate set in regulation.<sup>21</sup>

A reasonable interest rate to compensate for the passage of time for an actuarially-based retirement system would likely be higher than three percent above the federal reserve rate. The retirement system needs to charge interest on indebtedness that is reasonable in light of the rate of return that it would have earned on its investments if had been able to invest Ms. C’s contributions during the years since she incurred the indebtedness. The reasonableness of the interest rate must be determined as a matter of expectation—what the retirement system would generally expect to earn (not what it actually did earn).

The retirement system’s current projected rate of return is posted in the most recent asset allocation on the Alaska Retirement Management Board’s website for PERS. This posting contains the following information, which indicates the target rate of return for the trust funds managed by the Board:

Projected Arithmetic Return	8.1%
Expected Return – 5-Year Geometric Mean	7.2%
Projected Standard Deviation	15.3% <sup>22</sup>

Because this posting of the retirement system’s target rate of return for 2016 is for only one year, and no testimony was received on the issue of the retirement system’s rate of return, this posting will be treated only as an example, not as conclusive evidence. This example shows, however, that the retirement system should likely charge a higher rate of interest than that charged to judgment debtors. It tends to show that the seven percent charged under regulation may be a reasonable rate.

Given that available data indicates that seven percent appears to be a reasonable interest rate for a retirement system to charge on an indebtedness, Ms. C has not proved that the interest

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<sup>20</sup> 153 P.3d 994 at 1002 n.31.

<sup>21</sup> AS 39.35.345(b).

<sup>22</sup> FY 2016 Asset Allocation, *available at*: <http://treasury.dor.alaska.gov/Portals/3/docs/AssetAllocation/FY2016%20Asset%20Allocation.pdf>.

charged her was punitive. That does not necessarily mean that a rate of seven percent is not prejudicial, however, and prejudice is the element at issue in the four-part *Crum* test for estoppel against the government. Yet, the only argument for prejudice made by Ms. C was her argument that the interest rate charged by the Division (which she assumed was the statutory rate, apparently meaning the 10.5 percent rate under AS 45.45.010) was punitive. I have not been presented with any rationale for concluding that paying a rate of interest that reasonably compensates the creditor is prejudicial. Therefore, Ms. C has not met her burden of proving prejudice.

Moreover, under the fourth prong of *Crum*, to estop the Division I would have to find that the estoppel would “serve the interest of justice so as to limit public injury.” Ms. C has also not met her burden of proving that she has met this fourth prong. The system’s failure to advise her of her ability to purchase additional service time in 1988 was not as obviously unjust as the situation in *Crum*, for example, where the Division had an obligation to provide the teacher with the proper form. Further, the actuarial balance requires that Ms. C pay a reasonable rate of interest—otherwise the burden of her increased participation will fall on the other participants in the system.<sup>23</sup> Therefore, the interests of justice do not support estopping the Division from charging Ms. C the rate of interest required under 2 AAC 35.400.

#### **IV. Conclusion**

The Division’s denial of Ms. C’s request that she not be charged interest on the indebtedness to the retirement system for the cost of service credit for her temporary service is affirmed.

DATED this 22nd of March, 2016.

By: Signed \_\_\_\_\_  
Stephen C. Slotnick  
Administrative Law Judge

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<sup>23</sup> From an actuarial point of view, Ms. C may benefit by delaying paying off her indebtedness because the passage of time reduces her risk that she would not receive a pension. This point is not determinative—I am not actuary, and I do not know whether this reduction in risk is significant or trivial. It does, however, support the conclusion that Ms. C has not met her burden of proving that she has met all four prongs of the *Crum* test for estoppel.

## Adoption

I adopt this Decision under the authority of AS 44.64.060(e)(1) as the final administrative determination in this matter.

Judicial review of this decision may be obtained by filing an appeal in the Alaska Superior Court in accordance with Alaska R. App. P. 602(a)(2) within 30 days after the date of this decision.

DATED this 19th day of April, 2016.

By: Signed  
Signature  
Stephen C. Slotnick  
Name  
Administrative Law Judge, DOA  
Title

[This document has been modified to conform to the technical standards for publication.]