



## INVESTIGATIVE REPORT

Ombudsman Complaint A2011-0480

Finding of Record and Closure

December 23, 2011

On April 26, 2011, an Anchorage resident complained to the Ombudsman's office that the Department of Labor and Workforce Development, Division of Unemployment Insurance Benefits was withholding his unemployment benefits to repay previously-assessed penalties, at a time when the complainant was unemployed and homeless. The complainant believed that, under the law, the division could withhold his benefit to repay previously overpaid benefits, but not to repay penalties.

The ombudsman opened an investigation into the following allegation, stated in terms conforming to AS 24.55.150:

***CONTRARY TO LAW: The Department of Labor and Workforce Development, Division of Employment Security, applied unemployment insurance benefits to repayment of penalties.***

Ombudsman Linda Lord-Jenkins gave written notice of the investigation to division director Paul Dick on August 24, 2011. Assistant Ombudsman Dale Whitney investigated this allegation.

By the conclusion of the investigation, the division had withheld enough money from the complainant's UI benefits to repay all of his overpayment and penalties, except for a small amount of Federal Additional Compensation (FAC) overpayment, and the case could be considered moot. However, the issue concerns a standard practice of the division, and the situation is likely to arise again. Because the practice in question imposes a significant hardship on benefits recipients in a manner appearing to be contrary to the intent of federal law governing state use of federal funds, the ombudsman proceeded with the investigation.

### INVESTIGATION

The complainant first filed a claim for unemployment insurance benefits in 2008. He received \$142 in benefits, but then withdrew his claim and returned the \$142. In 2009 and early in 2010, the complainant submitted multiple claims for unemployment insurance benefits. The claims were granted, but the Division subsequently determined that the complainant had in fact been employed, at least partially, and that he had improperly failed to disclose certain periods of employment. The Division determined that the complainant had received a total of \$2,484 that he was not entitled to. The Division also determined that the complainant was liable for penalties in the amount of \$1,242. On February 22, 2010, the Division sent the complainant a notice of the factual findings and advised him that he soon would be

receiving notice of the amounts for which he was liable. In addition to these amounts, the complainant was also liable for an additional \$225 of Federal Additional Compensation.

In October 2010, the Division seized \$1,179.40 of the complainant's permanent fund dividend under AS 43.23.072. This money was applied to reduce the amount of overpayment to the complainant. Thus, after his PFD was taken, the complainant was sent notice that his overpayment obligation was now \$1,304.60. His penalty obligation remained at \$1242, and the FAC obligation remained at \$225.

After a period of employment, the complainant again was laid off and he became eligible for unemployment insurance benefits. However, as weekly benefits became payable, the Division applied them to further reduce the balance that the complainant had previously been overpaid. The complainant said he had been expecting this. The complainant correctly believed that the division could withhold benefits to pay off previous overpayments, but not penalties. Penalties must be paid out of other sources, such as garnished wages or dividends. The federal law ensures that unemployed workers get their benefits during their period of distress, and permits them to repay other obligations when they are in a better position to do so. Knowing this, the complainant monitored his account online, carefully conserving his few resources to last until his overpayment obligation was satisfied and he began receiving his weekly benefits. While he expected to receive his benefits without having to immediately repay his penalty, the complainant also expected that his next permanent fund dividend or a portion of his wages when he found work would be taken in satisfaction of the \$1242 penalty obligation.

The complainant was distressed when, after enough benefits had been taken to satisfy his overpayment obligation, he still did not begin receiving weekly benefit checks. The complainant said that he had not received notice of any change to his account or status. The complainant reported that it was not until he contacted the Division that he learned that, in accordance with standard Division accounting procedure, the Division intended to continue applying ongoing benefits to the overpayment obligation, even though the full amount of the overpayment obligation had already been satisfied by the combination of the garnished PFD and weekly benefits.

To understand the reasoning behind the Division's accounting method, it is necessary to distinguish between an overpayment obligation and a penalty obligation, and between funds taken from weekly benefit entitlements and from all other sources. Money taken from a benefits recipient to refund an overpayment is deposited back into the unemployment insurance trust fund. Money taken to satisfy penalty obligations is deposited into the state general fund. As a matter of policy, the Division's first priority is preservation of the unemployment trust fund; thus, recovered funds from all sources are first applied to recoupment of money paid out from the trust.

When the Division garnished \$1,179.40 from the complainant's 2010 PFD, it applied the entire amount to the \$2,484.00 overpayment obligation, in accordance with the policy of protecting the trust fund first; none of this PFD money was applied to the penalty obligation. After withholding of a few more benefits checks, the overpayment obligation was satisfied, but the penalty was not. However, under federal law, funds may only be taken from a recipient's weekly benefits to repay an overpayment obligation, and for certain other purposes that do not apply to this case. Once the full amount of the overpayment obligation had been refunded, the Division was not permitted to keep taking the complainant's weekly benefits for application against the penalty. Money for the penalty repayment had to come from some other source, such as garnishment of a future PFD or wages after the complainant found another job.

In order to continue taking the complainant's weekly benefits to pay off the penalty amount, the Division devised an accounting maneuver that it programmed its computer to perform automatically. The programming applies when a benefits recipient has in the past made payments from a non-benefits

source, such as a garnished PFD or voluntary repayment, and that money had been applied to an overpayment, and the overpayment obligation has been satisfied but a penalty obligation remains, and weekly benefits are accruing. In this situation the computer retroactively characterizes part of the earlier transaction as a penalty payment, but only in the amount of the current week's benefit amount. This would re-create an overpayment obligation that was conveniently in the exact amount of the money available for confiscation from that week's benefit. The Division could then pay penalty money into the general fund in the amount of the recipient's benefit for the week, but also report that it had not taken any money out of weekly benefits for any other purpose than to repay an overpayment obligation.

This explains why, even after his overpayment obligation had been satisfied, the complainant did not receive his weekly benefit. Although he was homeless and did not have enough to eat at the time, the Division was withholding the complainant's weekly unemployment insurance benefit and depositing an equal amount into the state general fund, while adding nothing to the unemployment insurance trust fund. The Division even re-characterized the money the complainant had voluntarily returned in 2008 when he withdrew his claim as penalty, even though the wrongful claims that gave rise to the penalties had not occurred yet. According to the Division's Benefit Payment Control Unit Manager, this method of accounting has been employed since the Division programmed its computers in 1988 to accommodate a new law authorizing fraud penalties.

#### **ANALYSIS AND PRELIMINARY FINDING**

AS 24.55.150 authorizes the ombudsman to investigate administrative acts that the ombudsman has reason to believe might be contrary to law; unreasonable, unfair, oppressive, arbitrary, capricious, an abuse of discretion, or unnecessarily discriminatory, even though in accordance with law; based on a mistake of fact; based on improper or irrelevant grounds; unsupported by an adequate statement of reasons; performed in an inefficient or discourteous manner; or otherwise erroneous.

The ombudsman may investigate to find an appropriate remedy.

Under 21 AAC 20.210, the ombudsman evaluates evidence relating to a complaint against a state agency to determine whether criticism of the agency's actions is valid, and then makes a finding that the complaint is *justified*, *partially justified*, *not supported*, or *indeterminate*. A complaint is *justified* if, on the basis of the evidence obtained during investigation, the ombudsman determines that the complainant's criticism of the administrative act is valid. Conversely, a complaint is *not supported* if the evidence shows that the administrative act was appropriate. If the ombudsman finds both that a complaint is *justified* and that the complainant's action or inaction materially affected the agency's action, the complaint may be found *partially justified*. A complaint is *indeterminate* if the evidence is insufficient "to determine conclusively" whether criticism of the administrative act is valid.

***CONTRARY TO LAW: The Department of Labor and Workforce Development, Division of Employment Security, applied unemployment insurance benefits to repayment of penalties.***

Though administered in accordance with state law, unemployment benefits are paid out of an unemployment trust fund that is largely funded by the federal government. When disbursing funds to states for unemployment compensation, the United States Secretary of Labor "shall make no certification for payment to any State unless he finds that the law of such State, approved by the Secretary of Labor under the Federal Unemployment Tax Act, includes provision for (1) Such methods of administration...as are found by the Secretary of Labor to be reasonably calculated to insure full payment of unemployment compensation when due"<sup>1</sup> . . . Further, with certain exceptions that do not

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<sup>1</sup> 42 U.S.C. 503(a).

apply to this case, state law must provide that funds withdrawn from the trust fund may be used only for payment of benefits, or for repayment of previous overpayments of benefits.<sup>2</sup>

Alaska law provides that:

An individual who receives a sum as benefits from the unemployment compensation fund when not entitled to it under this chapter is liable to the fund for the sum improperly paid to the individual . . . The amount, if not previously collected, shall be deducted from future benefits payable to the individual.<sup>3</sup>

In addition to the liability for benefits the recipient was not entitled to, state law provides that a person who is disqualified for misrepresentation is also liable to the Division for a penalty equal to 50 percent of benefits obtained improperly.<sup>4</sup> Money collected for penalties must be deposited into the general fund.<sup>5</sup>

When the Division took the complainant's PFD, it notified him of the fact and applied the money towards overpayment of benefits. The complainant checked his account balance online and could see that his overpayment obligation had been reduced by the amount of the PFD, but that his penalty obligation remained at the full amount due. When the complainant again became eligible for benefits, he knew the benefits would first be applied against his remaining overpayment balance, but his reasonable expectation was that once the overpayment amount was satisfied, he would begin receiving a weekly benefit, and the Division would collect the penalty at some later time when the complainant was not in such a precarious financial position, most likely when the next year's PFDs came out. Application of the PFD against his overpayment balance was a substantial monetary transaction, and it appeared in the complainant's account as a completed transaction. The complainant reasonably assumed that, consistent with standard business practices, the transaction was final.

The finality of the 2008 transaction could only be considered more apparent. When the complainant returned the \$142.00 he had been paid, there was no way to foresee that it might someday be used for other purposes stemming from future events, leaving the \$142.00 obligation unpaid and subject to withholding of benefits when the complainant would most need them. At the end of 2008 the complainant's account was paid in full and his balance was \$0.00. Barring the discovery of undisclosed activity in 2008 or earlier, any reasonable person would believe this transaction to be final and the books to have been closed on the matter.

The Division never notified the complainant that the transaction might in some way be conditional, contingent, or subject to retroactive modification under certain circumstances. That lack of notice is unfair. The Division has explained that the only way a benefits recipient would learn that his earlier payment was later being "undone" and partially reallocated to penalties each week would be when the recipient did not receive the benefits he expected and then called the Division to find out why.

When an agency wishes to change a position it has taken, the doctrine of equitable estoppel may apply. In this case, the Division has changed its position that the complainant's PFD would be applied to his overpayment balance, and that the \$142 would be regarded as a return of the benefit the complainant had received. The Alaska Supreme Court has examined the doctrine of equitable estoppel in a case involving food stamps. In *Allen v. State*, 203 P.3d 1155 (Alaska 2009), the court considered a case in which the benefit recipient had properly reported changed circumstances that should have reduced her benefits.

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<sup>2</sup> *Id.*

<sup>3</sup> AS 23.20.390(a)-(b).

<sup>4</sup> AS 23.20.390(f).

<sup>5</sup> *Id.*

The state nevertheless continued to pay her the higher level of benefits, and then later sought to recover the overpayment out of ongoing benefits. The court held that

Alaska's doctrine of equitable estoppel, if applied, would completely bar recoupment in many, if not most, cases of overpayment caused by agency error. Equitable estoppel applies against the government in favor of a private party if four elements are present in a case: (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. Most food stamp recipients receive and spend their food stamps in reasonable reliance on the eligibility determinations of the Agency. While we cannot presume that each of the elements of equitable estoppel would necessarily be present in every case in which a food stamp overpayment is caused by agency error, it is safe to say that they would be satisfied in many of these cases. *Allen* at 1164 [Footnotes omitted]

The *Allen* case involved an innocent recipient and an agency error. The complainant's case may have originally arisen from the misconduct for which he was penalized, but as to the application of his dividend to the overpayment obligation, the complainant was in no way at fault; he accepted the allocation as the Division made it. A significant difference between the two cases is that in the *Allen* case, the state agency was merely trying to correct a genuine mistake it had made, whereas in the complainant's case the agency is reversing, for its own convenience, an action that it fully intended to make at the time.

Applying the elements of equitable estoppel to the complainant's case shows retroactive change of the agency's action to be erroneous. For equitable estoppel to apply, the government body must first assert a position by conduct or words. The Division applied the garnished PFD to the complainant's overpayment obligation and reduced the balance owing on that obligation. This was communicated by showing the transaction and adjusting the balances displayed when the complainant checked his account online. These were not mere words, however; an actual financial transaction occurred. Money transferred and deposited constitutes conduct.

One could argue the degree to which the complainant acted in reasonable reliance on the Division's action. Presumably, the complainant did not become unemployed based on his expectation that he would eventually be able to collect benefits again. The *Allen* court determined that in most cases food stamp recipients do receive and spend their food stamps in reasonable reliance on the agency's determination. The communications received from the complainant show that in fact he was very aware of the point at which his overpayment would be satisfied, and that he was carefully marshaling the few resources he had to tide him over until the point at which he expected he would again start receiving benefits. It is no stretch of imagination to consider that in many or most cases unemployed people are acutely aware of when they can expect benefits to resume and that they do in fact act in reliance on the balances shown in their online account summaries.

The last two elements of estoppel are not difficult to show. Benefit recipients clearly suffer prejudice when the benefits they expected to survive on do not materialize when expected. The interests of justice are served when the unemployed are spared unpleasant financial surprises.

The *Allen* court found that equitable estoppel did not apply to the food stamp case because federal law, which required recoupment of overpayments, preempted the state equitable doctrine. But there is no such federal preemption in the complainant's case. To the contrary, federal law limits the reasons for which accrued benefits can be withheld, and restricts the use of money from the trust fund. The policy behind the federal law is clearly to make sure that the unemployed receive benefits as needed. When

disbursing federal funds to states for unemployment compensation, the United States Secretary of Labor is prohibited from certifying payment to any state “unless he finds that the law of such State, approved by the Secretary of Labor under the Federal Unemployment Tax Act, includes provision for (1) Such methods of administration...as are found by the Secretary of Labor to be reasonably calculated to insure full payment of unemployment compensation when due...”<sup>6</sup> Further, with certain exceptions that do not apply to this case, state law must provide that funds withdrawn from the trust fund may be used only for payment of benefits, or for repayment of previous overpayments of benefits.<sup>7</sup>

At the very least, the Division’s practice of withdrawing money from the unemployment trust fund, transferring it to the general fund, and then immediately replacing the money with newly accrued benefits that can be used to recoup overpayments would seem to violate the policy of the law, if not the letter.

The Division may assert that it is not withdrawing money for transfer to the general fund, but merely recharacterizing part of an earlier transaction and then applying funds in a manner permissible under the new characterization. One could view the transaction in different ways, but at the least there is room to question the true nature of the action.

In the preliminary report, the ombudsman suggested that even if the federal government and the courts would accept this accounting method as legally permissible, the Division may wish to reconsider the practice as a matter of policy. This method of accounting results in a small, unexpected contribution to the general fund at the expense of someone who has been unemployed for some time while not receiving benefits. While deterrence to misconduct is necessary and appropriate, it may be asked whether someone who has admittedly committed some wrongdoing in the past really must be penalized right at the moment of his greatest desperation, or whether it would not be preferable to exact the prescribed retribution at a time when the person is more likely to have the means to still provide himself with minimal food and shelter. Further, in cases involving truly fraudulent activity, such matters are best handled by referral to the courts and the district attorney; the Division should not be too eager to assume the role of police, prosecutor, judge and jury when it thinks a crime has been committed.

When the Division has applied funds toward overpayment and communicated that fact to the recipient, the Division is estopped from later transferring application of those same funds to penalties. In the preliminary finding, the ombudsman proposed to find the allegation *justified* on this basis, without reaching a conclusion on whether the practice violated more than the spirit of the federal law.

## **RECOMMENDATION**

People should generally be able to consider a financial transaction to be complete when it is concluded, absent notice to the contrary. When somebody pays for something, the money should be used for the intended purpose, absent notice that the recipient intends to do something else with it. State principles of equity estop the state from asserting that it intends to do one thing with a person’s money, and then later use the money for something else without proper notice beforehand. Therefore, the ombudsman recommends the following:

***RECOMMENDATION: The Division should regard application of payments, whether voluntary or garnished, as final transactions and program its computers accordingly.***

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<sup>6</sup> 42 U.S.C. 503(a).

<sup>7</sup> Id.

The ombudsman suggested two approaches to collections when there is both a penalty and an overpayment obligation. First, the Division could apply any cash payments, such as garnished PFDs, to penalties first, and then to overpayment obligation after the penalty has been satisfied. While this would allow full collection of all debts in the shortest amount of time in a case like the complainant's, it would short the trust in favor of the general fund in cases where a debtor remained employed and had no easily collectible source of funds, such as PFD eligibility. This method would appear to be contrary to the Division's policy of placing higher priority on preservation of the trust fund.

The better approach would be to continue applying all collected funds to overpayment first, as the Division does now, but once all overpayments have been satisfied, no collection should be made from benefits. Penalties should be collected from subsequent cash sources, such as later PFDs or wages. Admittedly, this will mean that the Division will have some accounts open longer with unsatisfied debt. In some cases, it might not be possible to collect the penalty at all, if the debtor has no further resources that can be garnished. This does not mean, however, that the penalty will be a less effective deterrent to wrongful claims, and penalties should not be relied on as a general fund revenue source. The worst case scenario of this approach is that the general fund would not receive a tiny amount of revenue that the state does not necessarily have any expectation of receiving anyway. There would be no loss or repayment delay to the unemployment trust fund. The drawbacks do not outweigh the benefits of having transactions that are final, displayed account balances that can be relied on by benefit recipients, and compliance with policy directives discouraging use of accruing benefits for anything other than benefit payments or overpayment recoupment.

In response to the above preliminary finding, the Division director wrote the following:

For purposes of 21 AAC 20.230(a), the Employment Security Division (ESD) does not accept the finding that the complaint was legally justified.

ESD consulted the following U.S. Department of Labor (DOL) officials in early September regarding our accounting procedures as reported in your August 24 Preliminary Finding letter: Steve Narolewski, Benefit Payment Control and Fraud Liaison; and Jamie Bachinski, Division Chief, Unemployment Insurance. Both stated that our accounting procedures were not in violation of federal law. You can reach them at [narolewski.steve@dol.gov](mailto:narolewski.steve@dol.gov) or [bachinski.jamie@dol.gov](mailto:bachinski.jamie@dol.gov) for verification. ESD did not request written correspondence from the U.S. DOL.

ESD also consulted state Assistant Attorney General Toby Steinberger in early September. Ms. Steinberger also stated that our accounting procedures were not in violation of state law.

However, ESD does recognize that the accounting procedures as outlined in your August letter may cause confusion and appreciates your bringing this to our attention. ESD is currently in the process of changing its accounting procedures to procedurally recognize payments, whether voluntary or garnished, as final transactions. If you would like to visit our offices, we can demonstrate how we are changing our procedures.

To follow up on the Division's response, the ombudsman's office contacted the officials mentioned. The assistant attorney general confirmed that, in her opinion, there was no violation of state law or equitable principles. While the ombudsman questions whether a court would agree, the Division has at least relied on advice of counsel to conclude that it has not violated state law or principles of equity.

The ombudsman's office contacted Mr. Narolewski, of the federal labor department, to confirm that the Division had in fact verified the acceptability of its practices. Mr. Narolewski reported that he fields

many calls per day from various states and could not say whether the Alaska Division had contacted him on this issue. He did report that the issue was complex enough that he would never have offered an opinion over the phone, nor was he willing to do so for the ombudsman's office. He explained that answering a question of this nature would require a request for a formal opinion from the administrator. The ombudsman therefore sent a request for a formal opinion to the administrator of the Office of Unemployment Insurance, and received the following response:

Dear Ms. Lord-Jenkins:

This letter is in response to your request of October 26, 2011, for a formal opinion on the legality of a specific accounting practice maintained by Alaska's Division of Employment Security relating to the repayment of overpaid unemployment compensation (UC) and penalties when the amount of a garnishment does not cover the entire amount of the overpayment and penalty, and the individual subsequently becomes eligible for UC.

In order to respond to your request, we had our Regional Office in San Francisco contact the Alaska agency to ascertain what their practice is and what law, regulation, or procedure supports the practice. Subsequently members of my staff, along with staff from the Regional Office, held a conference call with senior staff of the Alaska agency. In light of what we learned, we informed the state that the practice did not conform to the requirements of Federal UC law.

The state assured us that the practice was a result of an inadvertent programming specification document rather than any specific law or regulation. They have also assured us that, as a result of your contact with them, they have already begun action to have the programming changed in order that the practice will not continue. They have also stated that they assign a high priority to making sure that this practice will not affect any individual in the future.

We have asked our Regional Office to maintain contact with the Alaska agency in order to monitor the situation and ensure that the state agency resolves this issue as expeditiously as possible.

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## **FINDING OF RECORD AND CLOSURE**

Based on the opinion of the administrator of the U.S. Department of Labor Office of Unemployment Insurance, this complaint has been closed as *justified*. Because the administrator has assured the ombudsman that the federal agency will be monitoring the Division to ensure compliance with federal law and the ombudsman's recommendation, the complaint has been *rectified*.