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April 23, 2003

BY HAND DELIVERY

Representative Tim Knopp
Chairman
House Committee on Public Employee
Retirement System
900 Court St. NE H-295
Salem OR 97301

Senator Tony Corcoran
Chairman
Senate Committee on General Government
900 Court St. NE S-319
Salem Or 97301

Re: PERS
Our File No.: 5415-237

Dear Representative Knopp and Senator Corcoran:

By letter dated March 11, 2002 legislative counsel Greg Chaimov expressed the opinion that portions of then-existing House Bill 2003 and House Bill 2004a likely impaired the existing contract rights of PERS members. By letter dated March 26, 2003 Bill Gary, speaking on behalf of his clients, took issue with Mr. Chaimov's opinion, arguing that the question of the constitutionality of the then-pending house bills had not been finally determined by the Oregon Supreme Court. Curiously, despite being very critical of Mr. Chaimov's opinion, Mr. Gary made no effort to articulate any coherent theory of pension contracts and how the Supreme Court might analyze legislative enactments to determine whether they are impairments or breaches of the existing PERS contract. It is not my intention in this correspondence to engage in a point-by-point refutation of Mr. Gary's analysis though I would be happy to do so if that would be deemed helpful to either of your committees. Rather it is my purpose in this letter to point out that Mr. Chaimov's analysis, though brief, is the correct analysis under existing case law and will be the analysis applied by the court in determining whether enactments of this legislature breach or impair existing contract rights.

In *Hughes v. State of Oregon*, 314 Or 1 (1992), the Oregon Supreme Court determined that PERS constituted a legislative contract which existed between employers and employees in public service in the state of Oregon. Having established that a contract exists, the next logical question is what are the terms of that contract? The consistent, logical, and quite straightforward answer to that question, which is supported by numerous citations in Oregon cases, is that employees have been promised certain benefits and that those benefits must be paid. In *Hughes* the court quoted extensively from a 1953 Attorney General opinion

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requested by then-Governor Patterson about the contractual nature of pension benefits. The Attorney General opinion was given at the time that the legislature was abolishing then-existing PERS so that the State could enter the Social Security system, and the question arose as to what replacement system, if any, the legislature was obligated to enact. In that context the Supreme Court in *Hughes* found that the legislative intent in the establishment of modern PERS was based on the Attorney General opinion. The court quoted from the Attorney General's opinion as follows (314 Or at 19):

“ ‘In response to your request for our opinion as to the constitutionality of modification of the present retirement annuity and pension plan of the State of Oregon applicable to employees for the state and its political subdivisions, we advise you that the existing plan may validly be changed by legislative action, *if vested rights are preserved by such legislation.*”

“ ‘The vested rights to which we refer are of two kinds: (1) Rights of retired members of the public employees retirement system to specific amounts of pensions and annuities, provided by chapter 401, Oregon Laws 1945, [the 1945 Act] as amended; and (2) rights of all present members of the public employees retirement system to a substantial equivalent of the benefits upon which, upon retirement, they would be entitled to receive as members of that system.’ ”
(emphasis in original)

The court then went on to say (314 Or at 20):

“We conclude that the actions of the 1953 legislature, in enacting ORS 237.950 to 237.980, reflect a recognition of the concerns posited by the Attorney General. We hold that the legislature intended and understood that PERS constituted an offer, by the state to its employees, for a unilateral contract. We now turn to an examination of the essentials of that PERS contract.

“Accrued and accruing pension benefits are protected under Oregon Law. ***”

Both the 1953 Attorney General opinion as well as the *Hughes* court make clear that what is protected under Oregon law in the unilateral pension contract is the promised benefits which have been made to members of that system.

The focus on benefits is not unique to the *Hughes* case. In *Oregon State Police Officers v. State of Oregon*, 323 Or 356 (1996), in declaring Ballot Measure 8 to be an invalid impairment of contract, the court engaged in a discussion of the protection of pension benefits. However, the

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court also made a lengthy review of prior case law which consistently shows the court's concern with the protection of pension benefits. Following are citations all taken from *Oregon State Police Officers* in which the court cites language from previous cases.

Citing *Crawford v. Teachers' Ret. Fund Ass'n*, 164 Or 77, 86-88 (1940) at pp. 365-66:

“[W]hen there has been full performance on the part of the plaintiff, *** her rights became vested and no subsequent change in the by-laws could interfere with or impair such rights. Any other rule would utterly destroy all stability and security in the retirement fund plan[.]”

“*** The teacher, by continuing in the service and making contributions to the fund, has, in effect, accepted the offer of the State, through its governmental agencies, to pay an annuity upon retirement at a certain age. *** [We are dealing] with the rights of an employee to the payment of an annuity provided for under the terms of the statute which became a part of the contract.”

Citing from *Harryman v. Roseburg Rural Fire Prot. District*, 244 Or 631, 634-35 (1966) at p. 367 :

“When plaintiff entered upon his employment with defendant he was advised that he would receive an allowance for accumulated sick leave upon termination of employment. He accepted employment upon the assumption that the allowance for sick leave was a part of his compensation for services. Since it was a part of the inducement to accept employment, it can be regarded as a contractual term of plaintiff's employment. Defendant could not, therefore, deprive plaintiff of the allowance after he had earned it.”

From *Taylor v. Mult. Co. Dep. Sher. Ret. Bd.*, 265 Or 445, 451-54 (1973), at p. 368-69:

“*** [P]laintiff's tender of the contributions and acceptance of the plan terminated defendants' power to revoke the offer, and plaintiff would be entitled to the benefits of the plan if she continued to work for the requisite period necessary for retirement.”

From *McHorse v. Portland General Electric*, 268 Or 323, 331 (1974) at p. 369:

“[I]n the situation where the employee has satisfied all conditions precedent to becoming eligible for benefits under

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a plan, the better reasoned view is that the employee has a vested right to the benefits. This view sees the employer's plan as an offer to the employee which can be accepted by the employee's continued employment, and such employment constitutes the underlying consideration for the promise."

Citing *Bryson v. PERB*, 45 Or App 27, 30, (1979), *rev den* 289 Or 107 (1980), at p. 370:

"[I]t is without question that petitioner has a statutory and contractual right to receive retirement benefits computed at the most favorable rate applicable under laws in effect at any time during his judicial service."

Turning to *Oregon State Police Officers*, the court stated the following in holding that the guaranteed rate of return was contractual in nature:

"Once the employee performs services in reliance on the employer's promise to afford a particular benefit on retirement, the employer is contractually bound to honor that obligation." 323 Or at 377-78.

In holding that Ballot Measure 8's requirement of a mandatory 6% employee contribution was unconstitutional the court used the following language (323 Or at 375):

"The statutory pension system and the relationship between the state and its employees clearly established a contractual obligation to provide an undiminished level of benefits at a fixed cost."

The reason for the extensive quotes from the numerous Oregon cases cited is to show that the common thread that runs among them is the focus on the benefits which have been promised, and the protection of those benefits. As the court stated in *Oregon State Police Officers* at p. 375,

"Once offered and accepted, a pension promise made by the state is not a mirage (something seen in the distance that disappears before the employee reaches retirement). Nullification of an express term of plaintiffs' PERS contract with the state is an impairment for purposes of Contract Clause analysis."

This is the essence of pension contract analysis under state law.

Analysis under state law does not necessarily end once the court determines that the legislative enactment has had an adverse impact on pension benefits. The best example is the

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Hughes case itself, in which the court examined the tax exemption which had been promised and determined that the exemption was limited to benefits which had either accrued or were accruing and did not protect benefits which would accrue in the future. In other words, the legislature can place limits on the contractual commitment if it chooses to do so and in the case of the tax exemption the court determined that the legislature had made a limited promise.

The Governor's Plan

The Governor's recent proposals for amendment to the PERS system can be examined using the analytical techniques which have been used by the court.

1. Shifting the 6% employee contribution to a defined contribution account.
- 2.
3. The acknowledged purpose of this proposal is to create a very substantial reduction in the benefits which were promised to members through the money match system. Clearly the proposal will result in a reduction in benefits and it will be a breach or impairment of contract unless the statute itself indicates that the legislature retained the right to make such a change. Since the purpose of this proposal is to have a direct impact on the money match benefit it is appropriate to examine the language of the statute which provides for the money match benefit. ORS 238.300(2)(b) provides:
- 4.

“A pension under this subsection shall be at least:

“(A) The actuarial equivalent of the annuity provided
by the accumulated contributions of the member.”

Not only is this language central to one of the most important of the PERS pension benefit calculations, it is also specifically promissory in nature and contains no language suggesting any limitation on its application to benefits which have been promised to current members. A straightforward application of the principles articulated by the Oregon Supreme Court in numerous cases will hold this provision to be an improper impairment of contract.

1. Restructuring of the guaranteed rate of return.
- 2.
3. The Governor's proposal contemplates that Tier One members will no longer receive the guaranteed rate of return on a yearly basis, but will receive some lesser amount, still undefined, which in total will be no less than the actuarial assumption over the course of their career. In part the Governor seems to base this on a new-found interpretation of the meaning of ORS 238.255, limiting it to a guarantee of the assumed rate over the course of an employee's career. Unfortunately the language of the statute precludes that interpretation. It states as follows:
- 4.

“The regular account of an active or inactive member of the system shall be examined each year. If the regular account is credited with earnings for the previous year in an amount

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less than the earnings that would have been credited pursuant to the assumed interest rate for that year determined by the board, the amount of the difference shall be credited to the regular account, and charged to a reserve account in the fund established for that purpose. ***” (emphasis added)

The language is not susceptible to the interpretation suggested by the Governor. Further, if the legislature were to change this statute along the lines suggested by the Governor, a straightforward application of contract principles would cause it to be declared an impairment of contract. This change in the statute is the equivalent of the change which was attempted in Ballot Measure 8, which was rejected by the court in the *Oregon State Police* case. This proposal will suffer a similar fate.

1. Deleting the COLA increase.

2.

3. Finally the Governor’s proposal suggests deleting the COLA increase until such time as the “overcrediting” of 1999 earnings has been resolved. Clearly this proposal is dependent on the affirmation of Judge Lipscomb’s opinion on this issue, a matter which will ultimately be decided in the Oregon Supreme Court. Further, an examination of ORS 238.360 again finds language which is very promissory in nature. The statute reads:

4.

“As soon as practicable after January 1 each year, the Public Employees Retirement Board shall determine percentage increase or decrease in cost of living for the previous calendar year, based on the Consumer Price Index (Portland Area-All Items) as published by the Bureau of Labor Statistics, U.S. Department of Labor for the Portland, Oregon area. Prior to July 1 each year the allowance which the member or the member’s beneficiary is receiving or is entitled to receive from August 1 for the month of July shall be multiplied by the percentage figure determined, and the allowance for the next 12 months beginning July 1 adjusted to that resultant amount.”

The language is specifically promissory in nature with no indication that the legislature has reserved to itself the ability to amend the statute on some prospective basis. A straightforward application of the principles clearly enunciated by the courts in numerous cases over the years will result in a finding that the Governor’s proposals are impairments of contract.

I hope this letter has provided some additional insight into the issues relating to consideration of proposed amendments to ORS Chapter 238; if I have raised additional questions which have not been adequately answered I would, of course, be glad to supplement any of the comments made in this letter.

Yours very truly,

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Enclosure

cc: PERS Coalition