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ANALYSIS OF PERS PROPOSALS

We have reviewed the September 8, 2016 Press Release issued by Senators Tim Knopp and Betsy Johnson,¹ outlining a number of PERS proposals designed ostensibly to reduce the unfunded liability of the system, which they maintain were found to be constitutional by Legislative Counsel in an opinion letter, dated August 31, 2016. A careful reading of that opinion letter, however, discloses that may not be the case. Depending upon the manner in which the proposals are drafted and actually implemented within the system, there are serious concerns not only about their legality, but also about whether they generate sufficient savings to warrant further reduction of benefits promised to active Tier 1, Tier 2, and OPSRP members who will already be retiring on a more modest pension².

In many respects, we agree with the Legislative Counsel's review of the Oregon Supreme Court's analysis in *Moro v. State*, 357 Or 167, 230-31, 351 P3d 1 (2015). For example, we are in agreement that although the court modified its legal analysis somewhat in *Moro*, its decision fully protected retirees because they have fully earned their benefits based on service already performed.³ The same reasoning would also apply to vested inactive members of the system. Together, retirees and inactive members account for 70 percent of the system's liabilities and virtually all of its "unfunded liability."⁴ The legislature must, thus, be mindful that if it could not legally reduce this liability for benefits attributable to prior service directly, it also cannot indirectly transfer that liability on to active members legally. Legislative Counsel addresses this concern in her discussion of the employee contribution diversion by noting that, if a proposal "required use of employee contributions to pay for pension benefits accrued before the date of the redirection, we believe it would be unconstitutional under *Moro*[".]"⁵

There remain, however, a few areas in which our review is not be identical to that of Legislative Counsel. First, our reading of the court's use of the term "benefits based on service performed" is broader than that of Legislative Counsel. It appears that Legislative Counsel's reading may be closer to the term "accrued benefits" as it is commonly used in the private sector, which was the approach advocated by Justice Brewer in his concurring opinion (357 Or at 236-253); however, no other justice joined in that opinion. Whether a proposal protects "benefits based on service performed" within the meaning of the majority opinion in *Moro*, thus, will

¹ <https://www.oregonlegislature.gov/knopp/Documents/09082016%20Knopp%20Johnson%20PERS%20rel ease%202.pdf>

² See "PERS By the Numbers" at http://www.oregon.gov/PERS/docs/pers_by_the_numbers_9-2016.pdf

³ See e.g. August 31, 2016 Letter to Sen. Johnson, p. 1.

⁴ See "PERS Facts" at http://www.oregon.gov/pers/docs/pers_facts_9-2016.pdf

⁵ August 31, 2016 Letter to Sen. Johnson, p. 9.

depend on the specific terms of the proposal and how it can be applied in this complex system. Legislative Counsel at least acknowledges this concern.⁶

Second, the determination of what will be found by the court to be an “explicitly” or “impliedly” irrevocable benefit will ultimately depend upon an exhaustive analysis of text, context, and legislative history of the statutory provisions at issue. That level of analysis was clearly beyond the scope of the Legislative Counsel’s opinion letter and is also not attempted here. It must, however, be undertaken for an actual legislative concept. At a minimum, we agree with Legislative Counsel that proposals which attempt to modify or invalidate the core benefit have a “significant” risk of invalidation.⁷

Finally, it is important to note that in both *Moro*, 357 Or at 230-31 and *Strunk v. PERB*, 338 Or 145, 207-08, 108 P3d 1058 (2005), the Oregon Supreme Court rejected the argument that “economic necessity or hardship” required the State of Oregon to reduce promised retirement benefits to public employees in order to fund other services like public safety and education. The Oregon legislature, therefore, must be cautious of misusing our shared public responsibility to properly fund schools and public safety as its excuse for why it “must” cut PERS benefits.

Below, we briefly analyze the proposals being entertained to reduce retirement benefits for active Tier 1, Tier 2, and OPSRP members for: (1) compliance with the legal principles articulated in *Moro* and *Strunk* and (2) generation of actuarially significant savings. Further analysis will be performed once we have actual drafts of legislative concepts. Also, not included at this time are the significant public policy issues concerning further reduction of benefits for active members who are also not the cause of the unfunded liability of the system.

1. Ending the PERS Plan Altogether/Freezing Liability.

- Would not result in any reduction in the “accrued liabilities” of the system. In fact studies analyzing the experience of other states suggest it may actually raise the liability of the existing plan.⁸
- Legislative Counsel says this brings a significant possibility of being invalidated by the Supreme Court because it eliminates core benefits which are either “expressly” or “impliedly” irrevocable.⁹
- The concept of “freezing liability or benefits” is also not consistent with the protection of benefits based on service performed within the meaning of the majority opinion in *Moro*.

⁶ *Id.*

⁷ See e.g. August 31, 2016 Letter to Sen. Johnson, p. 4.

⁸ See e.g. National Institute on Retirement Security, *Case Studies of State Pension Plan that Switched to Defined Contribution Plans* (February 2015), which can be located at:
http://www.rsaal.gov/uploads/files/Case_Studies_State_Pension_Plans_that_switched_to_DC_Plans.pdf

See also, Mark Olleman and Illana Boivie, *Decisions, Decisions: Retirement Plan Choices for Public Employees and Employers* (September 2011), which can be located at:

http://www.nirsonline.org/storage/nirs/documents/Decisions%20Decisions/final_decisions_decisions_report.pdf

⁹ See e.g. August 31, 2016 Letter to Sen. Johnson, p. 4.

2. Reducing the Formula.

- Eliminates core benefits which are either “expressly” or “impliedly” irrevocable. Legislative Counsel also agrees that significant enough changes to the formula again would also give rise to a significant possibility of invalidation by the Supreme Court.¹⁰
- Legislative Counsel also notes that depression of the Full Formula could push more active members into retiring on Money Match, reducing the potential savings.¹¹

3. Capping Final Average Salary (FAS).

- “Benefits based on service already provided” is a broader concept and would require application of the full uncapped salary to that portion of service already provided. Legislative Counsel’s opinion states that cap which impacts accrued benefits “would likely be unconstitutional.”¹² In other words, the cap could not be applied to the time worked prior to the cap.
- As a result, a proposal consistent with the *Moro* majority opinion would result in significantly less savings than that estimated by the PERS Actuary which was based on different assumptions.¹³

4. Use Market Rate for Money Match Annuities.

- Violates the *Strunk* court’s construction of the statutory term “actuarial equivalency” and the *Moro* decision because the account balances on which Money Match annuities are to be calculated are attributable solely to service which was completed prior to 2004.
- Legislative Counsel also acknowledges the unreasonableness of a situation where one rate is used to calculate employer rates and another to calculate benefits.¹⁴

5. Diversion of the Six Percent IAP Contribution from current workers to pay the state’s unfunded liability for retirees.

- If new employee accounts are structured in a manner which allows funds to be used to pay down the unfunded liability (either directly or indirectly) then the proposal is illegal even under the Legislative Counsel’s narrower view of “accrued benefits.” Legislative Counsel acknowledges that any proposal which requires use of the contributions to pay for pension benefits accrued before the date of the redirection “would be unconstitutional under *Moro*.”¹⁵

¹⁰ *Id.*

¹¹ *Id.* at n. 21.

¹² *Id.* at 6.

¹³ See PERS Actuary Letter at https://www.oregon.gov/pers/docs/2016-002_legconcepts.pdf

¹⁴ See e.g. August 31, 2016 Letter to Sen. Johnson, p. 8.

¹⁵ *Id.*, p. 9.

- Even if it could be applied consistently with *Moro* solely for benefits attributable to future service say for OPSRP members, it would not result in any reduction of the existing unfunded liability, reduction in future liability would also be limited by compensating salary increases bargained by employees.

6. Stopping Future Use of Sick Leave and Vacation in Calculating FAS.

- In *Moro*, the court did not disavow the part of *OSPOA* decision which found these benefits to be contractual. Also a component of a core benefit.
- Has little impact on employers' liability for benefits but breaks obligations made to long-term employees who have not taken vacations or sick time in exchange for the retirement benefit.

7. Spread Final Average Salary out over Five Years.

- Impacts core benefits which are either "expressly" or "impliedly" irrevocable.
- Legislative Counsel acknowledges that protecting "accrued benefits" could be complicated under this proposal.¹⁶
- Unclear what the fiscal impact would be if done more narrowly even within Legislative Counsel's more narrow definition of "accrued benefits."

8. Adopt a 401(k) Plan for New Hires.

- To generate any savings, the employer contribution rate to the 401(k) plan would have to be lower than the current employer contribution to OPSRP. To the extent it is lower there will be short term savings for employers in pension costs. However, the closing of the OPSRP plan to new entrants will increase the employer cost – and potentially the unfunded liability - of the plan over the long term. Studies of the experience of other states who moved to a 401(k) from a defined benefit confirmed the substantial cost of closing down a defined benefit plan.¹⁷
- Whatever advantage the state and local employers enjoy in recruiting and retaining employees because of the attraction of a defined benefit pension plan would be lost. Studies consistently show that a defined contribution plan is a much less efficient vehicle for providing retirement benefits than a defined benefit plan.

9. Allow Full Bargaining of Pick-Up and Limit it to 5 Year Agreements.

- Local governments already have the ability to bargain over the pick-up of employee contributions, and many employees around the state already pay their own contributions to the IAP.¹⁸

¹⁶ *Id.* at p. 6.

¹⁷ *See supra* n. 8.

¹⁸ *See* ORS 238.205; ORS 238A.335

- Most collective bargaining agreements providing for pick-up of employee contributions have terms which are less than 5 years already.
- Any projected savings could be minimal due to the alternative benefits that would be negotiated by workers in exchange for giving-up the pick-up.