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Appellate Court Records

IN THE SUPREME COURT OF THE STATE OF OREGON

EVERICE MORO; TERRI DOMENIGONI; CHARLES CUSTER; JOHN HAWKINS; MICHAEL ARKEN; EUGENE DITTER; JOHN O'KIEF; MICHAEL SMITH; LANE JOHNSON; GREG CLOUSER; BRANDON SILENCE; ALISON VICKERY; and JIN VOEK,

Petitioners,

v.

STATE OF OREGON; STATE OF OREGON, by and through the Department of Corrections; LINN COUNTY; CITY OF PORTLAND; CITY OF SALEM; TUALATIN VALLEY FIRE & RESCUE; ESTACADA SCHOOL DISTRICT; OREGON CITY SCHOOL DISTRICT; ONTARIO SCHOOL DISTRICT; BEAVERTON SCHOOL DISTRICT; WEST LINN SCHOOL DISTRICT; BEND SCHOOL DISTRICT; and PUBLIC EMPLOYEES RETIREMENT BOARD,

Respondents,

and,

LEAGUE OF OREGON CITIES; OREGON SCHOOL BOARDS ASSOCIATION; and ASSOCIATION OF OREGON COUNTIES,

Intervenors.

and,

CENTRAL OREGON IRRIGATION DISTRICT,

Intervenor Below.

Supreme Court No. S061452 (Control)

Continued…

WAYNE STANLEY JONES, Petitioner, v. PUBLIC EMPLOYEES RETIREMENT BOARD; ELLEN ROSENBLUM, Attorney General; and JOHN A. KITZHABER, Governor, Respondents.	SC No. S061431
MICHAEL D. REYNOLDS, Petitioner, v. PUBLIC EMPLOYEES RETIREMENT BOARD, State of Oregon; and JOHN A. KITZHABER, Governor, State of Oregon, Respondents.	SC No. S061454
GEORGE A. RIEMER, Petitioner, v. STATE OF OREGON; OREGON GOVERNOR JOHN KITZHABER; OREGON ATTORNEY GENERAL ELLEN ROSENBLUM; OREGON PUBLIC EMPLOYEES RETIREMENT BOARD; and OREGON PUBLIC EMPLOYEES RETIREMENT SYSTEM, Respondents.	SC No. S061475

Continued…

GEORGE A. RIEMER,

Petitioner,

v.

STATE OF OREGON, OREGON GOVERNOR JOHN KITZHABER, OREGON ATTORNEY GENERAL ELLEN ROSENBLUM, PUBLIC EMPLOYEES RETIREMENT BOARD, and PUBLIC EMPLOYEES RETIREMENT SYSTEM,

Respondents.

SC No. S061860

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Special Master

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STATE RESPONDENTS' ANSWERING BRIEF

INTRODUCTION

This case is about prospective changes enacted by the Legislative Assembly in Oregon Laws 2013, chapter 53, sections 1, 3, 5, and 7 (SB 822) and Oregon Laws 2013, chapter 2, sections 1, 3, and 8 (Special Session) (SB 861) to two components of retirement benefits paid by the Public Employees Retirement System ("PERS"). The two components are (1) cost of living adjustments ("COLA") and (2) so-called "tax remedy" payments added in 1991 and 1995 to compensate certain PERS members for state taxes on their benefits. With respect to COLAs, the bills change the manner in which the COLAs are calculated. The bills decrease the potential maximum COLA each year while eliminating the possibility of negative COLAs. They provide for a 1.5 percent COLA for one year, followed by annual COLAs based on a retiree's yearly benefits in the prior year. With respect to the tax remedy, SB 822 eliminates the compensatory payments for retirees who are not subject to Oregon income taxes because they are not Oregon residents.

SB 822 and 861 make those adjustments to the COLA and tax remedy payments in order to ensure the long-term health and solvency of the PERS system. While the changes are modest relative to overall benefits from the point of view of individual members, the impacts are spread across the entire population of PERS members and result in aggregate long-term savings of more than $5 billion. This enabled the Public Employees Retirement Board ("PERB") to reduce employer contributions to PERS in the current biennium by approximately $810 million, savings that will be replicated and increase in future biennia.

The central issue in this case is whether the adjustments made by SB 822 and SB 861 are constitutionally permissible or whether, as petitioners contend, they interfere with the contract rights of PERS members in violation of Article I, section 21, of the Oregon Constitution or its federal counterpart, Article I, section 10, clause 1, of the United States Constitution. This court should uphold both bills. The particular benefit components that they adjust—the COLA and the tax remedy—are not part of the PERS contract at all.

As this court has made clear, not every PERS statute or payment provided to PERS members is part of the PERS contract. The only provisions that *are* part of the contract are those components that the legislature unambiguously intended to be part of a contractual offer to prospective employees, who can accept those conditions by working for an employer that participates in PERS. Neither the COLA nor the tax remedy components meet that definition. And even if an obligation to include COLA or tax remedy payments is considered part of the PERS contract, the legislative changes here at issue do not impair that obligation. SB 822 and SB 861 change the manner in which COLA and tax remedy payments are calculated, but they do not eliminate them. In short, SB 822 and SB 861 are measured and prudent steps that do not interfere with the PERS contract and that are needed to protect the long term health of the system. They are a lawful and appropriate exercise of the legislature's authority.

QUESTIONS PRESENTED

1. Are the COLA and tax remedy[1] statutes terms of the "PERS contract"?

2. If the COLA and tax remedy statutes are terms of the PERS contract, do SB 822 or 861 impair those contract terms?

3. If SB 822 or SB 861 did impair the PERS contract, is the impairment substantial?

4. If SB 822 or SB 861 substantially impairs an obligation of the PERS contract, are the reductions in system liabilities and employer contribution rates a significant and legitimate public purpose justifying the impairment?

5. Did the legislature violate any federal or state constitutional provision other than the respective contract clauses, or any other law, when it enacted SB 822 or SB 861?

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[1] The Special Master used the term "SB 656/HB 3349 benefits" rather than "tax remedy." *See* Special Master Report ("SMR") at 3 n 4.

SUMMARY OF ARGUMENT

SB 822 and SB 861 do not violate any provision of the Oregon or United States Constitutions or any other law. SB 822 and SB 861 make narrow and permissible adjustments to PERS without violating the contract rights of PERS members because the bills affect two aspects of PERS—COLA and tax remedy payments—that are not part of the PERS contract. Instead, both are payments that members receive over and above retirement benefits accrued by working. This court held in *Strunk v. PERB*, 338 Or 145, 221, 108 P3rd 1058 (2005), that a portion of what was then the only COLA statute, ORS 238.360(1), was a term of the PERS contract, but that holding, unlike this court's other holdings in *Strunk*, was based on scant argument, included little analysis and should be disavowed. There is no evidence—let alone the clear and unambiguous evidence necessary—that the legislature intended the COLA statutes to create a binding contractual obligation. On the contrary, the original version of the COLA statute benefitted members who already were retired and who, therefore, could not have accepted those provisions as contract terms. The same is true of the tax remedies that the legislature created first with SB 656 and later in HB 3349. Indeed, HB 3349 expressly disclaims creation of any contract rights. In addition, the legislature could not have intended the tax remedy payments provided in SB 656 and HB 3349 to be binding unilateral offers because both provided payments to existing members based on service rendered *before* their respective effective dates, to compensate members who previously had performed service when PERS benefits were not subject to Oregon state income tax. Consequently, those statutes were not intended to be an "offer" because each provided payments to members who could not possibly have accepted those provisions as contract terms. Because neither the COLA nor tax remedy provisions can be contract terms, this court's analysis should end here.

Even if this court adheres to its holding that ORS 238.360(1) (2001) ("ORS chapter 238 COLA") is a contract term, and even if it extends that holding to ORS 238A.210(1) (2011) ("OPSRP COLA"), the changes did not impair those COLA provisions. Those statutes provide only for consideration each year of a COLA based on an index. By their terms, they do not guarantee any particular COLA amount and, in fact, they allow that COLAs may be positive *or negative*. In other words, to the extent those statutes create a contractual obligation, it is at most an obligation to consider annually the need for a COLA. The amendments to the COLA statutes by SB 822 and SB 861 are consistent with that obligation. In fact, the amendments provide *more* than consideration of a COLA; they provide a positive COLA each year. Accordingly, the modifications to the COLA statutes enacted in SB 822 and SB 861 do not impair any contract terms.

Similarly, SB 822's changes to the tax remedy payments, which affect only non-residents of Oregon, do not impair any term of the PERS contract. SB

656 and HB 3349 provide compensation to members who accrued retirement benefits when they were not subject to Oregon personal income tax but later became subject to that tax. Even if the legislature had intended those statutes to create a contractual obligation to compensate members for state taxes, the changes in SB 822 are fully consistent with that obligation. The changes in SB 822 eliminate eligibility for tax remedy payments only for those members who are not subject to Oregon personal income tax because they are not Oregon residents. Eliminating compensatory payments for retired members who are not subject to state tax does not impair any contractual obligation to compensate members for state taxes.

Even assuming that SB 822 and SB 861 actually impair contract terms, the changes made by the bills are still lawful because any impairment is insubstantial. Although this court has not had occasion to consider whether violation of Article I, section 21, requires proof of a *substantial* impairment, that is the rule under the federal constitution's contract clause and is the rule that the vast majority of state courts apply under their respective state constitutional contract clauses. The same rule applies under Article I, section 21, because that rule applied under the federal contract clause at the time of Oregon statehood.

The changes made in SB 822 and SB 861 do not affect benefits accrued during service to PERS-participating employers. The bills affect only add-ons to those accrued benefits. A change to a peripheral and unaccrued payment component is not the kind of change that could constitute a substantial impairment of an obligation of the PERS contract. In addition, the magnitude of the changes that SB 822 and SB 861 would have on total payments to retirees is not substantial. It is well below the decrease in retirement allowances, which are the benefits accrued by working, that this court assumed in *Strunk* to be substantial.

Federal contract clause analysis also considers the purpose of the enactments and whether the changes are justified and appropriate under the circumstances. State Respondents urge the court to include this step in its Article I, section 21, analysis, if the court gets that far, and to conclude that the changes are appropriate and justified.

Petitioners' other constitutional and non-constitutional claims should not long detain this court. The other constitutional claims largely rise or fall based on this court's disposition of the contract clause claims. For example, takings claims are based on deprivation of a property right, but whether there is a property right to COLAs or tax remedy payments depends on whether a contract right exists. The non-constitutional claims are similarly unavailing.

SUMMARY OF FACTS

To decide the issues raised by this case requires understanding the basic structure of the PERS retirement plan, how the COLA and tax remedy payments fit within that structure, and how SB 822 and SB 861 changed those two components. State Respondents therefore begin by explaining that legal framework in order to provide the necessary context for the arguments that follow.[2]

I. The Structure of PERS

PERS is a single, tax-qualified retirement plan that includes several programs and different types of members. *See* ORS 238.600(1). A member's benefits depend on characteristics of the member including, because of legislative changes enacted over time, when the member established membership. The majority of members are general service, others are "police and fire." Other participants in the system include judge members, "alternate payees" (divorced spouses or former same sex partners of members) and beneficiaries of deceased members. All members are either active, inactive or retired employees of employers participating in PERS.[3]

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[2] State Respondents generally accept Petitioners' Summaries of Facts, except for portions that are argumentative or inaccurate.

[3] As of December 31, 2012, PERS had 331,011 members, of which 167,103 were active, 41,871 were inactive, and 122,037 were retired. Ex 49 at 2.

There are three "tiers" of PERS members: Tier One, Tier Two, and OPSRP.[4] Tier One members established membership before January 1, 1996. As such, many Tier One members provided PERS-covered service before October 1, 1991, which makes them eligible for payments under HB 3449, the tax remedy provision added in 1995. *See* ORS 238.364(7). Most of them also are eligible for payments under SB 656, the tax remedy provision added in 1991. *See* ORS 238.366(6) (requiring membership before July 14, 1995). Members eligible for payments under both SB 656 and HB 3349 receive the higher of the two. ORS 238.364(1)(a).

Tier Two members established membership beginning January 1, 1996, through August 28, 2003. *See* ORS 238.430; 238A.300. Tier Two members therefore are not eligible for tax remedy payments. COLAs for Tier One and Tier Two members are governed by ORS 238.360.

OPSRP members are those who established membership on and after August 29, 2003. ORS 238A.025(2). Like Tier Two members, they are not eligible for payments under SB 656 or HB 3349. COLAs for OPSRP members are governed by ORS 238A.210.

PERS is funded by three sources: member contributions, employer contributions, and earnings on the Public Employees Retirement Fund. The

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[4] "OPSRP" is the Oregon Public Service Retirement Plan established in ORS chapter 238A. *See* ORS 238A.025.

PERB biennially sets employer rates, expressed as a percentage of payroll, that employers must pay to PERS. *See* Special Master's Report ("SMR") at 10. Those employers include the state, counties, cities, school districts and special districts.

Benefits paid to retired members include service retirement allowances and disability retirement allowances for Tier One and Tier Two; for OPSRP members those payouts are called pension "benefits." *See* ORS 238.300; 238.320; 238A.125, 238A.235.[5] Other benefits include lump sum payouts and, germane to this case, COLAs and tax remedy payments. Tier One and Tier Two members generally are subject to ORS chapter 238, but they participate in the Individual Account Program (IAP) under ORS chapter 238A created in 2003. OPSRP members are governed by ORS chapter 238A.

As of December 31, 2011, PERS had an unfunded actuarial liability (UAL) of $16 billion. SMR at 26. The UAL is the amount on that date by which all liabilities of the system (benefits to be paid over time) exceed all assets of the system (current assets plus actuarially determined future employer

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[5] Two petitioners use the term "service retirement allowance" incorrectly to refer to the total amount paid rather than only to the allowance itself. *See* Reynolds at 20 (arguing that SB 656 and HB 3349 increases are "reduced by subtracting from those allowances the [tax remedy] benefit increases."); Riemer at 11 (reference to contractually based service retirement allowance as including pre-SB 822 amounts he was receiving, including HB 3349 payments).

and member contributions and earnings). *See* SMR at 9. Sixty-eight percent of the UAL was attributable to retired and inactive members.[6] SMR at 9. The PERS actuary projected that before SB 822 and SB 861, employer rates, on a system-wide average basis, would reach 25 percent of payroll by 2017-19 and remain at that level for nearly twenty years. SMR at 27; Ex 27 (Larrabee Dec) at 10. In other words, the actuary projected that on an aggregate basis, public employers would have to designate an amount equal to one-quarter of their payrolls for at least 20 years to be paid to PERS.

II. History of COLAs and tax remedy payments and the changes enacted in SB 822 and SB 861

The history of the pertinent laws and the changes made in SB 822 and SB 861 are described in detail at SMR 22-38 and may be summarized as follows:

A. COLA Payments

Beginning in 1964, the Legislative Assembly enacted ad hoc, uncodified "thirteenth check" payments providing extra benefits to retirees. In 1971, the Legislative Assembly enacted permanent benefit increases for all retired members, along with a COLA statute. The COLA statute provided for COLAs based on an index that could range from negative to positive 1.5 percent in any

[6] This means that those unfunded liabilities result from amounts that must be paid to members who no longer are making any contributions to the system. Consequently, if no changes were made to their benefits, the burden of eliminating the UAL would be borne entirely by public employers and the 32 percent of members who are, or in the future will be, active.

year and provided that negative COLAs could not reduce a member's benefits below the retirement allowance established at the time of retirement, thereby establishing the retirement allowance as a floor.[7] The statute also included what is known as the "COLA bank." In years when the index exceeded 1.5 percent, the additional amount was "banked" and was available to supplement, or decrease if the banked amount was negative, the COLA in a subsequent year. *See* SMR at 23.

The legislature modified the COLA statute in 1973, increasing the range of potential COLAs from +/- 1.5 percent to +/- 2.0 percent. SMR 22-24. The COLA statute was codified in ORS 238.360 (2001).[8]

As part of the 2003 PERS reforms, the legislature enacted ORS 238A.210, providing a COLA to persons who establish membership in PERS

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[7] The term "retirement allowance" encompasses both "disability retirement allowances" and "service retirement allowances," which are the benefits paid before any additions, such as for COLAs or under SB 656 or HB 3349. *See* ORS 238.300; 238.320.

[8] The legislature amended the COLA statute two more times. It reorganized the statute in 1989, including by eliminating the original subsection (1), which had provided the date of the first COLA and established the floor, and moving the "floor" into subsection (2). Or Laws 1989, ch 799, § 2 (Ex 52). The legislature made a housekeeping change in Oregon Laws 2001, chapter 945, section 79. Ex 57.

Moro Petitioners' exhibits 50-58 are the legislative history of the enactment and amendments to the COLA statute (the ORS 238 chapter version) and the tax remedy statutes. Exhibits 59 and 60 are the legislative history of SB 822 and SB 861.

on or after August 29, 2003, that was similar to ORS 238.360 (2001). ORS 238A.210, however, never included a "COLA bank." *See* Or Laws 2003, ch 733, § 23.

B. Tax Remedy Payments

Before 1991, PERS benefits were not subject to Oregon state income tax. That changed following the decision of the United States Supreme Court in *Davis v. Michigan Dept. of Treasury*, 489 US 803, 109 S Ct 1500, 103 L Ed 2d 891 (1989), which requires that a state must tax state and federal pension benefits in the same manner. In response to *Davis*, the legislature could have chosen to cease taxing federal pension benefits or to begin taxing PERS benefits. It chose the latter and taxed both. *See Hughes v. State of Oregon*, 314 Or 1, 9, 838 P2d 1018 (1992).

In the same 1991 session in which the legislature made PERS benefits taxable, it also enacted SB 656 to provide an extra payment to PERS members whose benefits would now be taxed. It provides a payment equal to a fixed percentage of a monthly retirement allowance. The percentage is based on years of service. The maximum is four percent for members who retire with at least 30 years of service. *See* ORS 238.368.

In 1995 the legislature enacted HB 3349, which provides an additional payment based on a formula derived from what was the maximum Oregon personal income tax rate in 1995. *See* ORS 238.364. Like SB 656, HB 3349 added payments for PERS retirees who performed service when PERS benefits were not subject to Oregon state income tax but which became subject to that tax after *Davis*. Members eligible for payments under both SB 656 and HB 3349 receive the higher of the two. ORS 238.364(1)(a). SMR at 25.

C. SB 822 and SB 861

During the 2013 regular legislative session, the Governor presented to the legislature the question whether reforms to PERS were needed in order to "maintain a sustainable, secure, and affordable retirement system." The Governor presented this question in light of challenges resulting from economic conditions following the 2008 stock market downturn and changes to PERS in 1995 and 2003 demonstrating "the legislature's history of rebalancing the system when economic factors, retirement trends, or member demographics tilt the balance between affordability and benefits." Ex 59 at 31. The legislature's initial response was SB 822.

SB 822 changed both COLA statutes by eliminating the reference to an index and instead setting the COLA for 2013 at 1.5 percent and thereafter on a graduated scale: 2.0 percent based on the first $20,000 of benefits paid in the prior year, 1.5 percent on the next $20,000, 1.0 percent on the next $20,000, .25 percent on anything above $60,000. SMR at 30. SB 822 also eliminated the COLA bank in ORS 238.360(3) (2011). SB 822, § 3.

SB 822 also eliminated the tax remedy payments as of January 1, 2014, for retired members who are not subject to Oregon personal income tax because they are not residents of Oregon as of that date. SMR at 31; *see also* ORS 238.372(1). It provides that eligibility determinations must be made each year. SB 822, §§ 13-16.

The legislature then passed SB 861 in a special session about five months after SB 822 was enacted. SB 861 supersedes SB 822 for COLAs to be paid beginning in 2014, setting COLAs at 1.25 percent per year on the first $60,000 of benefits paid in the prior year and .15 percent on amounts above $60,000. SB 861 also provides annual supplemental payments up to $300 for six years for certain members. SMR at 31. The COLA changes do not reduce past benefits; they reduce the potential rate of increase of future payments.

SB 822 and SB 861 are projected to decrease system liabilities by $5.3 billion dollars. SMR at 34. As a result, employer rates, on a system-wide average basis, are projected to peak at 18 percent in 2015-17 and decline thereafter. *Id.*

COMBINED RESPONSE TO ALL ASSIGNMENTS OF ERROR

No provision in SB 822 or SB 861 violates the contract clause of the Oregon or United States Constitution, or violates any other federal or state constitutional provision or other law.[9]

A. Standard of Review

The legislature conferred jurisdiction to determine all issues as original matters in this court. SB 822, § 19; SB 861 § 11. This court conducts a *de novo* review of the evidentiary record and a plenary review of the legal issues presented. *Strunk*, 338 Or at 155.

B. Preservation of Error

State Respondents agree that all petitioners preserved their various assignments of error.

C. Argument

The primary question in this case is whether SB 822 or SB 861 impairs any term of the PERS contract. They do not for any of four reasons under contract clause jurisprudence, primarily because the aspects of PERS that SB 822 and SB 861 changed are not terms of the PERS contract. To reach this conclusion as to the COLA changes, State Respondents invite this court to

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[9] Because Petitioners and *Amici* have filed six separate briefs with differently stated but ultimately similar Assignments of Error, State Respondents do not set out and separately respond to each assignment of error. Instead, State Respondents address all issues in a combined response.

reconsider and disavow its holding in *Strunk* that ORS 238.360(1) is a term of the PERS contract.

The other constitutional issues raised by Petitioners[10] are largely derivative of the contract clause issues. For example, takings claims are based on the existence of a property right to COLA or tax remedy payments, but whether there is a property right depends on whether there is a contract right to those payments.

One of Petitioners' non-constitutional claims, that the changes to the COLA and tax remedy provisions breach the contract, also will rise or fall based on this court's disposition of the contract clause issues, because the analysis is identical. Petitioners' other non-constitutional claims lack merit for other reasons.

I. SB 822 and SB 861 do not violate the state or federal contract clauses.

As noted above, the primary question here is whether SB 821 and 861 interfere with the contract rights of PERS members in violation of the state or federal constitution. The inquiry under the state and federal constitutions is, or should be, the same. Article I, section 21, prohibits laws "impairing the obligation of contracts." Article I, section 10, clause 1 of the United States

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[10] Unless otherwise specifically stated, all petitioners are collectively referred to as "Petitioners".

Constitution is similar: "No State shall * * * pass any * * * Law impairing the Obligation of Contracts." As prescribed by *Strunk*, this court first addresses issues under state law, then federal. 338 Or at 171. The analysis begins as described in *Strunk*: "(1) is there a state contract?; (2) if so, what are its terms?; and (3) what obligations do the terms provide?" 338 Or at 170. So far, this court has not had occasion to go beyond those questions in cases under Article I, section 21. *See Strunk*, 338 Or at 208. State Respondents urge the court not to go beyond the first question in this case. However, if the court goes beyond those three questions, it should address additional questions presented under federal contract clause cases.

Federal contract clause cases address the same questions as *Strunk*, though in a slightly different format, and then ask additional questions. The federal analysis consists of three prongs: (1) whether a state law in fact operates as a substantial impairment of a contractual relationship; (2) if so, whether the state has a significant and legitimate public purpose for the law; and (3) whether the adjustment of the rights and responsibilities of the contracting parties is based upon reasonable conditions and of a character appropriate to the public purpose justifying the law's adoption. *See generally Energy Reserves Group, Inc., v Kansas Power & Light Co.*, 459 US 400, 411-12, 103 S Ct 697, 74 L Ed 2d 569 (1983); *United States Trust Co. v. New Jersey*, 431 US 1, 21-23, 97 S Ct 1505, L Ed 2d 92 (1977) ("US Trust"). The first prong of the federal contract clause analysis, whether a law substantially impairs a contractual relationship, itself "has three components: whether there is a contractual relationship, whether a change in law impairs that contractual relationship, and whether the impairment is substantial." *General Motors Corp. v. Romein*, 503 US 181, 186, 112 S Ct 1105, L Ed 2d 328 (1992).

Taking the state and federal contract clause analyses together, the issues may be framed as a four part inquiry: (1) What is the contract term at issue and does the state act modify it? (2) If the act at issue modifies a contract term, does the modification impair the contract term? (3) If there is an impairment, is it substantial? (4) If there is a substantial impairment, is it justified by a significant and legitimate public purpose?

The first two questions are commensurate with the questions presented in *Strunk*. Although this court has not yet had occasion to say so, the latter two questions, whether the impairment is substantial and whether it is nonetheless justified, are, for reasons explained below, applicable under Article I, section 21, and should be adopted by this court under its Article I, section 21, jurisprudence if the court reaches those latter two questions in this case.

But this court does not need to go beyond the first of the four questions to decide this case. Petitioners' arguments fail at the very threshold because the changes made by SB 822 and SB 861 are not changes to the PERS contract. This court's analysis need go no further.

But even if this court were to proceed, Petitioners' arguments also fail at each successive step in the analysis. In fact, for Petitioners to prevail; i.e., for this court to find a contract clause violation, this court would have to answer *all four* questions in the affirmative as to both the COLA and tax remedy changes. First, the court would have to reject State Respondents' invitation to reconsider its holding on ORS 238.360(1) in *Strunk* and hold that the changes made by SB 822 and SB 861 are to provisions of the PERS statutory contract. Second, even if the changes affect contract rights, the changes must impair those rights. Third, even if the changes to COLAs and tax remedy payments each impair a contract right, that impairment must be substantial. And fourth, even if any change substantially impairs a contract right, the change must not be justified by a significant public purpose. Petitioners prevail only if they persuade the court that all four of those criteria are met. As explained below, however, *none* of the four criteria is met.

A. The statutes affected by SB 822 and SB 861 are not terms of the PERS contract.

This court's first task in this case is to determine whether the COLA and the tax remedy statutes, as originally enacted or as amended before 2013, evince an unambiguous intent by the Legislative Assembly to create statutory contract terms. *See Hughes*, 314 Or at 25 (must determine "whether a particular statute is of a contractual nature"). Critical to that determination is whether the beneficiaries of those statutes could have provided consideration when accepting the offer from the legislature. They could not, because the "offers" were for additional, gratuitous payments based on service already rendered and could not be accepted in the manner that offers of the PERS contract must be accepted—by working. There is no evidence of unambiguous intent by the legislature to create statutory contract terms.

This court's decisions explain that while there is a statutory "PERS contract," not every part of PERS is a term of that contract. Instead, for a statute to be a term of the PERS contract, there are two requirements: (1) an unambiguous intent on the part of the legislature to create a contract term, and (2) acceptance by the employee of that contract term, which the employee does by working.

First, the legislature has to have unambiguously intended to create a statutory contract term. *Hughes*, 314 Or at 14 (offer must "unambiguously express an intention to create a contract.") (citing *Eckles v. State of Oregon*, 306 Or 380, 396-97, 760 P2d 846 (1988), *appeal dismissed* 490 US 1032, 109 S Ct 1928, 104 L Ed 2d 400 (1989)). The question is one of legislative intent. *Strunk*, 338 Or at 175; *Oregon State Police Officers' Assn. v. State of Oregon*, 323 Or 356, 495, 918 P2d 765 (1996) ("OSPOA") (Gillette, J., specially concurring in part and dissenting in part) ("[N]ot every statutory provision in [the PERS statutes] is a part of the contract. Instead, whether a particular provision is part of that contract is a question of legislative intent.”).[11] This requirement of unambiguous legislative intent is fundamental. It dates back not quite to the beginning of our Republic. *See Eckles*, 306 Or at 390-391 (citing *Charles River Bridge v. Warren Bridge,* 36 US (11 Pet.) 420, 544, 9 L Ed 773 (1837)).

Second, if there is unambiguous legislative intent to create a contract term, that term has to then be accepted by the employee. An offer of the PERS contract is accepted when the employee accepts employment. *Hughes*, 314 Or at 20, 20 n 23. More particularly, PERS members acquire contract rights to future benefits based on work currently performed. *Id.* at 20-21.

Under those principles, the COLA and tax remedy statutes are not statutory contract terms. The Legislative Assembly in 1971 could not have intended COLAs, and in 1991 and 1995 could not have intended tax remedy payments, to be contract terms because, as detailed below, at the time of those enactments, those payments were offered to persons who could not accept them. Consequently, no contract, let alone a statutory contract, could have been formed. Upon so holding, this court’s consideration of whether the changes to ORS 238.360 and to the tax remedy statutes enacted in SB 822 and SB 861

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[11] Members of this court criticized the majority opinion in *OSPOA*, saying that the court “lost sight of the polestar of statutory contractual analysis: clear, unambiguous, and unmistakable promissory intent.” *Strunk*, 338 Or at 239 (Balmer, J., concurring) (citation omitted).

impaired a term of the PERS contract is at an end and all remaining contract clause issues are moot.

1. The legislature did not intend COLA statutes to be terms of the PERS contract.

The Legislative Assembly in 1971 could not have intended the COLA statute to be a potentially binding contract offer. When it was enacted, it was offered to persons who could not accept it. They could receive COLAs only as gratuitous, additional payments. This court's statement in *Strunk* that ORS 238.360(1) (2001) is a term of the PERS contract is therefore mistaken and should be overruled.

a. ORS 238.360(1) (2001) is not a statutory contract term.

In *Strunk*, this court concluded only that subsection (1) of the 2001 version of the statute is a term of the PERS contract. The court's consideration of this issue was cursory and its holding should be reconsidered.

After reproducing subsections (1) and (2) of ORS 238.360 (2001), this court in *Strunk* said:

> "The legislature enacted that statute in 1971, and its substance has remained unchanged, notwithstanding other interim amendments. *See former* ORS 237.060(1) (1971), *renumbered as* ORS 238.360 (1995) (setting out original statute).
>
> "ORS 238.360(1), as it existed in 2001 and as presently worded, provides that PERS members' monthly service retirement allowances annually shall be adjusted to reflect 'the percentage increase or decrease in the cost of living for the previous calendar year[.]' Like the tax provision analyzed in *Hughes,* the text of ORS

> 238.360(1) (2001) evinces a clear legislative intent to provide retired members with annual COLAs on their service retirement allowances, whenever the CPI warrants such COLAs. We therefore conclude that the general promise embodied in ORS 238.360(1) (2001) was part of the statutory PERS contract applicable to the group of retired members affected by the 2003 provisions at issue here. Having so concluded, we now must determine the extent of that promise."

338 Or at 221. This passage is the court's entire analysis of the question. On this issue, the court lost sight of its polestar. It offered no connection between its assertion that ORS 238.360(1) is "[l]ike the tax provision analyzed in *Hughes*" and any existence of a "clear legislative intent to provide retired members annual COLAs." Its observation that the statute in "substance has remained unchanged" does not establish that connection.

Contrast that approach with the *Strunk* court's analysis on the issue of the redirection of employee contributions to the IAP. On that issue, this court reviewed in detail the history of PERS and the statutes at issue, ultimately determining that the provision in ORS 238.200 directing employee contributions to the ORS chapter 238 member account "was not immutable." *Strunk*, 338 Or at 183-193. Notably, ORS 238.200, like ORS 238.360, had in substance remained unchanged for a long period, but the court did not mention that factor in its consideration of the redirection of employee contributions.

The *Strunk* court's cursory analysis of ORS 238.360 reflects the dearth of briefing on the issue.[12] The Strunk Petitioners' Opening Brief contains one paragraph on the issue, at pages 37-38. The Non-State Defendants' response, at pages 49-50, was that the Petitioners failed to understand what the legislature was trying to accomplish with the so-called "COLA freeze" and failed even to mention whether ORS 238.360 should be considered a contract term. State Respondents are aware of no other statement, let alone argument, on this issue in any other brief filed in *Strunk*.

Those are precisely the circumstances this court posited would favor reconsideration and perhaps overruling a prior decision, especially when that prior decision is constitutional, because there is no one but this court who may correct such a decision if it is erroneous. *See Farmers Ins. Co. v. Mowry*, 350 Or 686, 697-98, 261 P3d 1 (2011). Accordingly, this court should reconsider its holding in *Strunk.* For the reasons discussed below, this court should disavow its holding that ORS 238.360(1) is a term of the PERS statutory contract.

As noted above, the original COLA statute, ORS 238.360, was enacted in 1971 and was amended several times, most recently in 2001. Nothing in the text of ORS 238.360, as originally enacted or as amended, evinces an

[12] The Department of Justice did not participate in *Strunk*.

unambiguous intent to create a contract term. The circumstances of its enactment put to rest any suggestion that it is a contract term.

Beginning in 1964, the legislature granted a series of ad hoc payments to retirees, described by the Special Master as “thirteenth check” payments. SMR at 22. Because those payments were made to members who already were retired, they are examples of gratuitous payments. That is because the retirees did not have to, indeed by definition could not, accept the “offer” by working, but surely they had no inclination to refuse the largesse. The ad hoc payments were not contract benefits.

The ORS chapter 238 COLA statute originally was enacted in Oregon Laws 1971, chapter 738, section 11. The language of the 1971 Act and its history demonstrate that the legislature intended to create gratuitous benefits for members already retired and the legislature was not making an offer of a contract term that could be accepted by working. In section 9, the legislature increased the retirement allowances of all retired members on a permanent basis. Or Laws 1971, ch 738, § 9; Ex 50; SMR at 23. Again, that permanent increase was a gratuitous benefit because no retiree could accept the offer of those additional payments.

In its original form, subsection (1) of the COLA statute provided the date when the first COLA would be added to retirees’ monthly allowances and included the formula later moved to subsection (2). The formula enacted in

1971 capped the COLAs at plus or minus 1.5 percent. Or Laws 1971, ch 738, § 11. The legislature changed the range to two percent in 1973. Or Laws 1973, ch 695; Ex 51; SMR at 23. The legislature reorganized the statute in Oregon Laws 1989, chapter 799. Ex 52 at 1. The 2001 version of subsection (1) found by this court to be a contract term was the original subsection (2).

The nature of contracts, let alone statutory contracts, eliminates any possibility that the COLA is a term of the PERS contract. Section 11 (COLA), like Section 9 (retirement allowance increase discussed above) of the 1971 Act increased payments to persons already retired. If sections 9 and 11 were offers of contract terms, the retired members could not, by definition, provide the consideration necessary for acceptance—acceptance of employment. Both sections 9 and 11 provided gratuitous increases to retired PERS members.

It is beyond doubt that Section 9 of the 1971 Act provided a gratuitous increase in benefits; the increases in retirement allowances were given to persons who retired before January 1, 1972, but the Act became effective on January 1, 1972. Or Laws 1971, ch 738, §§ 9, 12. Similarly, the COLA enacted in Section 11 immediately benefitted persons already retired who could not have given any consideration for the offer. The legislative history of the 1971 statute indicates that the legislature understood that COLAs would be granted to all presently retired members. Ex 50 at 27.

If there is any evidence of intent to create a statutory contract term in the 1971 Act, it could be only as to members who were able to accept the offer of the COLA as a contract term; i.e., members active on and after the effective date of the original COLA statute. Perhaps it is possible that the legislature could have contemplated the provision would be a gift to retirees but a contract term for any member who was an active member after the effective date of the statute. But there is no evidence of this, and a theoretical possibility is not enough. There must be unambiguous intent to create a statutory contract term. *Hughes*, 314 Or at 14. The legislature did not say that it intended to create a binding contract term for members who were or would be active on or after the effective date of the 1971 Act and nothing in that Act or its history supports an inference that the legislature unambiguously intended to create a statutory contract term. This precludes a conclusion that the COLA provisions were unambiguously intended to be contractually binding.

Unlike any other provision of what is now part of ORS chapter 238 that this court has determined to be a statutory contract term, there is no evidence that the COLA statute was "part and parcel" of the PERS contract. *See Hughes*, 314 Or at 25 (exemption from Oregon income tax part and parcel of 1953 enactment); *Strunk*, 338 Or at 191 (conclusion that 1981 statute changing what is now ORS 238.300 was "material" to, and therefore part of, the statutory contract).

Other than the COLA statute, every statute determined by this court to be part of the PERS contract shares three characteristics: (1) on the day each was enacted, it constituted an offer that could be accepted *only* by active (including future) PERS members; (2) on the day each was enacted, it had no effect on the benefits of members already retired; and (3) the benefits accrue during employment based on service performed.[13] The COLA statute simply does not possess those characteristics. That difference distinguishes the COLA statute, as enacted and as amended, as it existed in 2001 and in 2011, from all other statutes this court has determined are provisions of the PERS contract.

b. ORS 238A.210 (2011) also is not a contract term.

The COLA provision in ORS chapter 238A, unlike the one enacted in 1971, at the time of its enactment in 2003 did not apply to any retired member. Accordingly, the analysis of the OPSRP COLA provision has a different starting point than the analysis of ORS 238.360 because, when enacted, the

[13] This court has determined the following to be terms of the PERS contract. In *Hughes*, *former* ORS 237.201 (tax exemption for PERS benefits, enacted in both the 1945 and 1953 acts); *OSPOA*, ORS 238.205 (the pick-up, enacted in 1979 to apply on and after that date), 238.255 (guaranteed return on employee accounts, originally enacted in 1953), 238.350 (addition of accumulated sick leave to final average salary, originally enacted in 1973); *Strunk*, ORS 238.300 (service retirement allowances, as amended in 1981), 238.255 (same as in *OSPOA,* except that the court upheld a provision that the guaranteed return was a ceiling, as well as a floor, until certain conditions prescribed the legislature are met), 238.360(1).

ORSRP COLA applied only to persons who would be in a position to accept it as a contract term, if it was offered as one. It was not. It mimics the ORS chapter 238 COLA but provides less.

ORS 238A.210 (2011) was similar to ORS 238.360 (2001) in that it provided for a COLA based on an index, limited to plus or minus two percent per year. Like ORS 238.360, it provided a floor; negative COLAs could not result in benefits being less than the pension amount determined at retirement. Unlike the ORS chapter 238 version, ORS 238A.210 never included a COLA bank. This means that, in any year in which the index described in subsection (1) of the pre-SB 822 versions of both COLA statutes was less than two percent, OPSRP members could have no accumulation of unawarded COLAs to bring their COLAs for that year up to two percent.

The overarching intent of the Legislative Assembly when it enacted the 2003 PERS reforms was to reduce system costs. *See Strunk* Special Master Report ("*Strunk* SMR") at 73.[14] That intent is reflected in ORS 238A.460(1) (PERB may not take any action that increases liabilities under this chapter) and 238A.465 (expression of intent that any future increased benefits be provided through IAP and not OPSRP pension program). On that basis alone, this court should conclude that the legislature, in enacting a COLA provision in ORS

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[14] The *Strunk* SMR is Exhibit 15 herein. *See* SMR at 1 n 1.

chapter 238A, intended to provide to OPSRP members no greater benefit or contract rights than it provided to Tier One and Tier Two members in ORS 238.360.

The lack of a COLA bank in ORS 238A.210 is evidence that the 2003 legislature intended the OSPRP COLA to provide *less* than the ORS chapter 238 COLA. But as explained above, the legislature did not intend the ORS 238.360 COLA, for Tier One and Tier Two members, to be a contract right. *A fortiori*, the OPSRP COLA was not intended to create a contract right for OPSRP members either. Again, if the legislature had intended to create a contract right to COLAs for some members (OPSRP members) but not for others (Tier One and Two members), it could have said so. Its failure to do so precludes a finding that the legislature intended the OPSRP COLA to be contractually binding.

In arguing to the contrary, the Moro Petitioners contend that ORS 238A.470 demonstrates that the Legislative Assembly intended ORS 238A.210, including the range of COLAs in subsection (2) of the pre-2013 version of the statute, to be a statutory contract term. Moro at 58. But the Moro Petitioners ascribe more to this statute than its words can support.

ORS 238A.470 provides:

> "The Legislative Assembly may change the benefits payable to persons who become members of the Public Employees Retirement System on or after August 29, 2003, as described in

> ORS 238A.025, as long as the change applies only to benefits attributable to service performed and salary earned on or after the date the change is made."

The statute does not say whether any statute in ORS chapter 238A is a statutory contract term. Rather, it is a statement that the legislature may make only prospective changes to benefits provided in ORS chapter 238A that are based on "service performed." This is an acknowledgement that the OPSRP program creates contract rights similar to, and not greater than, those in ORS chapter 238, including that benefits accrued based on service, similar to retirement allowances under ORS 238.300, cannot be altered. Just as *Strunk* determined that ORS 238.200 was not immutable and could be changed prospectively, ORS 238A.470 does not mean that every statute in ORS chapter 238A is an immutable contract term.[15]

ORS 238A.470 is a statement that benefits accrued based on "service performed" cannot be changed by legislation. It leaves the door open to any prospective change, however, and it has no effect on any provision in ORS chapter 238A providing a benefit or payment not based on "service performed."

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[15] The title of ORS 238A.470 in the codification is "Contract rights under Oregon Public Service Retirement Plan." Titles of statutes are not a part of the statute. ORS 174.540. The title of ORS 238A.470 was included in the bill enacting it. *See* Or Laws 2003, ch 733. § 45. Even if that is a reason that ORS 174.540 should not apply, the title does not change the analysis of the text of the statute, even if the title is included as part of the text. The title refers to contract rights but does not say what they are.

Neither the ORS chapter 238 COLA statute nor its near-clone in chapter 238A has ever provided a benefit *based on service performed.* ORS 238A.210(1) (2011) required, in pertinent part:

> "Before July 1each year, the board shall adjust every pension payable under ORS 238A.180, 238A.185 and 238A.190, every disability benefit under ORS 238A.235 and every death benefit payable under ORS 238A.230 by multiplying the monthly payment by the percentage figure determined by the board."

COLA provisions stand in stark contrast with pension, disability and death benefits that accrue based on service performed.

An example illustrates the difference between benefits that accrue based on service performed compared with other payments and how ORS 238A.470 limits the ability of the legislature to alter the former but does not apply to the latter. Under the ORS chapter 238A pension program, a general service member who retires with 30 years of service at a final salary of $5000 per month receives a monthly benefit of $2,250 per month. ORS 238A.125(1)(a). That monthly benefit accrues during the 30 years of service and it is attributable to that service. Suppose, however, that during that member's thirty years of service, the Legislative Assembly reduces the formula for determining benefits from the 1.5 percent now in ORS 238A.125(1)(a) to, say, 1.0 percent. ORS 238A.470 does not allow that reduction to apply to service performed, and hence benefits accrued, before the statutory change, but it does not prohibit changes based on service not yet performed. Thus, if the change is made after twenty years of service, the member's benefit would be determined based on a formula of 1.5 percent for 20 years and 1.0 percent for 10 years, resulting in a monthly benefit at the time of retirement of $2000, of which $1500 results from the first 20 years of service and $500 from the last ten.

COLAs are different. In the example, the pension is $2250 per month under current law, $2000 if the posited change occurs. Either of those amounts is the pension based on service performed that is determined at the time of retirement, to which ORS 238A.210(1) (2011) refers. An annual COLA may be added to that pension, whatever it is. The amount of the COLA is determined by multiplying the applicable percentage to the pension. Importantly, however, the COLA amount is based on that arithmetical operation without regard to service performed—it is an additional payment over and above the accrued benefit; it is not an amount that is attributable to service performed. As a result, ORS 238A.470 does not apply. Nothing in ORS 238A.470 prevents the legislature from modifying the COLA.

ORS 238A.470 is not a statement by the legislature that all of chapter ORS 238A is a statutory contract. Rather, ORS 238A.470 is a statement that the legislature will not retroactively alter benefits accrued based on service performed. This is not a remarkable proposition. The legislative history shows that the provision emerged from legislative testimony arguing that the new retirement system should *not* create contract rights. *See* Tape Recording, House

PERS Committee, HB 2020, April 3, 2003, Tape 44, Side A at 67 (Statement of Jim Green) (RealPlayer at 40:00). ORS 238A.470 reflects this court's holdings in *Hughes* and, except as to ORS 238.360(1), in *Strunk*. Indeed, the ORS chapter 238 COLA, like the OPSRP COLA, does not accrue based on service performed. Both are benefits added to the statutory retirement allowance (chapter 238) or pension benefit (chapter 238A). ORS 238A.470 does not support an argument that ORS 238A.210 as originally enacted is a term of the PERS statutory contract.

In sum, nothing in the original version of ORS 238A.210 or any other statute hints at the possibility that the COLA itself accrues based on service performed. Rather, the OPSRP COLA, like the ORS chapter 238 COLA, is added each year after retirement to a benefit based on service performed. The limitation in ORS 238A.470 therefore does not apply to the OPSRP COLA. ORS 238A.470 does not support a conclusion that ORS 238A.210 (2011) is a term of the PERS statutory contract.

c. Even if this court adheres to its holding in *Strunk*, it should decline to hold that any portion of ORS 238.360 (2001) or ORS 238A.210 (2011) other than subsection (1) is a contract term.

For all of the reasons discussed above, this court should disavow its statement in *Strunk* that ORS 238.360(1) is part of the PERS contract, and it similarly should reject the idea that ORS 238A.210(1) is a contract term. The legislature did not intend the ORS chapter 238 COLA or the OPSRP COLA to be contractual requirements. But even if this court were to adhere to *Strunk* and conclude that ORS 238.360(1) and ORS 238A.210(1) create a contractual obligation to provide for COLA adjustments, it should not extend that holding to other provisions related to the calculation of COLAs. Yet that is what Petitioners ask this court to do. Petitioners urge this court to *extend* its holding in *Strunk* and declare that at least subsections (2) and (3) of the 2001 version of the ORS chapter 238 COLA statute, and all of ORS 238A.210—including all of the nuts and bolts regarding the specific manner in which COLAs are calculated—are all immutable contract terms. This court should decline that invitation.

No petitioner offers any rationale to support such a holding. None cites any evidence—let alone the unambiguous evidence required by this court's decisions—that the Legislative Assembly intended the range of COLAs that existed in 2011 (+/- 2 percent) or 1971 (+/- 1.5 percent) to be a statutory contract term. Moro Petitioners review the history of ORS 238.360 and conclude that this court should hold "that the COLA scheme enacted by the 1973 legislature consisting of the CPI, 2 percent maximum, and bank of any CPI above the maximum are" contract terms. Moro at 57-58. But their review of history refers to no statement of an unambiguous intent to create a statutory contract term and Petitioners offer no rationale why such intent may be inferred.

Moro Petitioners also offer no reason why the 1973 version should be considered the contract term rather than the 1971 version. Contrary to their unsupported assertion, the fact that the legislature chose to amend the COLA statute just one legislative session after enacting it is evidence that it did not intend the COLA statute, or at least the range of available COLAs, to be immutable, even if it did not revisit that provision for forty years. Obviously, it is to Petitioners' immediate advantage to have the higher range based on the 1973 amendment. But this result-oriented request fails to examine whether anything in the text, context or history of the COLA statutes provides any support for their position.

It does not. The only conceivable "guarantee" was that, in the event of negative COLAs, annual benefits could not be reduced below the amount of the retirement allowance determined at the time of retirement. ORS 238.360(2) (2001) ("no allowance shall be adjusted to an amount less than the amount to which the recipient would be entitled if no cost-of-living adjustment were authorized"), originally enacted in Or Laws 1971, ch 738, §11(1). The COLA statute thus incorporates and refers to the statutory promise that this court focused on in *Strunk*, which is the right to a retirement allowance based on what is now ORS 238.300. To be sure, *Strunk* concluded that the 1981 version of that statute is a current statutory contract term, but the statutes guaranteed some level of benefits based on service performed since 1967. *See Strunk*, 338 Or at

190 (reviewing history). The fact that the ORS chapter 238 COLA statute is older than ORS 238.300, as amended in 1981, is meaningless. The original subsection (1) of the COLA statute, which was subsection (2) in 2001, indicates that the legislature understood the statutory contract to provide a right to a retirement allowance. The "retirement allowance," a term which appears in ORS chapter 238 approximately 100 times, never includes increases in benefits resulting from COLAs. It refers only to the amount paid upon retirement based on service or disability.

If the 1971 Act created a statutory contract term, that term extends no farther than this court's holding in *Strunk.* It is only the 2001 version of subsection (1) that could be a contract term. If it is, then retired members have a right to consideration of a COLA, but not to any amount, because in any year the amount could be up or down.

The COLA in any year has never been guaranteed. The 1971 legislature enacted the COLA to provide increases on top of the statutory contract benefit when warranted by the CPI. The 2003 legislature replicated the COLA for OPSRP members, albeit without a COLA bank, but with the same floor as in ORS 238.360(2) (2001). *See* ORS 238A.210(2) (2011). The fact that it has been two percent per year for many retirees does not establish a contract right to a two percent COLA increase each year; that is a matter of history, and the effect of the COLA over time could not have been known at the time of enactment. The COLA statutes provide, and have always provided, for consideration of a COLA to be added to retirement allowances and pension benefits that are part of the statutory contract "whenever the CPI warrants such COLAs." The COLA is added to, not a part of, the statutory contract benefits.

2. The legislature could not have intended either tax remedy statute to create a statutory contract term because, like the original COLA statute, no member could provide consideration for the offer.

All petitioners who reside out of state assert that cessation of benefits paid to retired members under SB 656 who are not subject to Oregon state income tax because they are not residents of the State of Oregon violates Article I, section 21, of the Oregon Constitution. Petitioners Jones, Reynolds and Riemer assert that cessation of HB 3349 benefits also was impermissible.[16] As explained below, both challenges are meritless.

As described in the Summary of Facts, SB 822 requires that tax remedy payments not be made to retired members who are not subject to Oregon personal income tax because they are not residents of Oregon. Cessation of those payments in those circumstances is permissible because neither SB 656 nor HB 3349 is a contract term. Even if they were, cessation of those

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16 The Moro Petitioners do not join in that claim, which is not surprising in light of the fact that their counsel testified to the legislature during its deliberations on SB 822 that HB 3349 did not create a contract term. Ex 59 at 56, 164.

payments, which were added to compensate members who accrued benefits when they were not subject to Oregon personal income tax, is permissible because it would be consistent with the statute; the affected members are not subject to Oregon personal income tax because they are not Oregon residents.[17]

a. SB 656 is not a term of the PERS contract because it provides added compensation based on service rendered before enactment.

Similar to the original COLA statute, when SB 656 was enacted, it only provided extra compensation related to benefits that were accrued based on service rendered before enactment. As such, it cannot be a contract term, let alone a statutory contract term, because it immediately benefited only persons who already were retired, and would benefit some active members upon retirement only by increasing payments for service already performed. Consequently, no member who would receive the payment could accept the offer by accepting employment or working. Because SB 656 payments were added only to benefits already accrued, they cannot be a contract term.

[17] SB 822 did not amend SB 656 or HB 3349. Rather, the cessation of tax remedy payments is pursuant to amendments to ORS 238.372 to 238.378, which originally were enacted in Oregon Laws 2011, chapter 653, sections 2 through 5. That 2011 Act eliminated HB 3349 payments for members not subject to Oregon state income tax because they are not residents of Oregon and whose retirements are effective on and after January 1, 2012. *See* ORS 238.372 (2011). Sections 11-17 of SB 822 extend that concept to all members who are not Oregon residents regardless of date of retirement and to SB 656 payments.

The payments provided under SB 656 at issue in this case were enacted in Oregon Laws 1991, chapter 796, section 2, now codified as amended at ORS 238.366. As described by this court in *Vogl v. State of Oregon*, 327 Or 193, 199, 960 P2d 373 (1998), the legislature enacted SB 656 to increase compensation for members because, in another 1991 Act, the legislature repealed the statute exempting PERS benefits accrued before October 1, 1991, from Oregon income tax. The payments now codified at ORS 238.366, like COLAs, at the time of enactment were immediately payable to retired members and would be available to active and future members when they retired. Unlike COLAs, which are added to retirement allowances each year and are not based on service performed, SB 656 payments applied only to members who performed service prior to its enactment, i.e., service performed during the time when *former* ORS 237.201 exempted PERS benefits from Oregon state income tax. Members could not give consideration for that extra payment, because they were not required to perform any service to accept it.

Also like the 1971 COLA bill, SB 656 separately provided additional benefits solely for members already retired. Or Laws 1991, ch 796, § 3. SB 656, like ORS 238.360 and unlike any other statute this court has found to be a term of the statutory contract, benefitted retired members who could not provide consideration to accept the offer of a contract term, even if that is what the legislature had intended it to be. It was a gratuitous benefit because no one could provide consideration for the offer.

SB 656 increased compensation (the term used in *Vogl*) for retired members and other members who performed service prior to its enactment. No service performed after its enactment could qualify or entitle a member to the SB 656 benefit. This undercuts the requirement of unambiguous statutory intent to create a contract term. The fact that SB 656 in its entirety added payments based on service previously performed means that SB 656 provides gratuitous benefits. Consequently, cessation of SB 656 payments to members who reside outside of Oregon does not violate any contract term; it eliminates a gratuitous benefit.[18]

b HB 3349 did not create a statutory contract term.

Petitioners Jones, Reynolds and Riemer face an even higher hurdle when they argue a contract right to HB 3349 payments. The plain text of ORS 238.362(3) forecloses Petitioners' argument. ORS 238.362(3) provides that "[n]o member of the system or beneficiary of a member of the system shall acquire a right, *contractual or otherwise*, to the increased benefits provided by"

[18] By this same reasoning, elimination of SB 656 payments for all members would not violate the PERS statutory contract. However, elimination of those payments, and HB 3349 payments, for retired members who reside in Oregon and therefore are subject to Oregon personal income tax would raise other issues. *See* Section III.D.

HB 3349 (emphasis added). This provision was enacted in Oregon Laws 1995, chapter 569, section 2(3). This court said in *Strunk* that the wording of HB 3349 "could not be clearer in that respect." 338 Or at 178.

Despite that text and this court's statement in *Strunk*, Petitioners Jones, Reynolds and Riemer point to the legislative history of HB 3349 and argue that language now codified in ORS 238.362(3) was meant to apply only in the event that settlement of the class action referenced in ORS 238.362(4)(b), which is the settlement reached after remand in *Stovall v. State of Oregon*, 324 Or 92, 922 P2d 646 (1996), was not executed. *See, e.g.,* Jones at 31. But the legislative history of HB 3349 is replete with statements of intent to create no rights, contractual or otherwise, without any contingency based on the settlement. *See* Ex 54 at 69, 71, 77, 81, 84, 88, 91, 149, 254, 255, 259, 260. The intent not to create contract rights was unconditional and unqualified. Moreover, HB 3349 could not have been a contract term because it was enacted in 1995 to provide payments based on service provided before September 29, 1991. Or Laws 1995, ch 569, § 2(2). Therefore, no person could provide consideration for the offer, if that is what it was. HB 3349 provided a gratuitous benefit.

As with the amendments to the COLA statutes, this court's consideration of whether SB 822's changes to the tax remedy statutes violate terms of the PERS statutory contract should end here. Neither SB 656 nor HB 3349 is a term of the PERS statutory contract. The Legislative Assembly therefore did not violate the statutory contract when it made those payments unavailable to retired members who pay no Oregon state income tax because they are not residents of Oregon.

B. Even if the COLA or tax remedy statutes are statutory contract terms, the modifications by SB 822 and SB 861 did not impair those terms.

If the court concludes that either COLA or tax remedy statutes are statutory contract terms, it must determine what the terms are and whether SB 822 or SB 861 impair them. For the reasons explained below, even assuming that the legislature intended the COLA statutes and either tax remedy statute to create binding contractual obligations, the changes in SB 822 and SB 861 are fully consistent with those obligations. It follows that SB 822 and SB 861 do not impair the PERS contract.

1. COLA

a. To the extent that subsection (1) of each COLA statute is a contract term, the only contractual obligation is to conduct annual COLA determinations.

If this court adheres to its holding in *Strunk*, and if it extends that holding to ORS 238A.210(1) (2011), the next issue is whether the changes to those statutes in SB 822 and SB 861 impaired any contract term. They did not. Under this court's holding in *Strunk*, the COLA statutes require only that retirement allowances be considered for a COLA each year. They do not guarantee any particular amount, or whether the amount will be positive or negative. SB 822 and SB 861 changed the formula for determining the amount of the COLA each year but did not change the fact that all allowances/pensions are considered for COLAs. Moreover, SB 822 eliminated the possibility of negative COLAs. Thus even assuming that the COLA statutes created a binding contractual obligation, SB 822 and 861 are consistent with that obligation.

To determine whether there is an impairment of a statutory contract term, the court must first determine what the contract term is and what it provides. *Strunk*, 338 Or at 170. When the first COLA statute was enacted in 1971, it offered retired members, and active and future members upon their eventual retirements, annual consideration of a COLA based on an index that could go up or down by 1.5 percent (changed in 1973 to two percent). But this court held in *Strunk* that only the portion of the original enactment included in subsection 1 of the 2001 version is a contract term. Viewed from that perspective, the contract term, if the court adheres to that holding, did not guarantee that there would be a COLA increase in any year. It guaranteed only that, in the event of decreases, annual benefits would never be less than the retirement allowance determined at the time of retirement.

ORS 238.360(1) (2001) provided:

> "As soon as practicable after January 1 each year, the Public Employees Retirement Board shall determine the percentage increase or decrease in the 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 of the 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 on 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 the resultant amount."

The essential characteristics of this provision are a) all allowances receive a COLA each year; b) the COLA is based on an index. Even this court's holding in *Strunk* does not support a contract right to the *amount* of the COLA that may be applied in any year. The amount was determined each year by the formula in subsection (2), along with the COLA bank that was provided in subsection (3). ORS 238.360(1) (2011) did not guarantee any COLA being added to benefits in any year, because there is no guarantee that the index in all years will be positive. This court acknowledged that no COLA, let alone a specific amount, was ever guaranteed. *Strunk*, 338 at 221 (intent to provide COLAs "whenever the CPI warrants such COLAs"). If it is a statutory contract term, it only requires that all retirement allowances be considered for a COLA each year.

The analysis applicable to ORS 238A.210 is the same. ORS 238A.210, as enacted in 2003, replicated the 2001 version of ORS 238.360, except that ORS 238A.210 did not include a COLA bank and in subsection (1) it referred to pension "benefits" rather than "retirement allowances." The original version of ORS 238A.210(1), like the portion of ORS 238.360 held by this court to be a contract term, provides for a COLA, based on an index, to be applied to all pension benefits under ORS chapter 238A. It does not guarantee any COLA in any year, and in any year the COLA may be positive or negative.

The Special Master found that retired Tier One and Tier Two members generally have received COLAs of two percent since 1973, in part because the COLA bank made up any shortfalls in years when the index was less than two percent. *See* SMR at 22-24. But that is a matter of history since 1971, not a matter of contract; the legislature in 1971 did not guarantee, and could not have known, that the COLA bank would have a balance, positive or negative, as to any member in 2013. As a matter of law, ORS 238.360 (2001) did not guarantee any increases to anyone.

In sum, even if this court adheres to its holding in *Strunk*, all that means is that there is a right to *consideration* of a COLA as to all retirement allowances/pension benefits. The changes to the COLA statutes in SB 822 and SB 861 continue to provide for such consideration. Moreover, the changes in SB 822 and SB 861 eliminate any possibility of negative COLAs. Such changes do not impair ORS 238.360(1) (2001) or its counterpart in ORS chapter 238A, if those provisions are terms of the PERS statutory contract.

b. Even if *all* the subsections of both COLA statutes are contract terms, the amendments to those statutes by SB 822 and SB 861 do not impair them.

For the reasons explained above, this court should reconsider its decision in *Strunk* that ORS 238.360(1) is a contract term, and in any event it should decline Petitioners' invitation to extend that holding to the other subsections in ORS 238.360. Subsection (2) of each COLA statute provides the formula for setting the COLA based on the index described in subsection (1). In order for a change in the formula to effect an impairment, there must be a demonstration that the change results in all persons affected by the change receiving less as a result of the change. *See Baltimore Teachers Union v. Mayor and City Council of Baltimore*, 6 F3d 1012, 1015 (4th Cir 1993). But here that cannot be demonstrated, because whether or not any member is better or worse may vary by each member's circumstances. Some may be worse off as a result of the COLA changes in SB 822 and SB 861, but others may be better off. Consequently, even assuming for purposes of argument that the pre-2013 versions of the COLA statutes in their *entireties* are statutory contract terms, SB 822 and SB 861 are nonetheless constitutional because they do not impair those terms.

The COLA statutes as amended by SB 822 and SB 861 decrease the potential upside for the COLA in any year and eliminate the downside. For one year the COLA was 1.5 percent, and beginning in 2014 is an amount based on a formula that is applied to each member's benefit amount in the preceding year. No negative COLA adjustment is possible under SB 822 and SB 861.

The statutes as amended by SB 822 and SB 861 provide a different COLA, but the difference is not an impairment because it is impossible to say that the difference, based on the statutory language of the prior and former versions of the statutes, is better or worse.[19] The history of the index since 1971 opens the door to Petitioners' argument in this case that the current versions of the statutes provide a lesser benefit, but that reasoning is based on events subsequent to the enactment of the statute, not the statutory language. If the index had acted differently during that period and was often less than two percent or negative, the argument would be different. Under those circumstances the various petitioners in this case might have different views as to which is the better provision, because a person retired since 1971 may have a substantial COLA bank while one who retired in 1999 may not. And for OPSRP members who have no bank, the view of which provision is better

[19] The question of whether the modifications in SB 822 and SB 861 violate Article I, section 21, of the Oregon constitution, and hence the federal contract clause, must be determined based on the contract terms themselves. *See generally Strunk*, 338 Or at 145 (analyzing changes to statutes); *Energy Reserves Group*, 459 US at 400 (analyzing whether state's act imposing price controls on intrastate natural gas market impaired contracts that included escalator clauses).

depends on what happens each year, not on what has happened in the past. In a future in which the index is always less than, say, one percent, all members who do not have a COLA bank would prefer the COLA as modified by SB 822 and SB 861 to the former COLAs. And each member who has a COLA bank would favor the former COLA only for so long as that the member's COLA bank would result in COLAs in excess of the amount provided under SB 822 and 861. For this reason, it is impossible to say whether all members over time will receive greater or lesser COLA increases under SB 822 and SB 861 compared with potential increases and decreases under prior versions of the COLA statutes.

Because it is impossible to predict the effect of SB 822 and SB 861 on future COLAs for all members compared with effects of the prior COLA statutes over time, there is no basis on which this court can conclude, even if it begins from the premise that the pre-SB 822 versions of ORS 238.360 and ORS 238A.210 in their entirety are contract terms, that SB 822 and SB 861 impair them.[20]

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[20] SB 822 and SB 861 also have the effect of increasing the "floor," and the floor increases every year, because negative COLAs no longer are possible.

2. SB 656/HB 3349: Elimination of tax remedy payments is not an impairment because doing so is consistent with the statutory terms, whether or not they are contract terms.

A similar analysis applies to the tax remedy changes in SB 822. Even assuming that SB 656 is a contract term, cessation of SB 656 payments to members who do not pay Oregon personal income tax because they are not Oregon residents does not constitute an impairment of that term. SB 656 compensates members who accrued benefits before October 1, 1991, which were not subject to Oregon personal income tax but became subject to that tax as a result of legislation enacted in response to *Davis.* Cessation of SB 656 payments to persons who are not subject to Oregon personal income tax because they are not Oregon residents does not violate SB 656, whether or not it is a contract term.

SB 656 was enacted after the United States Supreme Court's decision in *Davis*, 489 US at 803, holding that states must tax state and federal pension benefits equally. When SB 656 was enacted, PERS benefits payable to retired members who were not residents of Oregon were subject to Oregon income tax. That changed when Congress enacted 4 USC 114, which became effective for tax years beginning January 1, 1996. Oregon subsequently enacted ORS 316.127(9), effective October 4, 1997, which conformed Oregon law to federal law. ORS 316.127(9) is the statute cited in ORS 238.372(1) as the trigger for when a SB 656 or HB 3349 payment must cease. As described in *Vogl*, this court decided in an earlier case that "the 1991 benefit increase was 'compensation' rather than an unlawful tax rebate." The SB 656 increase was enacted in 1991, the same year the legislature eliminated the tax exemption that was the subject of this court's decision in *Hughes*. *Vogl* 327 Or at 199 (citation omitted); *see also* SMR at 25.

This court's description of SB 656 in *Vogl* is supported by its text and history. Section 12 of SB 656 provides that "the increased benefits payable under * * * this Act shall not be paid in any tax year in which the retirement benefits payable under [PERS] are exempt from Oregon personal income taxation." Ex 53 at 5. Section 15 of SB 656 conferred jurisdiction on this court to determine whether "the taxation of retirement benefits received by retired members of [PERS]" and others violated "any constitutional provision." Ex 53 at 6. The legislative history of SB 656 includes that SB 656 was "not a benefit bill, but a bill to resolve a tax issue." Ex 53 at 178. The Legislative Revenue Office indicated that all increases in benefits were contingent on PERS benefits becoming taxable. *Id*. at 310, 347, 374.

Section 12 was included because of this contingency. When SB 656 was under consideration, the legislature also was working on how to resolve the issue raised by *Davis*. One option was to leave PERS benefits exempt from state income tax and also exempt federal pension benefits. Section 12 would have resulted in SB 656 payments not being made if the legislature decided to exempt all state and federal pension benefits from taxation.

Thus, if SB 656 is a statutory contract term, it promises compensation for PERS benefits that, when accrued, were not subject to Oregon personal income tax and became subject to Oregon income tax as a result of the repeal of *former* ORS 237.201 in 1991. Consequently, if a retirement allowance ceases to be subject to Oregon personal income tax because the member receiving the allowance is not an Oregon resident, the statutory basis for making SB 656 payments ceases to exist.

If this court determines SB 656 to be a contract term, then that contract term provides added compensation for PERS benefits that became subject to Oregon income tax after the benefits were accrued by performing service. If a retirement allowance, whether all or part is based on service before PERS benefits were subject to Oregon income tax, is not subject to Oregon income tax because the member is not an Oregon resident, then Section 12 of SB 656 does not require the SB 656 compensation to be paid. Consequently, elimination of SB 656 payments for retired members who are not subject to Oregon personal income tax pursuant to ORS 316.127(9) does not violate the contract term, if it is one.

The same rationale applies to HB 3349, though it should be beyond cavil that it is not a contract term. It also was enacted to be an added payment to compensate PERS members who accrued benefits during the time those benefits were not subject to taxation. As determined by *Hughes*, those members have a contract right that their retirement allowances not be subject to Oregon income tax. *See Vogl*, 327 Or at 199-200. In *Vogl*, this court determined that HB 3349 was a tax rebate, which means it was compensation for the elimination of the tax exemption. Indeed, HB 3349 contains language, codified in ORS 238.362(1), similar to section 12 of SB 656, that HB 3349 benefits shall not be paid in any tax year when the benefits are "exempt from Oregon personal income taxation under Oregon law."

In other words, the legislature could have eliminated SB 656 and HB 3349 payments to out of state residents at any time since PERS benefits paid to non-residents of Oregon ceased to be subject to Oregon income tax. The legislature's choice to allow the windfall to continue from 1996 through 2013 for retired members who are not residents of Oregon did not limit its ability to eliminate the windfall in SB 822.

Some petitioners point out that the legislature, when it enacted HB 3349, knew it was providing a windfall for at least some retirees, because it pegged HB 3349 payments for all members at what was, in 1995, the maximum Oregon personal income tax rate, despite the fact that some members may pay a lower tax rate.

Even if there was unambiguous legislative intent to provide a windfall, such intent does not preclude the legislature from changing its mind, so long as withdrawal of the windfall does not violate a statutory contract term. The statutory contract term relevant to both tax remedy payments is *former* ORS 237.201, repeal of which this court held in *Hughes* breached the PERS contract. Both SB 656 and HB 3349 were enacted to compensate for that repeal. Those tax remedy payments compensate retired members for having to pay Oregon state income tax on the portion of their PERS benefits accrued when PERS benefits were not subject to taxation. Cessation of those payments to retired members whose PERS benefits are not subject to Oregon personal income tax is consistent with the purpose for which SB 656 and HB 3349 were enacted. Out of state residents who accrued benefits when *former* ORS 237.201 was in effect are suffering no damages as a result of the repeal of that statute, because their PERS benefits are not subject to Oregon state personal income tax. Ending tax remedy payments to them does not violate SB 656 or HB 3349.

C. To the extent SB 822 or SB 861 impair any PERS contractual obligation, the impairment is not substantial.

For the reasons discussed above, the court should conclude that none of the statutes affected by SB 822 and SB 861 are terms of the PERS contract or, if they are, that the changes in SB 822 and SB 861 do not impair the contract terms. But if the court disagrees and reaches this third part of the contract clause analysis, the court should conclude that any impairment of the PERS contract caused by SB 822 or SB 861 is not substantial, and therefore does not violate the contract clause of either the Oregon or United States Constitution. Impairments only violate the federal contract clause if they are substantial in nature; the same rule should apply to Article I, section 21.

1. This court should use the substantial impairment standard when conducting an Article I, section 21, analysis.

This court has never ruled on whether an impairment needs to be "substantial" in order to violate Article I, section 21, of the Oregon Constitution (though it considered it in its federal contract clause analysis in *OSPOA*). *See Strunk*, 338 Or at 206 (declining to adopt substantiality requirement because "we need not answer that question in this instance"); *OSPOA*, 323 Or at 361. If this court concludes that SB 822 and SB 861 impair the PERS contract, this court should adopt the federal requirement that such impairment must be substantial into its Article I, section 21, analysis.

The reasons why the court should adopt this standard, and how the standard should be applied, are set forth below.

a. **The requirement that an impairment of the** obligation of contracts be substantial was incorporated into Article I, section 21, at **statehood.**

To determine the meaning of Article I, section 21, this court examines the text of the provision in context, the historical circumstances of the adoption of the provision, and the case law that has construed it. *Priest v. Pearce*, 314 Or 411, 415-16, 840 P2d 65 (1992). The court's goal is to determine the meaning most likely intended or understood by the framers of the constitution. *See e.g., Doe v. Corp. of Presiding Bishop*, 352 Or 77, 87, 280 P3d 377 (2012) (in interpreting the constitution, the court "attempt[s] to understand the provision, if possible, as the framers would have understood it").

Neither Article I, section 21, of the Oregon Constitution nor Article I, section 10, of the United States Constitution uses the word "substantial." However the requirement that an impairment be substantial is a consideration that dates back to *Trustees of Dartmouth College v. Woodard*, 17 US 518, 637, 4 L Ed 629, 4 Wheat 518 (1819) ("Because the government has given it the power to take and to hold property, in a particular form, and for particular purposes, has the government a consequent right substantially to change that form, or to vary the purposes to which the property is to be applied?"). Subsequent United States Supreme Court cases confirm that the substantiality requirement always has been part of the federal contract clause. *See Antoni v. Greehnow*, 107 US 769, 775, 2 S Ct 91, 27 L Ed 468 (1883) (quoting *Von Hoffman v. City of Quincy*, 71 US 535, 553-54, 18 L Ed 403, 4 Wall. 535 (1866)) ("It is competent for the States to change the form of the remedy, or to modify it otherwise, as they may see fit, provided no substantial right secured by the contract is thereby impaired."). In *City of El Paso v. Simmons*, 379 US 497, 503, 85 S Ct 577, 13 L Ed 2d 446 (1965), the court referred to a long line of cases extending back to *Sturges v. Crowninshield*, 17 US 22, 4 L Ed 529, 4 Wheat 122 (1819), "recognizing a distinction between contract obligation and remedy and permitting a modification of the remedy as long as there is no substantial impairment of the value of the obligation."

The framers of the Oregon constitution intended to incorporate the substance of the federal contract clause, as interpreted by the United States Supreme Court at the time of Oregon statehood, into Article I, section 21, of the Oregon Constitution. *Eckles*, 306 Or at 389-90. United States Supreme Court cases decided after 1859 "may shed light on the early history of the federal provision, and thereby on the Oregon provision." *Id*. at 390. Because United States Supreme Court cases both before and after 1859 demonstrate that the substantiality requirement in the federal contract clause pre-dated 1859, the framers of the Oregon constitution intended the substantiality requirement to be part of Article I, section 21. *Eckles* compels this court to include the remainder of the federal analysis in its state contract clause jurisprudence.

Including the substantiality requirement as part of the analysis under Article I, section 21, would align Oregon with the vast majority of states that have a contract clause in their state constitutions.[21] Those states have all concluded in one way or another that when the language in the federal and state

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[21] Of the 39 other states that have a contract clause in their constitutions, at least 31 have either expressly applied the "substantial impairment" standard or have conducted some part of a state and federal contract clause analysis simultaneously. *See, e.g, Hageland Aviation Services, Inc. v. Harms*, 210 P3d 444, 451-52 (Alaska 1992); *Fund Manager v. City of Phoenix Police Dep't Pub. Safety Personnel Retirement Sys. Bd.*, 728 P 2d 1231, 1240-41 (Ariz Ct App 1986); *Ellison v. Tubb*, 749 SW2D 650, 651-53 (Ark 1988); *Calfarm Inc. Co. v. Deukmejian*, 771 P2d 1247, 1262-63 (Cal 1989); *In re Estate of Dewitt*, 54 P3d 849, 858 (Colo 2002); *CDA Dairy Queen, Inc. v. State Ins. Fund*, 299 P3d 186, 190 (Idaho 2013); *Nissan North America, Inc. v. Motor Vehicle Review Bd.*, 7 NE3d 25, 39 (Ill App Ct 2014); *D.A.X., Inc. v. Employers Ins. of Wausau*, 659 NE2d 1150, 1155 (Ind Ct App 1996); *In re Estate of Serovy*, 711 NW2d 290, 294 (Iowa 2006); *Jones v. Board of Trustees of Kentucky Retirement Systems*, 910 SW2d 710, 716 (Ky 1995); *Segura v. Frank*, 630 So 2d 714, 728 (La 1994); *Kittery Retail Ventures, LLC v. Town of Kittery*, 856 A2d 1183, 1194-95 (Me 2004); *Wells Fargo Bank, NA v. Cherryland Mall Led. Partnership*, 835 NW2d 593, 599-600 (Mich 2013); *Jacobsen v. Anheuser-Busch, Inc.*, 392 NW2d 868, 872 (Minn 1986); *Public Employees' Retirement System v. Porter*, 763 So 2d 845, 849 (Miss 2000); *Beatty v. State Tax Com'n*, 912 SW2d 492, 497 (Mo 1995); *Neel v. First Federal Sav. and Loan Assoc. of Great Falls*, 675 P2d 96, 103 (Mont 1984); *The Lamar Co., LLC v. City of Fremont*, 771 NW2d 894, 905 (Neb 2009); *Koscot Interplanetary, Inc. v. Draney*, 530 P2d 108, 113-14 (Nev 1974); *New Jersey Educ. Ass'n v. State*, 989 A2d 282, 290-91 (NJ Super Ct App Div 2010); *Los Quatros, Inc. v. State Farm Life Ins. Co.*, 800 P2d 184, 194 (NM 1990); *First Federal Sav. and Loan Ass'n of Grand Forks and Minot v. Haley*, 357 NW2d 492, 494 (ND 1984); *Doe v. Ronan*, 937 NE2d 556, 562 (Ohio 2010); *City of Tulsa v. State*, 278 P3d 602, 608 (Okla 2012); *Rhode Island Insurers' Insolvency Fund v. Leviton Mfg. Co., Inc.*, 716 A2d 730, 736 (RI 1998); *Rick's Amusement, Inc. v. State*, 570 SE 2d 155, 159 (SC 2001); *Buchholz v. Storsve*, 740 NW 2d 107, 113 (SD 2007); *Working Waterman's Assoc. of Virginia, Inc. v. Seafood Harvesters, Inc.*, 314 SE2d 159, 163 (Va 1984); *Pierce Cty. v. State*, 148 P 3d 1002, 1009-10 (Wash 2006); *State ex rel. West Virginia Reg'l Jail and Corr. Facility Auth. v. West Virginia Inv. Mgmt. Bd.*, 503 SE2d 130, 134 (W Va

Footnote continued…

contract clauses are similar, the analysis should be similar too. This court should reach the same conclusion.

b. Whether an impairment of the obligation of contracts is substantial depends on the facts and circumstances of the impairment.

Because this court has never decided whether Article I, section 21, has a substantiality requirement, there has never been occasion to determine which kinds of impairments are substantial and which are not. If the court reaches this third part of the contract clause inquiry, the court should make that determination. As discussed below, the court should hold that whether an impairment is substantial depends on the facts and circumstances of the alleged impairment, consistent with the principles outlined in this section.

In *Strunk*, this court assumed without deciding that there was a substantiality requirement and concluded that the 2003 change to the guaranteed rate of return on Tier One employee accounts was substantial. The *Strunk* court found that change to be substantial for two reasons. First, the evidence showed that the change would decrease retirement allowances for Tier One members by 12 to 20 percent. Second, the change decreased accrued

(...continued)
1998); *Chappy v. Labor and Industry Review Com'n, Dep't of Industry, Labor and Human Relations*, 401 NW 2d 568, 574 (Wis 1987).

benefits based on past work. *Strunk*, 338 Or at 206.[22] In reaching this conclusion, however, the *Strunk* court did not announce any standard for determining what constitutes a substantial impairment. We therefore turn to the federal cases for guidance as to what constitutes a "substantial" impairment.

The United States Supreme Court has "provided little specific guidance as to what constitutes a 'substantial' contract impairment." *Baltimore Teachers Union*, 6 F3d at 1017 (4th Cir 1993). The constitutional prohibition on impairment of contracts "is not an absolute one and is not to be read with literal exactness like a mathematical formula." *Home Building & Loan Assn. v. Blaisdell*, 290 US 398, 428, 54 S Ct 231, 78 L Ed 413 (1934).

The court has made clear that on one end of the spectrum, technical impairments or minimal alterations are not substantial. *See Allied Structural Steel Co. v. Spannaus*, 438 US 234, 245, 251, 98 S Ct 2716, 57 L Ed 2d 727 (1978); *US Trust*, 431 US at 21. And on the other end of the spectrum, "total destruction of contractual expectations" is not necessary either. *Energy Reserves*, 459 US at 411.

"The ground between these spectral ends, though, has yet to be charted with any precision." *Baltimore Teachers Union*, 6, F3d at 1017. Some

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[22] This second factor is absent in the present case; to the contrary, COLAs and tax remedy payments are add-ons to benefits based on past work, additional compensation for past work, or both. Consequently, this second factor militates against a finding of substantiality in the present case.

principles can be discerned, however. An impairment is substantial if it interferes with core expectations of the parties to the contract, such as terms that induced the parties to contract in the first place, or terms on which the parties had especially relied. *Id.* (citing *Spannaus*, 438 US at 243 n 14; *City of El Paso*, 379 US at 514). The degree to which the subject matter of the contract was already subject to state regulation is another factor in substantiality. *United Healthcare Ins. Co. v. Davis*, 602 F3d 618, 628 (5th Cir 2010) (citing *Energy Reserves*, 459 US at 415-16); *see also Veix v. Sixth Ward Bldg. & Loan Ass'n of Newark*, 310 US 32, 38, 60 S Ct 792, 84 L Ed 1061 (1940).

Conversely, "state regulation that restricts a party to gains it reasonably expected from the contract does not necessarily constitute a substantial impairment." *Energy Reserves*, 459 U.S. at 411 (citing *U.S. Trust*, 431 US at 26–27, 37; *City of El Paso*, 379 US at 515). Similarly, "elimination of unforeseen windfall benefits" is not a substantial impairment either. *US Trust*, 431 US at 31 n 30; *see also Richmond Mortgage & Loan Corp. v. Wachovia Bank & Trust Co.*, 300 US 124, 130, 57 S Ct 338, 81 L Ed 552 (1937) (upholding a state law that limited mortgage rights to prevent party from obtaining "more than his due").

In some cases, the alleged impairment is not financial and cannot be quantified in percentage or other terms. *See, e.g., City of El Paso*, 379 US at 588 (limiting period to make payment in arrears). Even where money is directly concerned, however, it is still the character and nature of the change, not the *magnitude*, that controls. For example the United States Supreme Court found a substantial impairment when a state act imposed retroactive pension benefits on employers. *Spannaus*, 438 US at 247. There, the court found that the act "substantially altered" contractual relationships by imposing obligations on the employer beyond what it agreed to. *Id*. at 240. There is no indication that the decision turned on the amount the employer would have to pay under the act.

In summary, in order to determine whether an impairment is substantial, the court should consider factors such as the parties' reasonable expectations, the degree to which the parties relied on the term being impaired, whether the contract term induced the parties to form a contract, and the degree to which the underlying subject matter was regulated before the formation of the contract. The court should also consider whether the impairment merely brings parties back to gains reasonably expected from the contract, or whether it eliminates unforeseen windfalls.

2. None of the changes enacted by SB 822 or SB 861 substantially impair any contractual obligations.

Applying the principles just discussed, to the extent that the COLA and tax remedy provisions are contract terms at all, the changes brought about by SB 822 and SB 861 do not substantially impair the obligation of any contract terms. The changes do not interfere with reasonable expectations of any contract; they do not affect terms of the contract on which the parties especially relied or terms that induced the parties to enter into the contract. All SB 822 and SB 861 do is restrict parties to gains that could reasonably have been expected and eliminate any windfalls. As explained below, the evidence in the record demonstrates that that the projected impacts of SB 822 and SB 861—either on a petitioner-specific or an aggregate level—are different both in degree and in kind to changes that this court assumed to be substantial in *Strunk*. While SB 822 and SB 861 adjust the specific *manner* in which COLAs are calculated and make common-sense changes to eligibility requirements for tax remedy payments, the legislature's ability to make those kinds of changes is fully consistent with the reasonable expectations of both the legislature which created the PERS contract and the PERS members who accepted its terms.

a. The COLA changes in SB 822 and SB 861 do not rise to the level of substantial impairments.

With respect to the changes that SB 822 and SB 861 make to COLA calculations, the evidence in the record demonstrates that that the projected impacts of those changes—either at a petitioner-specific or an aggregate level—are not substantial. As noted above, in *Strunk*, this court assumed a reduction in *retirement allowances* provided under ORS 238.300 was substantial. Importantly, however, the 12 to 20 percent impacts assumed to substantial in

Strunk were impacts on core retirement allowances that members had already accrued or were accruing. The COLA changes here are different in kind. COLAs payments are added after retirement, and so, unlike the modification to retirement allowances at issue in *Strunk*, the change to the COLA calculation is not a change to a benefit already accrued based on service performed. In addition, COLA changes are different in degree. The projected reductions in future COLAs as a result of SB 822 and SB 861 are less—in some cases far less—than the 12 to 20 percent benefit reductions assumed by the court in *Strunk* to be substantial.

The evidence in this case analyzes expected reductions in overall benefits paid over time as a result of SB 822 and SB 861 both on the aggregate and petitioner-specific level. The Moro Petitioners point out that, in aggregate, the effect of the $5.3 billion reduction in system liabilities resulting from both SB 822 and SB 861 is $16,000 per PERS member. Moro at 35. This compares with average benefits of $209,205 based on total system liabilities of $69.2 billion before enactment of SB 822. Ex. 27 at 3. This reduction on a per member basis is 7.65 percent.

The percentage reductions for individual petitioners vary from this aggregate. The impacts of SB 822 alone vary widely, from as little as .83 percent on Moro and 1.9 percent on Domenigoni to more than 10 percent on Riemer and more than 12 percent on Silence. Exs S9, S10, S19, S24. As detailed below, even when the combined impacts of SB 822 and SB 861 are considered, only the impacts on Silence reach 12 percent, but the projections for Silence are the least reliable as to all petitioners. The next closest is Riemer at 11.64 percent, but a portion of his reduction results from the tax remedy change because he is an out of state resident.

Projections for unretired petitioners are less reliable than for retired members. For retired petitioners, employment histories are complete, years of service, salaries, beneficiary selection and age at retirement are known. The only material unknown is how long they will live, and for that State Respondents rely on life expectancies determined by the PERS actuary. *See* Ex S27 at 18 (explaining deficiencies in life expectancies used by Moro Petitioners). *See* SMR at 58-60.

For unretired petitioners, however, virtually all inputs into the projections are assumed, and the assumptions become less reliable the farther the petitioner is from retirement. For example, petitioner Silence's projections involve the following assumptions: that he will retire in 2035, that from now until retirement he will not change employment, that he will retire under the "police and fire" classification which provides greater benefits than general service, that his marital status will not change, and that he knows now the benefit option he will choose more than 20 years hence. *See* Ex 19. Given how speculative all of those assumptions are, State Respondents urge this court to give little weight to the evidence on Silence because the assumptions on which his projected benefits are based are the least likely to reflect what his actual experience will be.[23]

Moreover, the petitioner-specific evidence does not provide any basis for extrapolating effects as to all PERS members. All parties agree that the petitioners are not a representative sample of PERS members. SMR at 58 n 113. For example, fifteen of the sixteen petitioners chose, or indicate that when they retire they will choose, joint annuity options. *See* Exs S9 to S24. But only 50 percent of all retirees choose those options. Ex 49 at 8 (sum of Options 2, 2A, 3 and 3A). Election of a joint annuity option lengthens the total payout period because that period is based on two lives. Consequently, the petitioner-specific evidence skews the length of the payout period beyond what a representative sample would be. A longer payout period necessarily increases the compounding effect of COLAs, thereby magnifying impacts as time goes on.

It is important to note that all impacts on petitioners of the COLA changes in SB 822 alone or in conjunction with SB 861 are based on a

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[23] One of the petitioners, Johnson, was not yet retired during the Special Master proceedings but was projected to retire on July 1, 2014. Accordingly, among the unretired petitioners, the projections as to Johnson are the most reliable. The reliability of the assumptions, and hence the projections, as to all unretired petitioners decreases the farther each is from retirement, with projections as to Silence being the least reliable.

comparison of COLAs under those bills with COLAs assumed to be positive two percent in perpetuity for all petitioners had SB 822 and SB 861 not been enacted. This assumption is used despite the fact that there is no certainty as to what all future COLAs would have been. Additionally, the impacts of SB 822 as amended by SB 861 are greater for each petitioner than the impacts of SB 822 alone, due to the additional reduction in potential future COLA increases in SB 861. Here, State Respondents analyze the aggregate SB 822/SB 861 COLA impacts because, if they are not substantial, then the SB 822 impacts necessarily are not substantial.[24]

SB 822 on its own or as modified by SB 861 results in reduced COLA increases that, over the petitioners' actuarially determined life expectancies, decrease the benefits they are projected to receive during their lifetimes by less than 12 percent (compared against the two percent assumption described above). The only petitioner who appears to be impacted that much is Silence who, as described above, has the least reliable projections because his projected retirement date is so far away. Consequently, if this court applies a mathematical test and determines that impacts at the level it assumed in *Strunk* result in a substantial impairment, the evidence as to the sixteen petitioners in

[24] If the court perceives a need to parse the evidence beyond what is presented in the briefs, State Respondents suggest that the court establish the legal basis for the need to further parse the evidence and set additional proceedings before the Special Master for that purpose.

this case, considered as a whole, is not sufficient to support a holding that the reductions in future COLA increases substantially impair the obligation of the PERS statutory contract.

The highest impact, once again, is on Silence, at 14.15 percent. Ex S19. The next highest impact is on Riemer at 11.64 percent, but the reduction based on COLA alone is about two percent less than that. *Compare* Ex S24 at 1 with Ex S25 at 5.[25] Custer is the outlier at the low end (4.48 percent, Ex S11) while eight range from 6.3 to 9 percent. Exs S9, S10, S12, S13, S16, S18, S20, S23. The other five range from 9.45 to 11.06 percent. Exs S14, S17, S15, S21, S22. The 11.06 percent impact is on Reynolds, but nearly three percent of that is related to cessation of SB 656 benefits because he resides outside of Oregon. *See* Ex. S25 at 4.

With the exception of Silence – whose projections are unreliable for the reasons given above – no impact on any petitioner meets the 12 percent level assumed in *Strunk* to be substantial. Moreover, all of the impacts are calculated assuming two percent COLAs in perpetuity had there been no legislation. Applying that assumption to all present and future PERS retirees likely

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[25] The first page of Ex S24 shows aggregate impacts on Riemer of SB 822 and SB 861. Ex S25 shows the percentage reductions from cessation of tax remedy benefits for the five petitioners challenging Sections 11-17 of SB 822. The reduction for Riemer is 1.98 percent. Consequently, 1.98 percent of the aggregate SB 822, or SB 822 and SB 861, impact is not related to the COLA.

overstates what COLAs would have been if SB 822 and SB 861 never were enacted. While Tier One and Tier Two retirees with large COLA banks were more likely to have two percent COLAs each year, the same is not true for OPSRP members because they never had COLA banks. OPSRP members received COLAs of less than two percent in 2009 and 2010. *See* Ex 48 at 7. And even Tier One and Tier Two members did not always receive two percent COLAs. *See Id.*

Aggregate projections by the PERS actuary, on the other hand, reflect the actual experience of the system and its members over time, which makes future projections more reliable because those projections are based on the experience of all PERS members over time. *See generally* Ex 43 at 1-15 (actuarial report, explaining scope). The aggregate analysis compels the same conclusion. The aggregate reduction on a per-member basis is 7.65 percent in future payments, based on all changes enacted in SB 822 and SB 861. The COLA impact is about one-half percent less than that, because $400 million of the $5.3 billion liability reduction results from elimination of tax remedy payments for out of state retirees.[26]

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[26] The PERS actuary projected the elimination of tax remedy payments to out of state retirees would reduce system liabilities by approximately $400 million, Ex 20 at 1, of the $5.3 billion total reduction resulting from both SB 822 and SB 861.

As the discussion above demonstrates, the changes to the COLA calculation enacted in SB 822 and SB 861 reduce benefits from what they would have been if COLAs are assumed to remain at two percent in perpetuity. As a matter of degree, that reduction is not so large as to be "substantial." Thus, the above analysis shows that, even if one assumes that PERS members reasonably could have expected that they were guaranteed annual two percent COLAs in perpetuity, the changes made by SB 822 and SB 862 are not substantial.

The relevant question here is the extent to which the changes in SB 822 and SB 861 interfere with the overall benefits which PERS members reasonably expected. In that regard, it is important to note that total benefits that PERS members now receive *far* exceed the benefit levels that the legislature was seeking to achieve when it adopted the COLAs. The legislative history of the 1973 Act amending the COLA statute includes that the goal of that legislation was to increase amounts paid to reach the equivalent of a replacement ratio—the ratio of benefits at retirement to final salary—of 48 percent for a person with 30 years of service. Ex 51 at 7.[27] The evidence in this case is that system-

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[27] In its analysis in *Strunk* of ORS 238.300, this court said that the legislature in 1955 intended to increase replacement ratios to 50 to 60 percent of final average salary when it enacted the Full Formula. *Strunk*, 338 Or at 187. How it could have exceeded 50 percent for members with 30 years of service is puzzling because, arithmetically, the formula results in a benefit that is 50

Footnote continued...

wide average replacement ratios for retirees with 30 years or more of service was 100 percent in 2000, declining to 70 percent in 2012, while the replacement ratio for all retirees regardless of years of service was 46 percent in 2012. SMR at 13. On this basis alone, this court should conclude that increases in total benefits, including increases from COLAs, resulted in total benefits that exceeded what members reasonably could have expected in 1973, which is when the version of the COLA statute the Moro Petitioners contend is the contract term was enacted. Moro at 57-58. Prospective elimination of the COLA in its entirety, therefore, would not reduce overall benefits below that reasonable expectation. *See Energy Reserves Group*, 459 US at 411 (state regulation restricting party to gains reasonably expected under the contract not necessarily a substantial impairment.)

The replacement ratio for each petitioner in this case is shown on page one of Exhibits S9 through S24. Ten of the sixteen petitioners have replacement ratios greater than 48 percent, including some who retired or are projected to retire with less than 30 years of service. Exs S9, S11-S-16, S19,

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(...continued)
percent of salary after 30 years of service (final salary x 1.67 percent x 30; 30 x 1.67 percent = 50 percent). In any event, this analysis is unaffected by whether the target replacement ratio was 48 or 50 percent. And the fact that the 1973 legislature increased the range of COLAs to enable total benefits to reach a replacement ratio of 48 percent suggests that the smaller range enacted in 1971 was not enough to reach a 48 percent replacement ratio.

S21, S24. Of the six with replacement ratios less than 48 percent, two retired and the other four are projected to retire with less than 30 years of service. Exs S10, S17, S18, S20, S21, S22. All petitioners, therefore, received or are projected to receive benefits at the time of retirement exceeding the replacement ratio contemplated when the COLA statute was amended in 1973. There has been no showing that the prospective changes in the COLA or the elimination of tax remedy payments for non-residents of Oregon decreased total benefits paid to the petitioners below what was expected at the time those statutes were enacted.

Such a showing cannot be made. Nothing in SB 822 or SB 861 decreases benefits for any member below what the member was, or will be, entitled to at retirement. The bills mandate changes in COLAs that are awarded *after* retirement. The elimination of tax remedy payments for persons not subject to Oregon income tax did not reduce their retirement allowances. Rather, those changes eliminate payments made to compensate for portions of retirement allowances based on service before October 1, 1991, being subjected to Oregon income tax, but only for persons who are not subject to Oregon income tax.

Thus, the changes enacted in SB 822 and SB 861 do not decrease payments below what members reasonably could have expected when the COLA and tax remedy statutes were enacted. Moreover, the evidence in this case demonstrates that the magnitude of the reductions compared with what members' might have expected as of 2011—albeit without a statutory basis for doing so—is not substantial in the sense required in order to support a holding that there is a substantial impairment of the obligation of a contract term.

b. The tax remedy change in SB 822 does not rise to the level of a substantial impairment.

The evidence in the record shows that that the changes in SB 822 are not substantial as to tax remedy payments, either. The only change to the tax remedy payments was to eliminate eligibility to those who are out of state and not paying Oregon income taxes. The purpose of the tax remedy is to compensate members who are paying state taxes on their benefits. For those who are *not* paying such taxes, the tax remedy payments are essentially a windfall. Elimination of that windfall cannot be a substantial impairment.

In any case, the changes to the tax remedy payments do not substantially impair the obligation of any contract term for two other reasons. First, like the COLA payments, tax remedy payments are added after retirement and so, unlike the modification to retirement allowances at issue in *Strunk*, the change to the tax remedy is not a change to a benefit already accrued based on service performed. Second, as explained below, the impacts resulting from SB 822's elimination of tax remedy payments to certain PERS members is significantly less than the impacts of the COLA changes, and far less than the 12 to 20 percent reductions assumed in *Strunk* to be substantial.

The maximum tax remedy payment under SB 656 is four percent. That amount is added to the retirement allowance, as adjusted by any applicable COLA, of a member eligible for the tax remedy payment who has at least thirty years of service. Of the five petitioners who reside out of state and claim that sections 11 to 17 of SB 822 violate their rights, two, Smith and Jones, qualify for that percentage. Two of the others, O'Kief and Reynolds, qualify for three percent (at least 25, up to 30 years of service) and Riemer qualifies for two percent (at least 20, up to 25 years of service). Exs S15, S16, S22-24. Assuming, *arguendo*, that out of state petitioners are entitled to receive SB 656 payments despite residing out of state, elimination of those payments results in, at most, four percent reductions. The amount does not compound; it is a simple addition to the benefit in each year. *See* Ex S26 at 21.

All of the petitioners eligible for SB 656 benefits also are eligible for, and before enactment of SB 822 were receiving, benefits under HB 3349 and not under SB 656, because the HB 3349 benefits for each of them were greater. *See* ORS 238.364(1); Ex S26 (Rodeman Dec) at 21, 23. However, because ORS 238.362(3) provides that HB 3349 cannot be a term of the PERS statutory contract, if the petitioners have any right to any compensation for the breach discussed by this court in *Hughes*, it is only to SB 656 payments. For this reason, the spreadsheets submitted by State Respondents analyze the payments the petitioners would be entitled to, if this court rejects State Respondents' arguments in their entirety, to include SB 656, not HB 3349, payments. *See* Ex S9 to S24.

The question, therefore, is whether a four percent (at most) reduction in total amounts paid each year is a substantial impairment. The percentage amount is one-third of what this court assumed to be a substantial impairment in *Strunk*. Under all of the facts and circumstances applicable to SB 656 payments, this court should conclude that the reduction, even if it is an impairment of a contract term, is not substantial.

Those factors include that the reduction does not apply to all retired members; it applies only to those who are not subject to Oregon income tax because they live out of state. As discussed above in Section I.A.2, the SB 656 benefits are paid to compensate for PERS benefits accrued before October 1, 1991, being subjected to Oregon state income tax. Withdrawal of that compensation from retired members who are not subject to Oregon income tax because they reside out of state is not a withdrawal of a benefit to which those persons are entitled.

Moreover, the amount of the reduction itself is insubstantial relative to overall benefits. We use Petitioner Jones as an example, because in present value terms, his percentage reduction based on elimination of only SB 656 payments over his expected lifetime is the greatest among the five out of state petitioners, 3.71 percent, a reduction of $41,442 compared to total benefits of more than $1 million. Ex S25 (showing reductions related only to elimination of SB 656 payments). If this court upholds the changes to the COLA statutes, the reduction related to SB 656 will be even less, because each year the SB 656 amount will be applied to a total benefit (based on a service retirement allowance and accumulated COLAs) that increases by less than two percent each year. In that circumstance, elimination of Petitioner Jones' SB 656 payments would total less than $37,000. Ex S23, p 4 (sum of benefits in "Monthly Tax Remedy" column, beginning with 2014).

The percentage reduction for Petitioner Jones is well below the 12 percent level posited in *Strunk* as being substantial. For the other four petitioners on this issue, the percentage reduction is less than for Petitioner Jones. In all cases, elimination of SB 656 payments does not reduce or otherwise affect any member's retirement allowance; it eliminates a payment added on to retirement allowances to compensate for those allowances being subject to Oregon income tax. For out of state petitioners, those allowances are not subject to Oregon income tax. Elimination of the benefit for out of state residents does not impair, substantially or otherwise, any term of the PERS statutory contract

In sum, the COLA and tax remedy changes enacted in SB 822 and SB 861, viewed separately or in aggregate, based solely on SB 822 or both bills, do not substantially impair any term of the PERS contract. The changes do not interfere with any reasonable expectations about PERS benefits. Nor do the changes reduce any benefits accrued by working or payments made in the past. The COLA changes reduce the rate by which total benefits paid will increase in the future, and the tax remedy changes eliminate compensation for having to pay taxes, but the affected members do not have to pay those taxes. The tax remedy changes eliminate a windfall, and none of the changes reduce gains that reasonably could have been expected at the time the COLA and tax remedy statutes were enacted. For all of those reasons, even if the COLA and tax remedy statutes are contract terms, the changes to them by SB 822 and SB 861 do not substantially impair the obligation of those terms.

D. Even assuming that SB 822 and SB 861 substantially impair any obligation of the PERS contract, that impairment would be justified by a significant and legitimate public purpose.

If the court concludes that SB 822 or SB 861 substantially impair a term of the PERS contract, the last step in the analysis is what the federal cases describe as the second and third prongs: whether the change is justified by a significant and legitimate public interest (second prong), and whether the adjustment of the rights and responsibilities of the contracting parties is based upon reasonable conditions and of a character appropriate to the public purpose justifying the law's adoption (third prong). *Eckles* compels this court to include those in its consideration of the issues under Article I, section 21. *See* above, Section I.C.1.a. When it completes this analysis, the court will have addressed all issues under both the state and federal contract clauses. *See* Section I, above.

SB 822 and SB 861 reduced system liabilities by $5.3 billion, which enabled PERB immediately to reduce employer rates for 2013-15 by an aggregate 4.28 percent, resulting in PERS-participating employers having more than $800 million available for education, public safety and other government services. Those savings continue and compound in future biennia. Employer rates no longer are projected to reach and stay for 20 years at the crippling levels projected by the PERS actuary before enactment of SB 822. *See* SMR at 27-28; Ex S27 at 10.

Those circumstances compelled action, as requested by the Governor. *See* Ex 59 at 31. If this court concludes that the changes made by SB 822 and SB fail the third part of the four part inquiry, the court should conclude that the changes made by SB 822 and SB 861are justified by a significant and legitimate public purpose and are of a character appropriate to the public purpose, justifying the law's adoption. The brief submitted to this court on behalf of Linn County, all school district respondents and intervenors Association of Oregon Counties and Oregon School Boards Association address the final two prongs of the analysis. State Respondents refer the court to that argument.

II. Petitioners' other constitutional arguments are meritless.

In *Strunk*, after fully analyzing the state contract clause issues, the court turned to other constitutional arguments raised by the petitioners:

> "The foregoing holdings dispose of those claims, either because we have voided the challenged legislation in light of petitioners' state contract claims or because our determination of the particular obligations set out in the PERS contract obviates the fundamental premise of petitioners' remaining claims (that is, that the PERS contract granted them 'rights' that cannot be breached, impaired, or taken for public use)."

338 Or at 237-38. Similarly here, this court's disposition of the contract clause issues will either dispose of or moot most of the other constitutional issues raised by Petitioners.

A. All takings claims rise or fall based on this court's holding on the contract clause issues.

The Moro Petitioners and Petitioner Riemer assert a variety of claims under state and federal takings clauses based on a property interest, whether in COLAs, tax remedy payments or the COLA bank. Moro at 78; Riemer at 29. The asserted property interests are based on whether Petitioners' have a contract right to those items. If this court determines that they have such a property interest, this issue is moot because Petitioners will prevail based on the contract clause holding. If this court finds no contract clause violation, that holding disposes of the takings claim because the property right on which they are based does not exist. *See Strunk*, 338 Or at 237-38.

B. Elimination of tax remedy payments for out of state petitioners does not violate the Privileges and Immunities or Equal Protection Clauses of the state or federal constitutions.

Petitioners Jones and Riemer argue that SB 822's elimination of tax remedy payments violates the Privileges and Immunities or Equal Protection Clauses of the state and federal constitutions. It does not. Petitioner Jones' and Riemer's argument is not grounded in applicable law.

1. Cessation of tax remedy payments does not discriminate on the basis of residency.

Petitioners Jones and Riemer argue that Sections 11-17 of SB 822 discriminate against them because it provides that receipt of SB 656 or HB 3349 payments depends on residency. Again, this court's disposition of the contract clause claim may moot this issue or dispose of it against Petitioners.

In any event, beginning on January 1, 2014, whether a retired member receives SB 656 or HB 3349 payments depends on whether the member is subject to Oregon personal income tax. ORS 238.376. That determination is based on residency because 4 USC 114 and ORS 316.127(9) prohibit taxation of pension benefits by the source state when the beneficiary is not a resident of that state. Rather than discrimination on the basis of residency against Petitioner, it is a consequence of federal tax law. He may obtain his tax remedy payment by resuming residency in Oregon. If he does, all of his PERS benefits will be subject to Oregon income tax, not just the tax remedy portion.

As discussed in Section I.A.2.a, above, tax remedy payments are compensation for taxation on benefits accrued prior to October 1, 1991. Benefits accrued at that time were not subject to Oregon income tax, but they later became subject to Oregon income tax. Whether a member receives tax remedy payments depends on whether the member is a resident of Oregon, but that is because those payments are compensation for damages for the breach determined by this court in *Hughes*. Members who are not residents of Oregon do not suffer those damages because they are not subject to Oregon personal income tax.

2. The process for reestablishment of tax remedy payments does not violate any constitutional provision.

Petitioner Riemer asserts that the process for reinstatement of tax remedy payments upon reestablishment of Oregon residency violates the Equal Protection Clause of the Fourteenth Amendment to the United States Constitution and Article I, section 20, of the Oregon Constitution. Riemer at 38. His argument is that because SB 822 provides for an annual on/off switch he will be deprived of payments if he reestablishes residency in Oregon and his HB 3349 payment is not resumed immediately (Petitioner Riemer's HB 3349 benefit is greater than his SB 656 benefit, Ex 24).[28] His argument fails for any of three reasons.

First, it is not justiciable**.** Petitioner Riemer is a resident of Arizona and there is no evidence he intends to relocate and reestablish Oregon residency. *See* SMR at 80. His claim is not ripe and therefore not justiciable. *See Strunk*, 338 Or at 154.

Second, similarly, Petitioner Riemer's argument is predicated on the notion that, if he ever reestablishes Oregon residency, there will be a time lag before his HB 3349 payments begin to be paid. But there is no evidence to support that assertion. The statutes provide for a determination to be made once a year, but when implementing sections 11 through 17 of SB 822 and after notifying affected members that their tax remedy payments would be discontinued, PERS reinstated payments upon receiving timely notice from members that they were Oregon residents. *See* Ex S26 (Rodeman Dec) at 11-12. This suggests the possibility that PERS may implement a corrective process for members who change residency mid-year. For this separate reason, his argument is not ripe.

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[28] Petitioner Riemer is not concerned about the flip-side of this on/off switch, which would result in HB 3349 or SB 656 payments continuing during the year that a retired member who is an Oregon resident moves out of state.

Moreover, the extent to which any delay in reinstatement of SB 656 or HB 3349 payments may be impermissible will turn on whether the person experiencing a delay has a contract or other right to the payment. Once again, that claim will be either mooted or disposed of by this court's decision on the contract clause issues.

C. Petitioner Riemer's contention that a failure to provide pre-deprivation notice of changes in his benefits violated due process is not grounded in law and is factually incorrect.

Petitioner Riemer argues that the changes to his COLA adjustment and cessation of tax remedy payments were done "unilaterally without affording him any individualized pre-deprivation notice of the legal basis for doing so or an opportunity to challenge those actions before they went into effect." His assertion ignores evidence he submitted in this case. *See* SMR at 79 (quoting letter from PERS regarding cessation of tax remedy payment).

As for the COLA, he filed his initial petition in this case on July 1, 2013, one month before the 2013 COLA would be reflected in his monthly benefit payment. No additional process was, or is, due.

Whether pre-deprivation notice is required depends on a balancing of three factors: (1) the private interest affected, (2) the risk of an erroneous deprivation under existing procedures and the value of more elaborate procedures, and (3) the governmental interest, including fiscal and administrative burdens, affected. *Mathews v. Eldridge*, 424 US 319, 335, 96 S

Ct 893, 903, 47 L Ed 2d 18 (1976). Again, this court's disposition of the contract clause issue will determine the private interest affected and likely moot this issue or dispose of it. *See Strunk*, 338 Or at 237-38.

III. Petitioners' non-constitutional arguments are meritless.

A. SB 822 and SB 861 did not breach any term of the PERS contract for the same reasons they did not impair it.

If the state impermissibly changes a statutory contract term, there is a breach of contract when the change causes damages and an unconstitutional impairment when the change alters future obligations. The contractual analysis is the same; the only difference is whether damages must be paid in the event of a breach or, in the event of impairment, specific performance is required. *See Eckles*, 306 Or at 399-401. Consequently, as with Petitioners' constitutional claims other than under the state or federal contract clauses, whether SB 822 or SB 861 breach any contract term depends on this court's analysis of the impairment issues.

When enacted, SB 822 and SB 861 affected only future rights. Unlike the statutory change at issue in *Hughes* that this court determined to be a breach, neither SB 822 nor SB 861 affect any benefits accrued based on service performed. However, COLAs in 2013 and 2014 and elimination of tax remedy payments to out of state residents as of January 1, 2014, have been implemented according to SB 822 and SB 861. Those changes could result in a breach only if this court determines that those bills violated Article I, section 21. The analysis to make that determination is the same as discussed in Section I, above. Because there is no constitutional violation, there is no breach.

B. Arguments by Petitioners Jones and Riemer based on the notion of a contract established at the time of retirement mis-apply this court's holdings on what constitutes the PERS statutory contract.

Petitioners Jones and Riemer suggest that SB 822 and SB 861 violate a contract made at the time of retirement. Again, those arguments are derivative of the contract clause issues discussed in Section I. If this court finds no violations of the state or federal contract clauses, that finding will at least partially dispose of those arguments and if this court holds that SB 822 or SB 861 violate either contract clause, that holding would moot this issue in its entirety.

Petitioner Riemer asserts that "[o]nce a public employee has retired, unilateral changes to [retirement] benefits are prohibited by Article I, Section 21" of the Oregon constitution and permitted by the federal contract clause only under the "public purpose" analysis (discussed in Section I.D, above). Riemer at 11. As described in the Summary of Facts, above, and elsewhere, none of the changes made by SB 822 or SB 861 affect benefits accrued based on service. Those benefits, the "service retirement allowance" determined under ORS 238.300, cannot be diminished and are not affected by SB 822 or SB 861.

Petitioner Jones argues that the Notice of Entitlement (NOE) issued to him by PERS upon retirement established contract rights. Jones at 6-7, 18. The NOE is a communication from PERS to a member about the member's expected retirement benefits. As such, Petitioner Jones' argument is meritless based on the holding in *Strunk* that statements by PERB cannot change the statutory contract. *Strunk*, 338 Or at 175.

Three other points undercut Petitioner Jones' argument that the NOE establishes contract rights. First, if PERS pays benefits based on a NOE and those benefits are erroneous, PERS may correct them, including if the error resulted in an overpayment. *See Strunk*, 338 Or at 222. Second, Petitioner Jones's NOE, which is Exhibit B to his Petition dated June 19, 2013, indicates a monthly benefit of $5248.12 but says nothing about COLA or tax remedy payments. Consequently, if the NOE establishes his post-retirement rights, it fails to establish his right to COLAs or tax remedy payments.

Third, Petitioner Jones argues that the NOE creates contract rights because it shows his election of an Option 2 benefit and, despite his wife's subsequent death, the NOE will not allow him to change to a different option. He is correct that he cannot change his benefit option, but that limitation derives from ORS 238.305(6), which allows a change only from Options 2A or 3A upon the death of a spouse.

C. Petitioner Reynolds' argument that the cessation of tax remedy payments for out of state residents is a tax in violation of federal law rests on a fundamental misunderstanding of "tax."

Petitioner Reynolds contends that withdrawal of tax remedy payments taxes retirement incomes. SB 822 did not enact a tax. The cessation of tax remedy payments is just that, cessation of an add-on to retirement benefits. It does not trigger any requirement for anyone to pay anything to a government authority.

Petitioner Reynolds points out that a tax is measured by income. But the fact that tax remedy payments are determined by multiplying a retirement allowance by a percentage does not make cessation of the payments a tax measured by income. The cessation of the payments lacks the fundamental characteristic of a tax – it does not raise revenue.

Petitioner Reynolds' reasoning would transform any benefit reduction, whether unemployment compensation, Medicare, Medicaid, or any public assistance, into a tax. To the contrary, this court has strictly construed the phrase "bills for raising revenue," to include only those bills with a primary purpose of raising revenue and to exclude bills which only incidentally generate revenue. *Northern Counties Investment Trust v. Sears*, 30 Or 388, 402-03, 41 P 931 (1895). The characteristic feature of a bill for raising revenue is that it imposes a tax on the people for the use of government. *Id.* at 403; *Twin City*

Bank v. Nebeker, 167 US 196, 17 S Ct 766, 42 L Ed 134 (1897), *Dale v. Kulongoski*, 322 Or 240, 242-43, 905 P2d 844 (1995). Sections 11 through 17 of SB 822 do not raise revenue directly, indirectly or incidentally.

D. Cessation of tax remedy payments non-residents of Oregon is consistent with the *Stovall* Settlement

Petitioners Jones and Riemer assert that cessation of their HB 3349 payments violate the settlement in *Stovall*. Jones asserts that cessation of those payments violates his contract. Jones at 32. That assertion is addressed in Section I, above.

Riemer asserts that he "is still entitled to a remedy for the damages he suffered by repeal of the law that" this court in *Hughes* determined to breach the PERS contract. Riemer at 21 n 3. Those damages are the amount of Oregon state income taxes he must pay. But he is not subject to Oregon income tax because he resides in Arizona.

This court rejected a similar argument in *Strunk*. 338 Or at 178. Moreover, the *Stovall/Chess* Settlement Agreement provides that tax remedy payments may be decreased to the extent that Oregon personal income tax imposed on retirement benefits decrease:

> "If the benefits payable under HB 2034 (1997), HB 3349 (19950 or SB 656 (1991) are decreased at any time without an equivalent decrease in the Oregon personal income tax imposed on PERS benefits attributable to service rendered before September 29,

> 1991, this class action may be reopened and such further or supplemental relief entered as the court determines appropriate."[29]

The *Stovall/Chess* settlement provides no support for reinstatement of tax remedy payments to members who are not subject to Oregon personal income tax because they are not Oregon residents.

IV. CLOSING CONSIDERATIONS

The Legislative Assembly and all participants in this case share a fundamental goal. *Amicus* American Association of Retired Persons ("AARP") expresses it in terms of "income security." AARP at 5. The PERS actuary described changes to PERS as increasing "benefit security." AARP uses its term to refer to income security for each retiree while PERS "benefit security" refers to the ability of PERS to pay all benefits to all members over time. SMR at 22; Tr at 341.

This dichotomy is reflected in this court's discussion of trust principles in *Arken v. City of Portland*, 351 Or 113, 163, 263 P2d 975 (2011), where the court confirmed that PERB, as trustee of the Public Employees Retirement Fund (PERF), has a duty of impartiality as to all PERS members and cannot benefit one member or one class of members over all others. The Legislative Assembly's approach in SB 822 and SB 861 dovetails with this trust principle.

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[29] A copy of the settlement agreement is in the Appendix hereto. State Respondents request that this court take judicial notice of it.

It knew that employer contribution rates were anticipated to reach 25 percent of payroll and remain there for a long time. It considered many options. *See* SMR at 28-29. The evidence shows that 60 percent of the UAL of the PERF is attributable to retired members, with an additional eight percent attributable to inactive members. SMR at 9. The Legislative Assembly's choice to address the UAL by changing the COLA means that all active, inactive and retired members of PERS do or will share in what the PERS actuary referred to as "a shared cost for a shared benefit, enhanced benefit security for all members."[30] Tr at 341.

Still, sixteen petitioners object to the Legislative Assembly's choice. Because the claims made by the sixteen petitioners vary as to the provisions challenged and the requested relief, State Respondents urge this court, if it declares *portions* of SB 822 or SB 861 invalid, to consider establishing a procedure to determine how its holdings will apply to the individual petitioners and other PERS members rather than attempt to do so as part of its opinion in

[30] Other states have taken a similar approach. AARP asserts that other states have determined COLAs to be a contract term and a few of the cases cited by AARP did strike down, in whole or in part, COLA changes. AARP at 17-18. But other cases reject contract clause and other claims and uphold COLA changes. *See Maine Assoc. of Retirees v. Bd. of Trs. of Me. Pub. Emps. Retirement Sys.,* ___ F3d ___, 2014 WL 2915913 (1st Cir June 27, 2014); *Cloutier v. State*, 42 A3d 816, 820-21, 827 (NH 2012); *Bartlett v. Cameron*, 316 P3d 889, 891 (NM 2013); *Washington Education Assoc. v. Washington Dept. of Retirement Sys.*, ___ Wn2d ___, ___ P3d ___, 2014 WL 3970240 (August 14, 2014).

this case. Such a process also would enable consideration of whether some technical language, such as the definition of "yearly allowance" in SB 861, should remain in effect, as well as addressing claims for damages mentioned by the Moro Petitioners.

In the event this court upholds or, despite the fact that no party challenges all provisions in both bills, invalidates SB 822 and SB 861 in total, State Respondents anticipate that no further proceedings to implement such a decision will be necessary.

CONCLUSION

This court should hold that SB 822 and SB 861 are valid.

Respectfully submitted,

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NOTICE OF FILING AND PROOF OF SERVICE

I certify that on August 25, 2014, I directed the original State Respondents' Answering Brief on the Merits to be electronically filed with the Appellate Court Administrator, Appellate Records Section, and served upon Gregory A. Hartman and Aruna A. Masih, attorneys for Petitioners Arken; Clouser; Custer; Ditter; Domenigoni; Hawkins; Johnson; Moro; O'Kief; Silence; Smith; Vickery and Voek; Lisa M. Freiley, attorney for Respondents Bend School District, Estacada School District, Ontario School District, Oregon City School District # 62, West Linn School District, and intervenor Oregon School Boards Association; William F. Gary, attorney for Respondents Bend School District, Estacada School District, Ontario School District, Oregon City School District # 62, West Linn School District, Beaverton School District, and intervenor Oregon School Boards Association; Harry Michael Auerbach and Kenneth A. McGair, attorneys for respondent City of Portland; W. Michael Gillette, Leora Coleman-Fire, and Sara Kobak, attorneys for intervenor League of Oregon Cities; Sharon A. Rudnick, attorney for intervenors Association of Oregon Counties and Oregon School Boards Association, and respondents Beaverton School District, Bend School District, Estacada School District, Ontario School District, Oregon City School District # 62, Linn County, and West Linn School District; Daniel B. Atchison, attorney for respondent City of Salem; Edward H. Trompke, attorney for respondent Tualatin Valley Fire &

Rescue; Rob Bovett, attorney for respondent Linn County; Craig A. Crispin, attorney for amicus curiae AARP; and upon Sarah K. Drescher, attorney for amicus curiae International Association of Fire Fighters, by using the court's electronic filing system.

I further certify that on August 25, 2014, I directed the State Respondents' Answering Brief on the Merits to be served upon George A. Riemer, *pro se* petitioner; Eugene J. Karandy II, attorney for respondent Linn County; William B. Crow, attorney for intervenor League of Oregon Cities; Michael D. Reynolds, *pro se* petitioner; Wayne Stanley Jones, *pro se* petitioner; and upon Stephen K. Bushong, Circuit Court Judge, by mailing a copy, in an envelope, with postage prepaid, addressed to:

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CERTIFICATE OF COMPLIANCE WITH ORAP 5.05(2)(d)

I certify that (1) this brief complies with the word-count limitation in ORAP 5.05(2)(b) and (2) the word-count of this brief (as described in ORAP 5.05(2)(a)) is 22,933 words. I further certify that the size of the type in this brief is not smaller than 14 point for both the text of the brief and footnotes as required by ORAP 5.05(2)(b).

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