Verified Correct Copy of the Original 6/23/2014

B/7 B

RECEIVED
STATE COURT ADMINISTRATOR
JUN 20 2014
SUPREME COURT
COURT OF APPEALS
DEPUTY
FILED

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; CENTRAL OREGON IRRIGATION DISTRICT; and ASSOCIATION OF OREGON COUNTIES,

Intervenors.

S061452 (Control)

WAYNE STANLEY JONES,

Petitioner,

v.

PUBLIC EMPLOYEES RETIREMENT BOARD, ELLEN ROSENBLUM, Attorney General and JOHN A. KITZHABER, Governor,

Respondents.

S061431

MICHAEL D. REYNOLDS,

Petitioner,

v.

PUBLIC EMPLOYEES RETIREMENT BOARD, State of Oregon; and JOHN A. KITZHABER, Governor, State of Oregon,

Respondents

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.

S061475

GEORGE A. RIEMER

Petitioner,

v.

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

Respondents.

S061860

PETITIONER REYNOLDS' OPENING BRIEF

Judicial Review (Original Proceeding)
Oregon Laws 2013, Chapter 53 (Senate Bill 822)
Oregon Laws 2013, Chapter 2 (special session) (Senate Bill 861)

GREGORY A. HARTMAN #741283
ARUNA A. MASIH #973241
210 SW Morrison St.
Suite 500
Portland, OR 97204-3149
Telephone: 503-227-4600

Attorneys for Petitioners Moro, Domenigoni, Custer, Hawkins, Arken, Ditter, O'Kief, Smith, Johnson, Clouser, Silence, Vickery and Voek

Michael D. Reynolds
8012 Sunnyside Avenue N.
Seattle, WA 98103
Telephone: 206-910-6568

Petitioner *pro se*

George A. Riemer
23206 N.Pedregosa Drive
Sun City West, AZ 85375
Telephone: 623-238-5039

Petitioner *pro se*

Wayne S. Jones
North F
North Salt Lake, UT 84054
Telephone: 801-296-1552

Petitioner pro se

ELLEN ROSENBLUM #753239
Attorney General
ANNA M. JOYCE #013112
Solicitor General
KEITH L. KUTLER #852626
Assistant Attorney General
MATTHEW J. MERRITT #122206
Assistant Attorney General
MICHAEL A. CASPER # 062000
Assistant Attorney General
400 Justice Building
Salem, Oregon 97310
Telephone: 503-378-4402

Attorneys for State Respondents

HARRY AUERBACH #821830
Office of the City Attorney
1221 SW 4th Avenue, Ste 430
Portland, OR 97204
Telephone: 503-823-4047

Attorney for Respondent City of Portland

WILLIAM F. GARY #770325
SHARON A. RUDNICK #830835
PETER F. SIMONS #095632
HARRANG LONG GARY RUDNICK PC
360 E. 10th Ave., Suite 300
Eugene, OR 97401
Telephone: 503-242-0000

Of Attorneys for Respondents Linn County, Estacada, Oregon City, Ontario, West Linn School Districts and Beaverton School Districts, and Intervenors Oregon School Boards Association and Association of Oregon Counties

DANIEL B. ATCHISON #040424
Office of City Attorney
555 Liberty Street SE Rm 205
Salem, OR 97301
Telephone: 503 588-6003

Attorney for Respondent City of Salem

EUGENE J. KARANDY II #972987
Office of the County Attorney
Linn County Courthouse
104 SW Fourth Avenue, Room 123
Albany, OR 97321
Telephone: 541 967-3840

Of Attorneys for Respondent Linn County

LISA M. FRIELEY #912763
Oregon School Boards Association
PO Box 1068
Salem, OR 97308
Telephone: 503 588-2800

Of Attorneys for Respondents Estacada, Oregon City, Ontario, and West Linn School Districts and Intervenor Oregon School Boards Association

ROB BOVETT #910267
Association of Oregon Counties
1201 Court St. NE Ste 300
Salem, OR 97301
Telephone: 971-218-0945

Of Attorneys for Respondent Linn County

EDWARD F. TROMPKE #843653
Jordan Ramis PC
Two Centerpointe Drive, 6th Floor
Lake Oswego, OR 97035
Telephone: 503 598-5532

Attorney for Respondent Tualatin Valley Fire & Rescue

W. MICHAEL GILLETTE #660458
LEORA COLEMAN-FIRE #113581
SARA KOBAK #023495
WILLIAM B. CROW #610180
SCHWABE WILLIAMSON & WYATT PC
1211 SW 5th Ave Suite 1900
Portland, OR 97204
Telephone: 503-222-9981

Of Attorneys for Intervenor League of Oregon Cities

June, 2014

INDEX OF CONTENTS

INDEX OF AUTHORITIES

Cases Cited

Constitutional and Statutory Provisions

Other Authorities

STATEMENT OF THE CASE

A. Nature of the action

Petitioner Reynolds seeks judicial review of Oregon Laws 2013, Chapter 53 ("SB 822") and Oregon Laws 2013, Chapter 2 (special session) ("SB 861"). SB 822 reduces the current and future service retirement allowances of non-resident, non-domicilliary PERS retirees and reduces the cost of living adjustment ("COLA") for all PERS retirees. SB 861, in effect, amended SB 822 to cause a further reduction in the COLA for all PERS retirees. Petitioner contends that the legislature, in enacting SB 822, violated federal law and impaired or breached the PERS contract with non-resident PERS retirees insofar as that law reduces their service retirement allowances due solely to their out-of-state residency. Petitioner further contends that SB 822 and SB 861, impairs or breaches the PERS contract by amending the COLA provision of that contract in such a way as to reduce current and future COLA increases. Petitioner asks that the court declare these laws to be invalid or to have breached the PERS contract, or provide such other relief as the court deems appropriate.

B. Jurisdictional basis

Sections 19 and 11 of SB 822 and SB 861, respectively, confer jurisdiction to review the Acts directly in this court upon the filing of a petition for judicial review within 60 days of the bills' effective dates.

C. Timeliness of petition

The petition challenging SB 822 was filed on June 28, 2013, within 60 days of May 5, 2013, the Act's effective date.

The amended petition including a challenge to SB 861 was filed on December 4, 2013, within 60 days of October 8, 2013, the Act's effective date.

D. Questions presented

1. SB 822 reduces retirement benefits and hence the service retirement allowances ("SRA") of non-resident retirees in order to provide additional funds for PERS employers to spend on other governmental services. The reduction for all non-resident retirees is based on a percentage of their pre-SB 822 SRA allowance.

a. Is this reduction a "tax" on the retirement incomes of non-resident PERS retirees under 4 USC §114(a) prohibiting a state from taxing the retirement incomes of non-resident, non-domicilliary retirees?

b. Does this reduction impair the obligations of or breach non-resident retirees' PERS contract by reducing their SRA a) after that allowance has been set and retirement has commenced, or b) when doing so is not residence neutral?

2. SB 822 and SB 861 reduce the annual COLA for all current and future retirees by reducing the COLA's maximum yearly percentage increase.

SB 822 also eliminates the so-called "banking" provision by which increases in the cost of living index are cumulated and applied in years in which the cost of living index is less than the maximum permitted percentage increase.

Do SB 822 and SB 861, in effecting these changes to the COLAs of all PERS retirees post retirement, impair the obligations of or breach their PERS contract?

E. Summary of argument

1. In examining whether a state exaction is a "tax" as that term is used in federal statutes, substance counts and labels are ignored. Applying the functional analysis used by federal courts and this court, SB 822 and, specifically, sections 11-17, imposes an "income tax" on the retirement incomes of non-resident PERS retirees within the meaning and prohibition of 4 USC § 114. The legislature directed PERB to reduce non-resident PERS retirees' retirement benefits solely because those benefits are not, and, under federal law cannot be, subject to Oregon's state income tax. Yet, the reduction is based on a percentage of non-resident retirees' pre-SB 822 SRA and achieves the identical result as would an "income tax" by providing PERs employers with additional revenues to use for other governmental services. The reduction satisfies the requirements for a "tax" under federal law, even though not labeled as such, and thwarts the congressional purpose behind the tax prohibition in 4

USC §114, which was to avoid the economic harm to non-resident retirees caused by source-state taxation.

2. Should this court disagree that sections 11 – 17 of SB 822 impose an "income tax" on non-residents PERS retirees for purposes of 4 USC §114, the reductions in retirement benefits nevertheless violate the PERS contract. First, fundamental principles of government pension law require that, once retirement occurs and a benefit amount has been set, that amount may not be reduced, at least absent the occurrence of an event for which the employer expressly has reserved the right to make a reduction. Here, benefit amounts have been set and no events have occurred for which either PERB or the legislature has reserved the right to make a reduction. Accordingly, sections 11-17 either impair the obligation of or breach the PERS contract with non-resident retirees.

Second, from its inception in 1945, the retirement system for public employees, in its various forms, has never authorized PERB to pay a different level of gross benefits to non-resident retirees than it pays to resident retirees solely on the basis of their post-retirement residency. Rather, the formulae used to determine a member's gross benefit amount at retirement, as well as the actual payment of that benefit during retirement, always have been residence neutral. This facet of equal treatment – residence neutrality in the payment of gross service retirement allowances to PERS retirees -- is so engrained in the PERS contract that its express recital as an obligation is unnecessary. The state's direction to PERB in Senate Bill 822 to reduce retirement benefits only for non-resident retirees requires PERB to violate this requirement and, therefore, to breach the state's promise to be residence neutral in the payment of benefits to PERS retirees.

3. The promise of an annual COLA based on the Portland consumer price index, with a two percent maximum and the automatic "banking" of amounts in excess of that maximum have been part of the PERS contract since 1971. SB 822, as amended by SB 861, impairs or breaches the PERS contract by reducing the COLA's maximum percentage increase and eliminating the "banking" provision for all PERS members who had retired prior to their enactment.

F. Factual background

1. PERS before SB 822/861

For PERS members like petitioner Reynolds, who became part of the PERS retirement system prior to 1991, their contract of employment with the state entitled them to eventual retirement under one of three methods that produced the highest retirement benefit or SRA.[1] Those methods included the full formula, pension plus annuity and money match methods. *See, generally Strunk v. PERB,* 338 Or 145, 160, 108 P3d 1058 (2005). In applying those

---

[1] Petitioner Reynolds has been a retired member of PERS since 2003 and has, since retirement, resided in the State of Washington. *See* SMFR 75-79.

formulae to calculate a member's SRA, PERB used the following factors: the member's length of service (ORS 238.300(2)(a)(B)); the member's final average salary (ORS 238.300(2)(a)(B); the member's accumulated contributions (account balance) at the time of retirement (ORS 238.300(1); unused sick leave (ORS 238.350) ; and the member's age at retirement (ORS 238.280). A member's actual SRA also depended on PERB's application of actuarial equivalence factors that PERB had adopted and were in effect at the time of the member's retirement. ORS 238.607.

Since 1971, PERS retirees, by statute, have received annual cost-of-living adjustments (COLAs) based on the Consumer Price Index for Portland (CPI). Special Master Final Report ("SMFR") 23-24.[2] In 1973, the maximum COLA was increased to 2% and remained at that level until the enactment of Senate Bill 822 in the 2013 legislative session. *Id.* As the special master found:

"Before SB 822's enactment, the COLA provisions provided for a carryover or 'bank.' When the CPI is greater than 2 percent, retirees would receive a 2 percent COLA and the difference between the CPI and 2 percent is carried forward in a 'bank' to be used in future years when the CPI was less than 2 percent. While varying year to year, in most years since 1971, the CPI has been over 2 percent. In some years, the CPI has been below 2 percent. As a result . . most retired petitioners have a COLA carryover or 'bank.'"

Id.

Regardless of the formula used, prior to 1991 PERS retirement benefits were exempt from the state's income tax. *Strunk* at 176 (*citing* ORS 237.201

---

[2] Cited pages from the special master's report are included in the excerpt of record.

(1989). In 1991, the state began taxing the retirement benefits of PERS retirees. *Strunk* at 176 (*citing* Oregon Laws 1991, chapter 823).[3] To partially offset the effects of subjecting their benefits to the state's income tax, the legislature also in 1991 granted a benefit increase to PERS retirees who had at least 10 years of service. Oregon Laws 1991, ch 796 §2 (Senate Bill 656, now codified as ORS 238.366) (hereafter "SB 656 increase" or "1991 increase"). SB 656 told these PERS members that, upon retirement, they would receive an increase of between 1% and 4% of their service retirement allowance, as computed under the statutory formula providing the highest allowance, depending on their total years of service. ORS 238.366(1), (4).

The legislature's repeal of the tax exemption sparked litigation by PERS members who asserted that the repeal breached or impaired their PERS contract. In *Hughes v. State of Oregon,* 314 Or 1, 838 P2d 1018 (1992), this court agreed that the repeal both impaired and breached PERS members' contractual rights as to retirement benefits accrued and accruing as of the effective date of the repeal. Certain PERS members then initiated lawsuits, collectively described as *Stovall/Chess,* to address the damages that they had

---

[3] As *Strunk* observed, 338 Or 176-177, the state's decision to tax PERS retirement benefits was in direct response to *Davis v. Michigan*, 489 US 803, 109 S Ct 1500, 103 L Ed 2d 891 (1989) (state tax exemption for state and local retirees violates intergovernmental tax immunity doctrine when state simultaneously taxes retirement benefits of federal retirees).

sustained or would sustain as a result of the tax exemption repeal. *See, e.g., Stovall v. State of Oregon,* 324 Or 92, 99 -107, 922 P2d 646 (1996) (discussing procedural history of litigation).

While the *Stovall/Chess* litigation was pending in Marion County Circuit Court, the 1995 legislature undertook the task of enacting legislation that would provide a full and complete remedy and, with it, bring the *Stovall/Chess* litigation to an end. That task culminated in the enactment of Oregon Laws 1995, ch 569 (HB 3349) (hereafter "HB 3349 increase" or "1995 increase"). Rather than simply ameliorate to some degree the economic consequences of the income tax on PERS retirees' retirement incomes, as the 1991 increase had done, this increase sought to fully nullify the tax consequences for work performed prior to 1991. *See* Revenue Impact of HB 3349, Legislative Revenue Office, June 6, 1995. ER-24 (Ex. 54).

To accomplish its goal of ensuring a full and complete remedy, HB 3349 utilized a formula to calculate the amount of the increase. First, the formula required the Public Employes Retirement Board (PERB) to determine the percentage of benefits due a PERS retiree for work performed prior to 1991 when the tax exemption was repealed. Next, PERB was required to multiply the percentage times a fraction --1/.91 – and take that result, expressed as a percentage, and multiply it times the benefit amount due the retiree under one of the three formulae mentioned above to calculate the amount of the increase. Or Law 1995, ch 569, §3 (now codified as ORS 238.364).

HB 3349's benefit increase was an alternative to the 1991 increase, and any retiree was entitled to the increase that was the more advantageous of the two. Ch 569, §3(1) (ORS 238.364(1)). As with the 1991 increase, however, the increase was extended to all PERS retirees regardless of their individual tax situation. Indeed, the legislature was fully aware that the HB 3349 increase would more than offset the economic consequences of subjecting PERS retirees' retirement incomes to state income taxation for three categories of retirees: 1) those for whom a portion of their retirement incomes were simply a return of contributions and therefore not subject to income taxation; 2) those who resided out of state and, therefore, paid no state income tax; and 3) those in lower income tax brackets who paid less than the top marginal state tax rate. *See* House State and School Finance Committee, May 12, 1995, Tape 227B (testimony of Dick Yates, Legislative Revenue Office). *See also* Ex 54 (ER-24)[4]

---

[4] At the time the legislature was considering HB 3349, pursuant to ORS 316.127(1)(a) (1995 Replacement Part) non-resident retirement income derived from work in Oregon, including that of PERS non-resident retirees by virtue of the 1991 tax exemption repeal, was subject to Oregon income tax. As discussed later in the text, however, also at this time Congress was considering legislation that would prohibit states from taxing the retirement incomes of non-residents. That legislation ultimately passed, and the 1997 Oregon legislature responded by amending ORS 316.127 to provide that that "[r]etirement income received by a nonresident does not constitute income derived from sources within this

From 1945, when PERS first started, until December 31, 2011, the PERS statutes did not authorize PERB to use a member's post-retirement residency as a factor in calculating or adjusting that member's gross service retirement allowance.[5] Accordingly, from SB 656's effective date in 1991 and HB 3349's effective date, in 1995, and until December 31, 2011, non-resident PERS retirees received the same gross monthly service retirement allowance as their state resident PERS counterparts who, except for their post-retirement residence, were otherwise similarly situated.

2. Legislative action directed at non-resident PERS retirees

a. 2011 legislation

---

state unless the individual is domiciled in the state." Or Laws 1997, ch 839, §10 (codified as ORS 316.127(9)). It further provided that the amendment applied retrospectively to income received after December 31, 1995. Ch 839, §11.

Except for Yates' testimony before the House State and School Finance Committee, the record in this case does not reflect whether, in fact, Oregon was taxing non-resident PERS retirees' benefits in May, 1995. Even assuming his statement was incorrect as to Oregon's taxation practice at that time, the committee considering HB 3349 understood the increased benefits under consideration would be paid to non-resident retirees and that they would not be subject to Oregon income tax. Its understanding as to taxation proved to be correct, in fact, as a result of the Congress' passage of 4 USC §114 in 1995, discussed in the text, *infra*, and the 1997 legislature's retrospective amendment to ORS 316.127.

[5]As the Special Master found, "PERS' Deputy Director testified . . . that before the 2011 legislation [discussed in text, infra], he could not recall any other instance in which PERS distinguished between Oregon residents and nonresidents in determining a retiree's gross service retirement allowance." SMFR, p 25, n. 57.

In 2011, for the first time ever, the legislature decided to begin treating non-resident PERS members differently from their in-state, similarly-situated counterparts in the payment of their gross monthly service retirement allowance. Effective January 1, 2012, the legislature required PERB to adjust downward a non-resident PERS member's gross SRA by an amount equal to the 1995 benefit increase. Or. Laws 2011, Ch 653, § 2(1) (codified as ORS 238.372(1), 2011 replacement part).[6] The law achieved this result by stating that the increase authorized under the 1995 law could not be paid to a PERS member "if the board receives notice under ORS 238.372 to 238.384 that the payments made to the person under this chapter are not subject to Oregon personal income tax under ORS 316.127 (9)." However, the legislature limited the application of the law only to members retiring after January 1, 2012. Chapter 653, §2(2), codified as ORS 238.372(2) (2011 replacement part). Moreover, the legislature imposed no downward adjustment requirement for PERS members retiring after January 1, 2012, who would receive the benefit increase under SB 656.

b. 2013 legislation

The 2013 legislature, in SB 822, changed the 2011 law in two primary respects. First, the legislature amended ORS 238.372(1) to require PERB also

---

[6] As a result of the enactment of 2011 Oregon Laws chapter 653, several of the PERS statutes were renumbered and new sections were added. The new sections were, and presently are, codified at ORS 238.372 to 238.384. .

to adjust downward the SRAs of those non-resident retirees whose SRA had included the increased benefits under SB 656 (1991). SB 822, §11. Second, it repealed ORS 238.372(2), thereby casting its net to include all non-resident PERS retirees whose retirement allowances included increases under the 1991 or 1995 law and regardless of the date of their retirement. SB 822, section 11. Thus, not only would members retiring after January 1, 2012, be subject to the reduction, but PERS members who had retired before that date would be subject to the reduction as well.

3. COLA Reduction

SB 822 lowered the COLA in two phases. The first phase, operative from July1, 2013 until July 1, 2014, amended ORS 238.360 (2011 Replacement Part) to lower the cap on the annual COLA from 2% to 1.5% but made no other changes. SB 822, § 1. The second phase, operative on July 1, 2014, further amended ORS 238.360 to put in place a variable COLA approach. The COLA started with 2% for the first $20,000 of a member's SRA, 1.5% for the next $20,000, 1.0% for the next $20,000 and .25% for a member's SRA above $60,000. SB 822, §3. It also repealed the "banking" provision contained in ORS 238.360(3) (2011 Replacement Part). Senate Bill 861 reduced the COLA caps even further, beginning July 1, 2014. The legislature imposed caps of 1.25% on benefit amounts up to $60,000 and .15% above $60,000. SMFR 30-

31. SB 861 includes an annual "supplemental payment" for the first six years equal to .25% of the benefit amount, subject to a cap of $150. *Id.* at 32.[7]

4. Reasons for 2013 legislative action

The costs associated with PERS are captured in the following equation: Benefits = Contributions + Actual Investment Earnings. SMFR 8. In its simplest form, when investment earnings are down, to maintain the same level of benefits employer contributions must go up. Similarly, if investment earnings are up, then employer contributions can be reduced to maintain the same benefit level. A third way of achieving balance if contributions and/or investment results are down, or if investment results are up but employers want their contributions to go down, is to reduce benefits.

Prior to and during the 2013 legislative session, public employers and the Governor's office expressed concern that employer rates and, hence, their required contributions to the PERS fund (PERF) already were too high and projected to go even higher. *See, e.g.,* SMFR 52-53. While the immediate cause of the increase in rates was the negative investment returns from the economic downturn of 2008 (SMFR 19), concern was also expressed that "the growing cost of PERS was in significant part attributable to the cost of benefits being paid to existing retirees ***." SMFR 53. The Governor's office, the school boards association and others thus focused on reducing PERS benefits as

[7] The full texts of SB 822 and SB 861 are set forth in the appendix.

a means of reducing their PERS related costs. They viewed cost savings on PERS expenditures to be necessary because those savings would make additional funds available to spend on other governmental services they deemed to be more important. SMFR 54.[8]

The legislature's response – enactment of SB 822 and SB 861 –is projected to reduce PERS current and future liabilities and, hence, the current (2013-15 biennial) and future contribution costs of PERS employers by $5.3 billion. SMFR 34. This figure also represents the amount of benefits that will not be paid to PERS retirees. SMFR 35. PERS' actuary estimated that the cost savings associated solely with SB 822's reduction in the service retirement allowances of non-residents would be $55 million in the 2013-15 biennium and, by itself, would reduce employer contribution rates by .3 percent. SMFR 28. More recently, PERS staff has estimated that this benefit reduction will result in savings of $60 to $70 million through 2015. SMFR 37. That reduction represents slightly more than 6% of the benefits paid to this population (approximately 16,500 retirees) since the reduction began. SMFR 37. The reduction will thus average $3600 to $4000 per non-resident retiree through 2015. All other things being equal, PERS members who retired before or

[8] The School Board's Association lobbyist, John Tapogna, testified that benefit reductions were warranted so that "public agencies could provide levels of service quality, at given levels of taxation that would be more comparable to those provided in Washington, Idaho, and other states that compete with Oregon for businesses and households." SMFR 56.

closer to the time of the 1991 tax repeal will be impacted more than the average because their service retirement allowances included a larger benefit increase under HB 3349 than PERS members retiring later. (Ex. 20, p. 2).

School Districts submitted testimony that the savings resulting from reducing retirement benefits would provide them with more funds to add more school days and/or more teachers. SMFR 84 – 85. Linn County testified that its savings in payroll costs were the "equivalent to the cost of 8.5 "average positions * * * or about 7.5 deputy sheriff positions." SMFR 89. Implicit in the City of Portland's testimony is that with the savings from SB 822 and SB 861 it will be able to add back positions that it has had to eliminate as a result of the recent economic recession. SMFR 90-91.

ARGUMENT

I. SB 822 taxes the retirement incomes of non-resident PERS retirees in violation of 4 USC §114(a).

A. Introduction

During the 2013 legislative session, PERS employers successfully lobbied to reduce their pension costs in order to make available more funds for other government purposes. The legislature responded by enacting SB 822 which, in part, required PERS to reduce the service retirement allowances (SRAs) of non-resident retirees. The legislature singled out non-resident PERS retirees for a pension reduction because their SRAs, by virtue of ORS

316.127(9), were not subject to the state's income tax. Conceivably, the legislature could have simply repealed ORS 316.127(9), thereby subjecting non-resident PERS retirees' benefits to the Oregon state income tax, and used the tax revenues to make more funds available to PERS employers for other government services by reducing their pension costs. That option was not available, however, because federal law – 4 USC §114(a) -- prohibits states from taxing the retirement incomes of non-residents.

Notwithstanding the federal prohibition, the legislature's solution resulted in making more funds available to PERS employers for other government services by reducing their pension costs. This case presents the question whether the legislature's solution is itself a "tax" on the retirement incomes of non-resident retirees in violation of 4 USC §114.

B. 4 USC §114

1. The Act

4 USC §114(a) provides:

"No State may impose an income tax on any retirement income of an individual who is not a resident or domiciliary of such State (as determined under the laws of such State)."

Section 114(b)(1)(G) defines "retirement income" to include retirement income from "a governmental plan (as defined in section 414(d) of such code);"* **"

26 USC §114(d) defines "governmental plan" to mean

> "***a plan established and maintained for its employees by the Government of the United States, by the government of any State or political subdivision thereof, or by any agency or instrumentality of any of the foregoing."

4 USC §114(b)(2) defines the term "income tax," by incorporating the definition of that term as used in section 26 USC §110 (c). That section provides:

> "c) The term 'income tax' means any tax levied on, with respect to, or measured by, net income, gross income, or gross receipts."

2. Legislative history.

4 USC §114 was first introduced in early January, 1995 as H.R. 394, titled "An Act To amend title 4 of the United States Code to limit State taxation of certain pension income." The bill had two sponsors and was broadly supported with 158 co-sponsors. It was referred to the House Judiciary Committee and reported, as amended, in early December, 1995. Both the House and Senate passed the bill by voice vote and it became law (Public Law 104-95) on January 1, 1996.

The House Report (104-95), set forth in the appendix, explained the background and need for the legislation. Congress was keenly aware that

> "[i]n our system of government the States have general dominion, and, saving as restricted by particular provisions of the Federal Constitution, complete dominion over all persons, property and business transactions within their borders; they assume and perform the duty of preserving and protecting all such persons, property and business, and, in consequence, have the power normally pertaining to governments to resort to all

> reasonable forms of taxation in order to defray the governmental expenses."

(Footnotes omitted). App-18. Congress also was aware that States had the constitutional power to tax "incomes accruing to nonresidents from their property or business within the State, or their occupations carried on therein." App-19. That power included taxing pension contributions and investment earnings on which income taxes had been deferred until distribution to retirees. The report noted that most states with a "broad-based income tax provide a tax credit to residents for income taxes paid to another State on income which is also included in the tax base on the State of residence." *Ibid.* However, when a retiree moves to a state that does not impose an income tax "there is no system of income tax credits to offset payments made to another State." *Ibid.* As a result, "[r]esidents of such States who are subject to a pension source tax imposed by another State will clearly pay more in taxes than they would in the absence of source taxation." *Ibid.*

The Judiciary Committee "fully recognize[d] the rights of States to raise revenues in a manner of their own choosing" and it further recognized "that Congress should restrict State taxing authority only when such action is clearly necessary." App-20. As for retirees, however, it observed, *inter alia,* that "[u]nless States are prohibited from taxing nonresidents on their retirement income, increasing numbers of retirees will be overtaxed." Accordingly, it concluded

> "***that the practice of taxing nonresidents' pension income represents such a case [in which Congress should restrict State taxing authority]. Despite the legal and conceptual bases for pension source taxes, the burdens imposed on retirees, especially those with relatively low incomes, are all too often simply unreasonable."

App-20.

3. Analysis of 4 USC §114(a)

As set out above, 4 USC §114(a) prohibits states from imposing an income tax on the retirement incomes of non-residents.[9] "Retirement income" is defined as income from a "governmental plan," and "governmental plan" is defined as "a plan established and maintained for its employees by * * * the government of any State or political subdivision thereof, or by an agency or instrumentality of any of the foregoing."

Applying these definitions to the service retirement allowances of PERS retirees, there can be no question that those allowances constitute "retirement income" within the meaning of §114(a). Those allowances are "income" to PERS retirees. That income derives from PERS, a plan "established and maintained" for employees of the State of Oregon and its political subdivisions.

---

[9]For purposes of this argument, petitioner uses the term "non-resident" to encompass both non-residents and non-domicilliaries.

The only significant question is whether SB 822 imposes an "income tax" on non-resident PERS retirees' service retirement allowances.

The term "income tax" in §114(a) uses the definition supplied in 26 USC §110(c). Again, that definition states that an income tax is "any tax levied on, with respect to, or measured by net income, gross income, or gross receipts

a. SB 822's reductions are "with respect to, or measured by, *** gross income."

SB 822 mandates that non-resident PERS retirees' service retirement allowances be reduced by subtracting from those allowances an amount of money representing the benefit increases approved by the legislature in SB 656 (1991) and HB 3349 (1995) and included in the computation of retirees' service retirement allowance awards. As discussed earlier, SB 656 told PERS members that, upon retirement with at least 10 years of service, they would receive an increase of between 1% and 4% of their service retirement allowance, depending on their total years of service. ORS 238.366(1), (4).

HB 3349 provided an alternative benefit increase to PERS retirees. It utilized a percentage-based formula that, while more sophisticated than the 1991 formula, also calculated the amount of the increase based on the member's SRA as computed under the statutory formula that provided the highest allowance. The result produced the amount of the increase, which PERS then included in each retiring member's "final" service retirement allowance award.

In essence, the amount of the increase represented the income taxes that the member would pay on the portion of the service retirement allowance that was based on work performed prior to 1991, applying the state's maximum tax rate. As this court explained in *Vogl v. Dept of Revenue,* 327 Or 193, 206, 960 P2d 373, (1998), HB 3349

> "increases benefits by way of a formula that is fairly closely matched to the task of replacing PERS income that will be lost to taxes. In theory, that formula will leave PERS recipients with an after-tax amount that roughly approximates what they would have received, had their pension (or that portion of it that vested before 1991) been tax exempt. The formula parallels the maximum state income tax rate, including allowing the increase to rise and fall along with that rate. Although, in any individual case, the formula can only approximate the amount needed to offset the effect of the 1991 repeal, the formula is as close as the state can get to replicating the effect of the repealed tax exemption without delving into individual tax circumstances."

Section 11 of Senate Bill 822 prohibits PERB from "pay[ing]" to PERS retirees the amount of the increase calculated under either SB 656 or HB 3349 and included in their service retirement allowances if "the board receives notice under ORS 238.372 to 238.384 that the payments made to the person under this chapter are not subject to Oregon personal income tax under ORS 316.127(9)." Section 13 similarly requires PERB to "reduce" the service retirement allowance of any retiree whose allowance ceases to be subject to personal income tax under ORS 316.127(9) by the amount of any increase awarded under SB 656 or HB 3349. Section 14 also requires PERB to "reduce" the service retirement allowance of any retiree for whom PERB determines, based on information provided by the Department of Revenue, the service retirement allowance is not subject to personal income tax under ORS 316.127(9). As noted earlier, payments are not subject to Oregon personal income tax under ORS 316.127(9) if they are made to non-residents.

Applying sections 11, 13 and 14 demonstrates that the amount by which a non-resident's service retirement allowance is "reduced" --that is, the amount that is withheld from, not paid to, taken away from or removed from the service retirement allowance of a non-resident retiree -- is "measured by or based on" the retirement allowance of that retiree. For PERS retirees whose service retirement allowance included an increase under the 1991 law, PERB determines the amount to withhold, not pay, take away or remove by multiplying the applicable percentage (1% to 4%) times the retiree's service retirement allowance. For PERS retirees whose service retirement allowance included the benefit increase under the 1995 law, PERB determines the amount to withhold, not pay, take away or remove by multiplying the percentage used to calculate the amount of the increase times the retiree's service retirement allowance. In both instances, the amount that a non-resident retiree does not receive from PERB is determined by – that is, based on or measured by -- the amount of the retiree's service retirement allowance.

b. The amount PERB withholds from payment to a non-resident retiree or by which it reduces the retiree's service retirement allowance is a "tax" for purposes of 4 USC §114(a).

1) The federal analysis of "tax."

Congress did not define the term "tax" in 4 USC §114(a). Congress' statement that "income tax" has the meaning ascribed to that term in 26 USC §110(c) also does not provide much guidance, inasmuch as the term "tax" itself is not defined there, either. Understanding of the meaning of the term can start with a couple of basic propositions. First, as the Supreme Court has long stated, a tax is an "exaction." *See Wisconsin v. J.C. Penney Co.,* 311 US 435, 61S Ct 246, 85 L Ed 267 (1940) (so stating). To "exact" something is generally understood in this context to mean "to demand and force or compel (payment, surrender ***)." *See* Webster's Third New International Dictionary, 1961. Second, determining whether a state action is a tax or something else under a federal statute or constitutional provision is a federal question. *Jefferson County v. Acker,* 527 US 423, 119 S Ct 2069, 144 L Ed 2d 408 (1999). Third, "[t]he practical impact, not the State's name tag, determines the answer to that question." *Id.* at 439 (also citing *Detroit* v.*Murray Corp. of America,* 355 U. S. 489, 492, 78 S Ct 458, 2 L Ed 2d 441 (1958) ("[I]n determining whether th[e] ta[x] violate[s] the Government's constitutional immunity we must look through form and behind labels to substance."). *See also: Wisconsin v. J.C. Penney Co.,* 311 US at 444 ("Ascertainment of the scope of the exaction — what is included in it — is for the state court. But the descriptive pigeon-hole into which a state court puts a tax is of no moment in determining the constitutional significance of the exaction."); *Lawrence* v. *State Tax Commission,* 286 U.S. 276, 280, 52 S Ct 556, 76 L Ed 1102 (1932) ("[I]n passing on [the constitutionality of a tax] we are concerned only with its practical operation, not its definition or the precise form of descriptive words which may be applied to it.").

In *Jefferson County v. Acker*, the exaction at issue was a county "license or privilege" tax that was imposed on any person for engaging in any business within the county for which state law did not impose a license or privilege tax. Two federal judges resisted payment of the tax on the grounds that it was in reality an impermissible regulatory licensing scheme and not a non-discriminatory tax on compensation authorized under the Public Salary Tax. 527 US at 439. The court concluded, however, that the tax "serves a revenue raising, not a regulatory purpose." Because it did not discriminate against the federal judges, the court held that the tax fell within the meaning of "tax" as used in the Public Salary Tax Act. *Id* at 443.

In *Howard v. Commissioners of Sinking Fund of Louisville,* 344 U. S. 624, 73 S Ct 465, 97 L Ed 617 (1953), discussed in *Acker*, the court confronted the question whether a city "license fee" qualified as an "income tax" for purposes of the Buck Act, 4 USC §§105-110. The city imposed the fee on workers working within a geographic area that, although properly annexed to the city, was within the exclusive jurisdiction of the federal government. The fee was for the privilege of working in the city and was measured by one percent of all salaries, wages and commissions earned in the city. 344 US at 625. The Buck Act authorized the fee if it qualified as an "income tax," which 4 USC §110(c) defined as any tax levied on, with respect to, or measured by, net income, gross income, or gross receipts." Workers within the area challenged the city's authority to impose the fee, which the Kentucky Supreme Court had concluded was not an "income tax" within the meaning of that state's constitution. *Id* at 629.

The *Howard* court first observed that whether the fee qualified as an income tax as a matter of state law was not determinative; what was determinative was whether it qualified as an income tax within the meaning of the Buck Act. Even though the city labeled the exaction a "fee," the court had no trouble calling it a "tax" for purposes of the Buck Act. The only significant question was whether it was a tax on income or, as the Kentucky court had held, a tax on the privilege of working within the city. The court had little difficulty resolving this question as matter of federal law, because the tax clearly fit within the requirement that it be "measured by net income, gross income or gross receipts." 344 US at 629.

The Ninth Circuit, following leads from the Supreme Court and other circuits, has developed an analysis that focuses on two things: 1) Congress' purpose in enacting the federal "tax" provision; and 2) the nature of the state assessment or exaction. *In Union Pacific Railway Co. v. Public Utility Commission,* 899 F.2d 854 (9th Cir.,1990) the court was faced with the question whether a levy Oregon imposed on railroads to recoup the costs of regulating railroads violated the 4-R Act, 49 USC §11503(b)(4) prohibiting states from imposing a "tax that discriminates against a rail carrier." The court first observed that attempting to supply a universal definition of "tax," divorced from its context, has been described as a "metaphysical exercise in which courts do not have occasion to engage. The term comes before judges embedded in legal contexts from which the word gains concrete and specific meaning." *Union Pacific, Id.* at 858, n. 6 (quoting *Brock v. Washington Metro. Area Transit Auth.*, 796 F.2d 481, 489 (D.C.Cir.1986). The court specifically declined to apply the test for a "tax" used in the bankruptcy context, determining that "the characterization of a payment as a 'tax' in certain contexts has no 'talismanic significance.'" 899 F3d 861 and nn. 12-14.

In accord with this observation, the court first examined the nature of the levy Oregon had imposed. The levy was an "integral part" of the state's regulatory program involving railroads and "produced no revenues for the general expense of government but is devoted exclusively to defraying the costs of the regulatory program itself." 899 F3d 857. Second, the court determined that Oregon's levy was not the type of assessment about which Congress was concerned. That concern was that states were overtaxing railroads, requiring them to pay a disproportionate and unfair portion of the cost of state government. The court found no evidence that Congress was concerned about regulatory assessments that states used to finance their regulatory efforts. *Ibid.* Examining the nature and purpose of the state exaction or assessment at issue and the "tax" provision that the action was said to violate was consistent, the court concluded, with the analysis used in virtually all of the federal cases involving federal "tax" provisions. 899 F2d 858-59. Given Congress' concern in the 4-R Act that states discriminatorily would tax railroads in order to help defray the costs of general government, and considering the limited, regulatory nature and purpose of the state levy, the court concluded that Congress "did not intend the term "tax" in § 11503(b)(4) of the 4-R Act to bar" Oregon's regulatory levy. "[E]xcluding such a levy from the bar against discriminatory taxes," the court concluded, "is consistent with the purposes of §11503(b)(4)." *Id.* at 859.

In *Bidart Bros. v. The California Apple Comm'n.,* 73 F.3d 925 (9th Cir.1996) the Ninth Circuit employed an analysis similar to but somewhat more sophisticated than that used earlier in *Union Pacific* in deciding whether a state exaction was a "tax" for purposes of the Tax Injunction Act, 28 USC §1341 ("TIA"). In *Bidart*, the precise question was whether the TIA barred large apple producers from challenging in federal court the imposition of a fee imposed on them by the California Apple Commission equal to ¼ cent per pound of apples produced.

The court first examined the purpose of the TIA. It concluded that Congress' concern was "the damaging effect of state tax suits in federal court on state budgets." 73 F3d 929. Enabling suits in federal court to enjoin collection of state taxes might throw state tax administration into "disarray" and "obstruct" collection of state tax revenues, thereby causing damage to state budgets. *Id.* at 930 (citing and quoting from *Rosewell v. LaSalle Nat'l Bank,*450 U.S. 503, 527, 101 S.Ct. 1221, 1236, 67 L.Ed.2d 464 (1981). Other circuits, the court observed, in defining the meaning of "tax" in the TIA, had "appropriately distinguished between assessments that if enjoined would threaten the flow of central revenues of state governments and assessments that are not so critical to general state functions." *Ibid.*.

The Ninth Circuit then segued into its analysis of the nature of the apple "fee" the commission had imposed. Based in large part on the oft-cited decision in *San Juan Cellular Telephone Co. v. Public Service Commission of Puerto Rico*, 967 F.2d 683 (1st Cir.1992), the court distilled for itself three factors to be considered in determining whether an assessment is a tax" or a "fee" for TIA purposes: "(1) the entity that imposes the assessment; (2) the parties upon whom the assessment is imposed; and (3) whether the assessment is expended for general public purposes, or used for the regulation or benefit of the parties upon whom the assessment is imposed." 73 F3d 831. Considering those factors, the court determined that the apple fee in that case was not a "tax" for TIA purposes.

With regard to the first factor, the court observed that an assessment imposed directly by the legislature "is more likely to be a tax than an assessment imposed by an administrative agency." 73 F3d 931. While the legislature did set the initial assessment, the commission was free to adjust it in future years. Moreover, the commission's very existence depended on the will of the apple producers, who could terminate it at any time. Given the independence of the commission, the court concluded that this factor weighed in favor of finding the assessment was not a tax. *Ibid.*

As to the second factor, the court noted that an assessment "imposed upon a broad class of parties is more likely to be a tax than an assessment imposed upon a narrow class." 73 F3d 931. Because here the assessment was imposed only on apple producers, the court found this factor, weighed in favor of finding the assessment was not a tax, though as with the first factor, it was not dispositive.. *Id.* at 932.

With regard to the third factor, the court examined the assessment's "ultimate use." It noted that the assessment "is placed in a segregated fund and used only for Commission purposes." 73 F3d 932. That the commission served the interests of the public did not suffice to make the assessment one for the benefit of the public. Such an "indirect benefit," the court concluded, did not make the assessment a tax. *Ibid.* Citing *In re Head Money Cases,* 112 U.S. 580, 5 S.Ct. 247, 28 L.Ed. 798 (1884), and its *Union Pacific* decision, the court observed that "even an assessments levied for public purposes would not be a tax where it was part of a regulatory program." *Id. at 933.* The court then summed up its decision with the following:

> "Because the Commission's assessments are ultimately imposed by a non-legislative body on a small number of organizations, kept segregated from general California funds, and spent only for a purpose that does not directly benefit the public at large, the assessments are not taxes under the TIA. The district court properly found that it was not deprived of jurisdiction by 28 U.S.C. § 1341."

Ibid.

2) Application of the federal analysis to SB 822

(a) SB 822 imposes an "exaction" or "assessment."

The preliminary inquiry is whether the state action at issue is an "exaction" or an "assessment" or the equivalent. In the context presented here, where the purpose is to provide PERS employers with lower PERS costs and, hence, more money to spend on other governmental priorities, it is apparent that SB 822's reduction is an exaction every bit as much as would be the exaction caused by the straightforward imposition of a state income tax.

Imposition of an income tax in Oregon essentially involves four steps. First, employers withhold from employees' wages an amount, based on the total amount of wages and the number of withholding exemptions claimed by the employee, and that amount "shall be considered to be in part payment of the tax on such employees' income for the taxable year." ORS 316.167(1), (2) and 316.187. Second, the employer pays the amounts withheld over to the DOR. ORS 316.197. Third, DOR deposits or credits the amounts received to the state general fund. ORS 316.502(1). Fourth, once the collection process is completed, the legislature appropriates funds to state agencies to meet their statutorily-imposed responsibilities. ORS 291.232.

Under this process, if a non-resident PERS retiree were subject to a state income tax for work performed prior to 1991, and the legislature desired to use those funds for the purpose identified above, then: 1) PERS would determine and then withhold an estimated amount of taxes from the retiree's monthly benefit payment; 2) PERS would pay the amount withheld over to the DOR; 3) the amounts received by the DOR would be deposited in or credited to the state general fund; 3) the legislature would appropriate the revenues collected to PERB to be deposited into the Public Employees Retirement Fund (PERF); and 4) PERB would then re-calculate –and lower -- employer contribution rates, thus reducing employer costs and making available more dollars to PERS employers for other governmental priorities.

The SRA reduction process called for in SB 822 mirrors, but is much more streamlined than, the tax collection process outlined above: 1) PERS must determine the amount of the reduction from the retiree's service retirement allowance, using either the 1991 or 1995 benefit increase formula, and then subtract that amount from the retiree's monthly benefit payment; 2) because the PERF has more funds within it due to the reduced benefit payments for all non-resident retirees, PERS must recalculate – and lower -- employer contribution rates. Lowering PERS employer rates reduces their costs and makes more dollars available for other governmental priorities.

As the foregoing makes apparent, the only difference between the normal tax collection process and the direct reduction process is the number of steps involved. Unlike in the former, in the latter funds are not taken out of the PERF, transferred to DOR, deposited in the general fund, appropriated to PERB, and then deposited back into the PERF. The direct reduction process avoids these administrative steps, but achieves the identical result.

Moreover, for non-resident PERS retirees, the direct reduction process results in a net benefit payment that is smaller, just as the net payment would be were the retirees' benefits subject to the state's income tax. While the amount of the reduction for retirees whose pre-SB 822 benefits included the 1991 increase may or may not approximate the amount that would be withheld were the straightforward tax collection process followed, the reduction will be at least 1% and may be as high as 4% of their pre-SB 822 benefit. For retirees whose pre-SB 822 benefits included the 1995 increase, based on *Vogl* the amount of the reduction should at least approximate the amount that would be withheld were the normal tax collection process followed.

The foregoing should suffice to demonstrate that, in substance, the reduction in benefit payments caused by SB 822 is the functional equivalent at least of an assessment or exaction, given the legislative purpose in imposing the reductions.

(b) Nature of the reduction.

SB 822 reduces non-resident PERS retirees' allowances precisely because those allowances are not subject to the state's income tax. Senate Bill 822 on its face makes that point throughout. It says, point blank, that if a retiree's service retirement allowance is not subject to Oregon income tax because of ORS 316.127(9) – that is, because the retiree is a non-resident – then PERS is to make the reduction in the retiree's service retirement allowance. If a retiree's service retirement allowance becomes subject to Oregon income tax – that is, the retiree remains or becomes a resident -- then the reduction in the member's service retirement allowance does not take effect, or if it has already taken effect, is to be redacted. Clearly, a PERS retiree either is a resident receiving a full retirement allowance and subject to the state's income tax, or the retiree is a non-resident receiving a reduced service retirement allowance.

The nature of SB 822 not only is to reduce non-resident retirees' SRA's in lieu of subjecting them to the state's income tax, the effect produced for PERS employers is the same as what a state income tax could achieve and for non-resident PERS retirees is very similar to what a a state income tax could achieve. As demonstrated above, whether SB 822's reduction approach or an income tax collection approach is followed, PERS employers stand to reap the same benefit: reduced employer costs which translates into more money to spend on other governmental priorities. Granted, for PERS retirees, the result of directly reducing their service retirement allowance does not match "dollar for dollar" the result that would obtain were they allowed to keep their full retirement allowance but be subject to the state's applicable income tax rate. However, the results closely approximate each other. That is particularly true in the case of PERS retirees whose service retirement allowances included a benefit increase under HB 3349. Indeed, *Vogl* said so.[10] Even for PERS retirees whose SRAs included a benefit increase under SB 656, the reduction is based on a percentage of their pre-SB 822 SRA and would equal at least a portion of

---

[10] The amount of a PERS retiree's service retirement allowance reduction under Senate Bill 822 precisely matches the amount of the increase in that allowance provided for in HB 3349. While in individual cases that amount does not necessarily match the amount of state income taxes the retiree would pay, as previously discussed *Vogl* says that the collective amount comes as close to approximating the amount of taxes that would be paid as the state could do, without making individual calculations, and that is close enough. If as *Vogl* concludes, the amount of the benefit increase authorized by House Bill 3349 closely approximates the amount of taxes that retirees would pay based on work performed prior to 1991, then a reduction from retirees' service retirement allowances that equals the benefit amount necessarily also approximates the amount of taxes that retirees would pay based on that same work

the state income taxes they would pay if their benefits were subject to the state's applicable income tax rate. In any event, as is discussed, *infra*, nothing in 4 USC § 114(a) on its face or in its purpose, requires an exaction to equal the amount of the reduction that would result by applying the state's otherwise applicable income tax rate for it to qualify as *an* "income" tax.

Examining the nature of the reduction in light of the *Bidart* three-factor analysis reveals that the reduction is a "tax." The first factor is the entity imposing the exaction. While it is PERB that implements the exaction, the policy establishing and mandating the exaction is set by the legislature. PERB has no discretion in the matter. This factor strongly indicates the exaction is a tax.

The second factor is the entity upon whom the exaction is imposed. Here, the exaction is imposed on over 16,000 individuals. It is fairly broad-based, comprises an entire sub-group of PERS retirees, and is therefore indicative of a tax, though perhaps not as strongly as the first factor.

The third factor is the purpose for which the exaction is made. Here, the exaction is clearly for a public purpose to benefit the general public. That purpose is to reduce PERS employer contribution rates and their resulting PERS-related costs, in order that those employers will have more dollars to spend on other governmental services. This factor, as with the first, strongly indicates that the exaction is a tax.

(c) Congressional purpose

Congress' concern in enacting 4 USC §114(a) was to avoid the negative economic impact on non-resident retirees of having their retirement incomes subject to taxation by both the state of residence and the "source" state. While Congress recognized that most states with an income tax provide a credit for income taxes paid to the "source" state, that credit was not available for non-resident retirees living in states such as Washington that rely exclusively on the sales tax. But even with the tax credit available in most states, Congress deemed the burden on non-resident retirees of double taxation to be sufficiently onerous that it justified taking the unusual step of interfering in state revenue generation. Congress in effect said to the states in 4 USC §114(a) that they can tax the retirement incomes of their own residents, but that is all. And Congress said to retirees that they will be subject only to one tax on their retirement incomes – by the state where they reside.

SB 822 thwarts Congress' purpose in enacting 4 USC §114(a). SB 822 reduces non-resident retirees' retirement incomes in the "source" state and leaves those incomes subject to taxation in their state of residence as well. In doing so, it negatively impacts non-resident retirees in much the same way as would subjecting non-resident retirees' PERS-based benefits to an Oregon income tax.

In fact, however, Congress' purpose in avoiding economic harm to non-resident retirees most likely would suffer an even greater body blow if this court were to hold that SB 822's SRA reduction is not a tax under 4 USC §114(a). Resident states that have an income tax may well not give a tax credit for the amount of the reduction taken by Oregon. Such a holding, at a minimum, would force non-retirees' resident states to have to decide, for purposes of their own tax crediting procedures, whether Oregon's reduction is or is not a "tax." Not only could the results vary state to state, but the economic impacts on non-resident PERS retirees could be crippling. Clearly, a holding that SB 822's SRA reduction is not a "tax" could severely undermine Congress' purpose and motivation in enacting 4 USC § 114(a).

3) *Vogl's* analysis

The conclusion that SB 822's reduction in retirement benefits for non-resident PERS retirees is a "tax" for federal law purposes is supported, if not driven, by this court's analysis of a similar federal law question in *Vogl v. Department of Revenue*, *supra,* 327 Or. 193, 960 P.2d 373 (1998). In that case Vogl, a federal retiree taxpayer, claimed that the 1995 benefit increase involved in this case –HB 3349 -- violated the "equal tax treatment" mandate the court described as "inherent in the federal doctrine of intergovernmental tax immunity." 327 Or 197.[11] Vogl had asserted that the benefit increase was, practically speaking, a "tax rebate." The legislature, she argued, had bestowed this tax rebate on PERS retirees to compensate for having subjected their benefits to state income taxation in response to *Hughes.*

This court agreed with Vogl. First, it observed that in its earlier decision in *Ragsdale v. Dept of Rev.,* 321 Or. 216, 895 P.2d 1348 (1995), *cert. den.* 516 U.S. 1011, 116 S Ct. 569, 133 L Ed 2d 493, (1995), also involving the intergovernmental tax immunity doctrine, it had suggested that "substance," not labels attached by the state legislature, was what "count[s]" for purposes of analyzing whether a state law was discriminatory under that doctrine. 327 Or 205. But the court also deemed it significant that the legislature had designated the benefit increase as "legal compensation," because this description demonstrated that, insofar as the legislature was concerned, the increase

"is not a mere benefit increase. The increase purports to give PERS retirees what they were promised, *viz.,* tax-free retirement benefits. Because the retirees *were taxed,* the increase is the cure. And a cure for being overtaxed is

---

[11] As this court explained, while the intergovernmental tax immunity doctrine is "rooted" in the federal constitution, it is most recently codified in 4 USC § 111, which provides in part:

"The United States consents to the taxation of pay or compensation for personal service as an officer or employee of the United States * * * by a duly constituted taxing authority having jurisdiction, if the taxation does not discriminate against the officer or employee because of the source of the pay or compensation."

a *rebate.* The increase provided by Oregon Laws 1995, chapter 569, is just that—a rebate. Calling it increased compensation does not change its nature." *Id. at* 208 (italics original).

That this court in *Vogl* focused on the nature of what the *state* had done – *viz.*, to replace the taxes that PERS retirees would have to pay – and not on the mechanics of how the state achieved that goal, is significant. The court deemed of no significance the fact that the "tax rebate" was paid for by using funds in the PERF rather than the state's general fund. Nor did the court apparently care that while the intergovernmental tax immunity doctrine is focused on discriminatory tax treatment, House Bill 3349 imposed no "tax," but rather involved the *expenditure* of funds from the PERF. Nor did the court pay any heed to the state's argument that the intergovernmental tax immunity doctrine "is not, and should not be, concerned from a tax equality standpoint about how much a state pays its employees in retirement benefits, so long as the state taxes those benefits in the same manner that it taxes the retirement benefits of federal retirees." Respondent's Brief in *Vogl*, pp. 18-19. App. 28-29. And finally, it did not matter that the benefit increase was extended to PERS retirees who paid little or no state income taxes and did not match, dollar for dollar, the taxes PERS retirees actually were going to have to pay. It was enough, the court said, that its "design and effect more closely match such a purpose [of replacing actual taxes paid]" than did the 1991 benefit increase considered in *Ragsdale*:

"Clearly, as the state moves closer to replacing the lost net income on a dollar-for-dollar basis, the fact that the increase is in fact a tax *rebate,* rather than a general increase in compensation to 'make up' for lost net income, becomes more apparent."

327 Or 206.

This court in *Vogl* clearly focused on what the state had actually done and the state's purpose in enacting House Bill 3349, that is, the act's substance, and not the label the state had given (or not given) nor the mechanics of how it got there. That analysis is consistent with the analysis used by the federal courts that have analyzed questions of state "tax" policy in light of federal laws protective of or restrictive of that policy. Although on the surface the state taxed federal and state retirees the same, once the court concluded that the benefit increase under HB 3349 was an amount designed and intended to replace, and also closely approximated, the taxes paid by PERS retirees, the increase violated the equal treatment mandate of the intergovernmental tax immunity doctrine, as codified in 4 USC §111.

When *Vogl's* analysis is applied here, it is apparent that SB 822's reduction in benefits for non-resident retirees is, "in substance" a "tax" for purposes of 4 USC 114. The reduction is imposed *because* non-resident retirees pay no state income taxes. The amount of reduction is measured by the amount of their PERS-based retirement income. The result is both an increase in dollars available to PERS employers to spend on other governmental services deemed more worthy and a decrease in non-resident retirees' service retirement allowances.

Finally, it should be noted that the distinction that the *Ragsdale* and *Vogl* decisions made between the 1991 and 1995 benefit increases is not germane to the tax question presented in this case. Those cases involved the intergovernmental tax immunity doctrine. Congress' purpose in codifying that doctrine in 4 USC § 111, was to ensure equal tax treatment of federal and state retirees. *Davis* v. *Michigan Department of the Treasury*, 489 U.S. 803, 109 S Ct 1500, 103 L Ed2d 891 (1989). But Congress was not merely concerned with equality, it also intended to bar discriminatory state taxation that would have the effect of "reducing state employment costs at the expense of the federal treasury." 489 U.S. 815, n. 4. It is for this reason that the court in *Davis* implicitly endorsed the approach of increasing compensation – and hence, increasing federal taxation – in a non-discriminatory way as a means of replacing an invalid state-retiree tax exemption. *Ibid.* This court in *Ragsdale* and *Vogl* understood this federal policy. It was only because the 1995 increase was intended to be, and operated as, a full and complete replacement for any taxes that PERS retirees might have to pay that this court in *Vogl* concluded that the benefit increase was, in effect, discriminatory taxation that violated the intergovernmental tax immunity doctrine.

4 USC § 114(a), on the other hand, is not concerned with equal treatment, but with the economic health of retirees. That concern is implicated regardless whether the reduction approximates the income taxes that would be paid under the state's applicable income tax rate. The reductions here, whether based on the 1991 benefit increase or the 1995 benefit increase, qualify as a "tax" on income. Both reductions were made because non-resident retirees do not otherwise pay state tax on their PERS retirement benefits. Both reductions are made for the precise purpose of making additional revenue available to PERS employers to spend on other governmental priorities. In both cases, the amount of reductions is determined by applying a percentage times the non-resident retirees' pre-SB 822 monthly service retirement allowances. Finally, both reductions result in economic harm to non-resident retirees. Both reductions therefore satisfy the applicable federal analysis for what is a "tax." There is simply no reason to hold, in the context presented here, that Senate Bill 822's reduction in non-resident retirees' service retirement allowances based on the 1991 benefit increase is any less of a tax for purposes of 4 USC § 114 than is Senate Bil 822's reduction involving the 1995 benefit increase.

The analysis federal courts use to determine whether a state exaction or assessment is a "tax" for federal law purposes is well established. That analysis, coupled with this court's precedential *Vogl* decision, lead inexorably to the conclusion that Senate Bill 822's reduction in benefits for non-resident

PERS retirees is a "tax" within the meaning of the prohibition set forth in 4 USC § 114(a). Applying the Supremacy Clause of the United States Constitution, Article VI, clause 2,[12] sections 11 – 17 of Senate Bill 822 which impose that reduction in benefits are invalid.

II. Senate Bills 822 and 861 violate the PERS contract

Senate Bill 822 reduces the retirement benefits, post-retirement, for PERS retirees who are presently or who may become non-residents. Senate Bill 822 and Senate Bill 861 also reduce the retirement benefits, post retirement, for all PERS retirees. The legislature's action violates fundamental principles of pension law and, thus, breaches or impairs the PERS contract with PERS retirees.

A. Vested rights.

It is unquestioned that PERS members acquire vested contractual rights in their pension benefits as a result of working for employers participating in the PERS system. *Hughes,* 314 Or 20-21. On vesting, members' "contractual interest in a pension plan may not be substantially impaired by subsequent legislation." *Hughes,* 314 Or 20 (citing Taylor v. Mult. Dep. Sher. Ret. Bd., 265 Or.445, 450, 510 P.2d 339 (1973) (*citing* Crawford v. Teachers' Ret.

---

[12] Article VI, clause 2 of the United States Constitution provides that the laws of the United States "shall be the supreme Law of the Land;....any Thing in the Constitution or Laws of any state to the Contrary notwithstanding." *See* Maryland *v.* Louisiana, 451 U. S. 725, 746, 101 S Ct 2114, 68 L Ed 2d 576 (1981) (state law that conflicts with federal law is "without effect.")

Fund Ass'n, 164 Or. 77, 87-88, 99 P.2d 729 (1940)); Adams v. Schrunk, 6 Or.App. 580, 586-87, 488 P.2d 831, *rev. den.* (1971).

Moreover, as for PERS members who have already retired, upon retirement their right to a specific pension amount cannot be "impaired or interfered with" by subsequent legislation. *Crawford v. Teachers' Ret. Fund Ass'n*, 164 Or 88 ("***upon full performance by the annuitant, rights accrue which cannot be impaired by subsequent legislation.") *See also*: *Oregon State Police Officers' Assn. v. State of Oregon,* 323 Or. 356, 365-366, 918 P.2d 765 (1996) (citing and quoting *Crawford*). The distinction between rights that accrue while a PERS member is employed and rights that have accrued at the time of retirement was also noted by this court in *Hughes* in the following quote from an attorney general's opinion addressing the legislature's authority in 1953 to replace the pension system first enacted in 1945:

> "***we advise you that the existing plan may validly be changed by legislative action, *if vested rights are preserved by such legislation.*
> "The vested rights to which we refer are of two kinds: (1) Rights of retired members of the public employes retirement system to specific amounts of pensions and annuities, provided by chapter 401, Oregon Laws 1945, [the 1945 Act] as amended; and (2) rights of all present members of the public employes retirement system to a substantial equivalent of the benefits which, upon retirement, they would be entitled to receive as members of that system."

314 Or 19 (emphasis original).

Simply put, upon retirement and after satisfying the conditions precedent to entitlement to a service retirement allowance, a PERS member is entitled to receive the benefits promised during the course of employment. Just as the employer cannot, after retirement, increase the cost of obtaining that benefit (*Crawford*) so too the employer cannot simply decrease the benefit, absent at least an express reservation of the right to do so at the time the benefit was earned. This principle is so fundamental that it is applied even by the courts of those few states that hold on to the gratuity theory of pensions or at least unlike Oregon, do not fully embrace the contract theory of pensions. *See*, *e.g.* *Christensen v. Minneapolis Mun. Employees Retirement Bd.,* 331 NW 2d 740 (Mn, 1983) (recognizing and applying doctrine of promissory estoppel in upholding retiree's rights to continue receiving pension despite legislature's attempt to modify eligibility requirements post-retirement); *Klamm v. State of Indiana,* 235 Ind 289, 126 NE2d 487 (1955) (even though pensions created by statute are gratuities, once statutory conditions for retirement in effect when the application for retirement is made are met, pension rights vest and cannot be "diminished or otherwise adversely affected by subsequent legislation"). *See also* cases collected in 52 ALR2d 437 and later case service.

B. Senate Bills 822 and 861 violate the principle of vested rights as to PERS members who were already retired.

Senate Bills 822 and 861 reduce the retirement benefits of PERS retirees in two ways. First, as to all retirees, SB 822 and 861 changed the COLA formula which has had and will have the effect of reducing PERS retirees' service retirement allowances. Second, SB 822 has further reduced the service retirement allowances of PERS retirees who are currently non-residents and will reduce the service retirement allowances of any PERS retirees who become non-residents in the future. These reductions will be addressed in reverse order.

1. Non-resident reduction.

As explained earlier, SB 822 reduces the service retirement allowances for PERS members retired prior to January 1, 2012, by taking away the benefit increases contained in SB 656 (1991) and HB 3349. SB 656, section 2, which granted the increase) was expressly "added to and made a part of [the PERS statutes]." Or Laws 1991 ch 796, §1. Although the 1991 benefit increase was a partial offset for the income taxes PERS retirees were required to pay following the legislature's repeal of the tax exemption, SB 656 did not expressly tie section 2's benefit increase in any way to the taxation of benefits. Moreover, the law provided, and still provides that "[u]pon retirement [of a PERS member] the Public Employees Retirement Board shall add to the amount of the allowance [the benefit increase set forth]." ORS 238.366(1).

As in *Hughes*, the use of the word "shall" in SB 656 evinces a clear legislative intent that the increase in benefits was intended to be contractual. Nothing in the remainder of SB 656 detracts from this conclusion. Given the text and context, it is clear that the increase in benefits authorized by SB 656 was a vested right of PERS members who retired at least while that provision was in effect.

Sections 2 and 3 of HB 3349, the operative provisions of the 1995 benefit increase, also were "added to and made a part of [the PERS statutes]." Or Laws 1995, ch 569 § 1. Section 3 similarly provided that "upon retirement [PERB] shall add to the amount of the allowance" an increase equal to the larger of the increase contained in SB 656 or "a percentage increase calculated under subsection (4) of this section." While this language coupled with inclusion of the benefit increase within the PERS statutes, standing alone, would evince a clear legislative intent that the benefit increase was intended to be part of the PERS contract, other language detracts from this conclusion. Section 2 contains two caveats. The first is a condition – that "the increased benefits payable under section 3 of this 1995 Act *** shall not be paid in any tax year in which [PERS] retirement benefits * * *are exempt in whole or part from Oregon personal income taxation." Or Laws 1995, ch 569, § 2(2). The second is the statement that "[n]o member of the system * * * shall acquire a right, contractual or otherwise, to the increased benefits provided by sections 3 to 10 of this 1995 Act."

In light of *Hughes*, the legislature understood that its act of adding the benefit increase in section 3 of HB 3349 to, and making it part of, the PERS statutes, coupled with the language stating that PERB "*shall* add" (emphasis added) the benefit increase to a PERS member's allowance upon retirement signified contractual intent. What then was its purpose in adding the "no contractual rights" language, and if it really meant it was creating no contractual rights, why did it deem it necessary to also include the what-would-be-superfluous condition that benefits not be paid if the tax exemption is ever reinstated? If, indeed, no contractual rights were intended to extend into the future, then the legislature could discontinue payment of the benefits for any reason, including reinstatement of the tax exemption. Inclusion of the tax reinstatement condition would thus be mere surplusage if indeed, the legislature intended that, going forward, PERS members would have no contractual right to the benefit increase.

The answer to this conundrum is found in HB 3349's legislative history. Legislative committee members first considering the bill and, in particular, Chairman Schoon, wanted to ensure two things if HB 3349 passed. The first is that HB 3349 would fully compensate PERS members for taxation of their retirement benefits. The second is that the state would not be bound contractually to continue paying the benefits HB 3349 authorized if the settlement negotiations in the pending *Chess/Stovall* litigation in Marion County Circuit Court (concerning the damages to be awarded PERS retirees as a result of the *Hughes* decision) failed to bring about a settlement. He stated that he had no intention of endorsing a bill unless it stated that it was in settlement of the lawsuit. *See* House State School Finance Committee, May 12, 1995, Tape 225B (testimony of chairman Schoon). Legislative Counsel had drafted amendments to the bill that addressed the chairman's concerns. Section 2(1) provided that the increase in benefits was intended to fully compensate for damages as a result of the state's decision to subject PERS retirement benefits to state income taxation. Section 2(3) specified that no person would acquire a contractual right to the benefit increase provided for in the bill. The chairman summarized the intent behind section 2(3) as follows:

> "So if plaintiffs in case decided not to accept this settlement, we would have no obligation to pay that beyond any funds that we might obligate during the current biennium. If we chose to rescind this."

Id., tape 227B. The chair then stated his position with respect to both sections 2(1) and 2(3) as follows:

> "I would like to say for the public record that between the section sub 1 and the entire section 2 this is intended to settle the suit that has been brought by the public retirees and uh PERS retirees and there is not a contractual right to this benefit if it is awarded and if the settlement should not work out then we would anticipate actually rescinding this benefit."

Ibid. A settlement was reached and approved ultimately by the *Chess/Stovall* court. *See Strunk*, 338 Or at 176.[13]

The legislative history thus clarifies that the legislative purpose of inserting the "no contractual rights" language was merely to guard against

---

[13] The signed settlement was filed with the court on September 18, 1997. App-24-26.

future contractual claims to the benefit increase *if the settlement of the Chess/Stovall litigation fell through.* Because the settlement did not fall through, even though the language was carried forward in subsequent amendments to the PERS statutes incorporating the 1995 benefit increase, its vitality was spent when the litigation settled. At most, it lies dormant unless and until revived, if at all possible, by a claim that the settlement is no longer viable or binding.

Upon petitioner's retirement in 2003, and upon the retirement of all other resident and non-resident PERS members who retired at least prior to December 31, 2012, payment of the increase contained in HB 3349 was mandatory and was, in fact, included in the members' service retirement allowances provided it was larger than the 1991 increase. It became vested at the time of retirement, if not before, subject perhaps only to divestment in case either 1) the tax exemption for PERS retirees was reinstated, or 2) the *Chess/Stovall* settlement became no longer binding.[14]

Finally, even assuming the right to either the 1991 or 1995 increase had not vested in any PERS retiree upon retirement, the PERS contract nevertheless

[14] The 1997 legislature, as did the settlement agreement, foresaw this possibility by including a provision authorizing the reopening of the *Stovall/Chess* class action lawsuit if the legislature ever reduced the amount of the increase HB 3349 authorized without a corresponding decrease in personal income taxes for benefits earned before 1991. 1997 Or Laws ch 175, § 4 (codified as ORS 238.362(4)(b).

constrained the legislature's authority to remove the increase and thus reduce the service retirement allowances of *non-resident* PERS retirees. The PERs statutes and, hence, the PERS contract, since its inception in 1945, have always been residence-neutral in the calculation and payment of a retirees' gross service retirement allowance. Residence neutrality is engrained in the fabric of and fundamental to the basic administration and functioning of the PERS system. As this court said in *Hughes*, basic contract principles apply to construing the PERS contract and whether a law has impaired that contract. *Strunk*, 338 Or 170 (quoting *Hughes,* 314 Or 14). This should be particularly so when at issue are the contract rights of PERS members who are already retired.

One basic contract principle, implicit in every contract, is the notion of good faith and fair dealing. *See* Williston on Contracts, Fourth Ed., §63.21, p 498; §63.22, pp 506-522. As Williston states:

> "***Thus, Judge (later Justice) Benjamin Cardozo was able to state nearly a century ago 'The law has outgrown its primitive stage of formalism when the precise word was the sovereign talisman, and every slip was fatal. It takes a broader view today. A promise may be lacking, and yet the whole writing may be 'instinct with an obligation,' imperfectly expressed . . . ' If that is so, there is a contract. Upon similar reasoning, as no other courts have stated: 'The courts are bound to give the same force and effect to the implied agreement of the parties, where such implications are determinable, as to the parts which are expressed, and, when once it is determined what the implied provisions are, they are to be read into the contract, and the rights of the parties are to be adjudged as though such provisions were expressed.' Thus, there is liability for breach of an implied in fact contract, as well as for breach of an implied term in a contract whose principal terms are set forth in express language; and the liability in either case is no different from or

> less than that which attends the breach of an express contract or term. * * *
> ***
>
> "Wherever, therefore, a contract cannot be performed in the way in which it was obviously expected that it should be, without one party or the other performing some act not expressly promised, a promise to do that act must be implied. This principle has been aptly expressed:
>
> 'Covenants are implied in two situations, one where the covenant is so clearly within the contemplation of the parties that they deemed it unnecessary to express it, and the other where the covenant was probably beyond the pale of conscious thought of the parties but is necessary in order to give effect to and effectuate the purpose of the contract as a whole. Though a court balks at making a contract for the parties, it will, where justice and expediency demand, infuse the contract with a spirit of good faith and fair dealing in order to justify the implication of a covenant which will prevent one party from impairing the right of the other party to receive the fruits of the contract.'

Williston, at 497, 505-06.

Residence neutrality in the payment of members' gross retirement allowances has been an obvious though implicit term of the PERS contract, at least until January 1, 2012. The legislature honored the principle of residence neutrality in enacting both SB 656 and HB 3349. In HB 3349, in particular and as discussed earlier, the legislature fully recognized that in paying the increase called for in the bill to all PERS retirees upon retirement that the increase would be added to the gross service retirement allowances of non-resident retirees as well as resident retirees. And it also was aware that non-residents would receive the increase even though they paid no Oregon income taxes.

Senate Bill 822 dishonors residence-neutrality for PERS members who retired prior to January 1, 2012. Even assuming that the 1995 legislature intended for future legislatures to be able to rescind the benefit increase post settlement of *Chess/Stovall,* rescission would have had to comply with the underlying PERS contract's requirement that it be residence neutral. SB 822 is not residence neutral. Prior to enactment of SB 822 and currently, ORS 238.364(1) has required PERB to pay the increased benefits under ORS 238.364(4) or ORS 238.366(4), whichever increase is higher. Because SB 822, § 11directs PERB not to pay that increase to non-resident retirees, § 11 breaches the promise contained in ORS 238.364 and, accordingly, breaches the PERS contract. *See Strunk,* 338 Or 223-24 (discussing impairment of the obligation of contract versus breach). Alternatively, should this court conclude that SB 822, §11 eliminates the promise contained in ORS 238.364(1) for nono-resident retirees, SB 822 impairs the obligation of the PERS contract in violation of Article I, section 21 of the Oregon Constitution.[15]

2. COLA reduction

Petitioner submits that not only under *Hughes'* analysis does the COLA statute evince clear contractual intent but in *Strunk*, this court settled the

---

[15] Article I, section 21 of the Oregon Constitution provides, in part, "No * * * law impairing the obligation of contracts shall ever be passed."

question of whether PERS members had a contractual right not only to a COLA, but to a COLA under the terms set forth in ORS 238.360 (2011 replacement part). Prior to its amendment by SB 822 and SB 861, the COLA statute provided, as it did at the time *Strunk* was decided, that each year PERB "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)." ORS 238.360(1). It then provided that "***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." *Id.* ORS 238.360(2) then limits the annual percentage increase or decrease, by providing that it "shall not exceed two percent." ORS 238.360(3) provides that the "amount ***in excess of the maximum annual retirement allowance adjustment of two percent shall be accumulated from year to year and included in the computation of increases or decreases in succeeding years."

This court in *Strunk,* in order to decide the precise question before it, first had to and did decide whether ORS 238.360(1) was contractual in nature:

"***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."

338 Or 221. Later, the court determined that the specific type of "allowance" at issue in that case was an "allowance" within the meaning of ORS 238.360(1) and therefore "falls within the scope of the promise set out in ORS 238.360(1) (2001) — that is, that PERB annually apply a COLA to each affected member's allowance (in years in which the CPI warrants such a COLA)***." *Id* at 223.

The language in ORS 238.360(3)—the "banking" provision – is every bit as promissory as the promise of a COLA in ORS 238.360(1). ORS 238.360(2), in imposing a maximum on the percentage COLA increase, qualifies the COLA right expressed in ORS 238.360(1). Thus, upon retirement, PERS members were promised a COLA under the terms of ORS 238.360(1) and (3), subject to the limitation set forth in ORS 238.360(2). At least for PERS members retired at the time Senate Bills 822 and 861 were being considered, the legislature could not, without violating *Crawford*, reduce the maximum percentage increase beyond what ORS 238.360(2) set out, or reduce future COLA increases by eliminating the banking provision of ORS 238.360(3). Because SB 822 and SB 861 in combination do both of these things, that is, they change the obligations previously existing under the PERS contract, they impair the obligation of the PERS contract in violation of Article I, section 21 of the Oregon Constitution. Should, however, this court conclude that these 2013

Acts merely direct PERB to breach the promise of a COLA capped at 2% and the banking of any excess, then SB 822 and SB 861 breach the PERS contract.

CONCLUSION

For the reasons set forth above, petitioner submits that sections 11 – 17 of SB 822 conflict with federal law and are invalid. Petitioner further submits that SB 822 and SB 861 impair the obligations of or breach the PERS contract. Petitioner requests that the court afford such relief as the court deems appropriate.

Respectfully submitted,

Michael D. Reynolds
Petitioner *pro se*

CERTIFICATE OF COMPLIANCE WITH BRIEF
LENGTH AND TYPE SIZE REQUIREMENTS

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 13,991 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(4)(f).

Michael D. Reynolds
Petitioner *pro se*

CERTIFICATE OF FILING AND PROOF OF SERVICE

I certify that I filed the original Petitioner Reynolds' Opening Brief with the State Court Administrator, Records Section, at 1163 State Street, Salem, Oregon, on June, 18, 2014, by priority mail, postage prepaid.

I further certify that on June 18, 2014, I served true copies of Petitioner Reynolds' Opening Brief upon the party or parties listed below, by first class or priority mail, postage prepaid, and addressed as follows:

GREGORY A. HARTMAN #741283
ARUNA A. MASIH #973241
210 SW Morrison St.
Suite 500
Portland, OR 97204-3149
Telephone: 503-227-4600

Attorneys for Petitioners Moro, Domenigoni, Custer, Hawkins, Arken, Ditter, O'Kief, Smith, Johnson, Clouser, Silence, Vickery and Voek

GEORGE A. RIEMER
N.Pedregosa Drive
Sun City West, AZ 85375
Telephone: 623- -5039

Petitioner *pro se*

WAYNE S. JONES
Road
North Salt Lake, UT 84054
Telephone: 801- -1552

Petitioner pro se

ELLEN ROSENBLUM #753239
Attorney General
ANNA M. JOYCE #013112
Solicitor General
KEITH L. KUTLER #852626
Assistant Attorney General
MATTHEW J. MERRITT #122206
Assistant Attorney General
MICHAEL A. CASPER # 062000
Assistant Attorney General
400 Justice Building
Salem, Oregon 97310
Telephone: 503-378-4402

Attorneys for State Respondents

HARRY AUERBACH #821830
Office of the City Attorney
1221 SW 4th Avenue, Ste 430
Portland, OR 97204
Telephone: 503-823-4047

Attorney for Respondent City of Portland

WILLIAM F. GARY #770325
SHARON A. RUDNICK #830835
PETER F. SIMONS #095632
HARRANG LONG GARY RUDNICK PC

360 E. 10th Ave., Suite 300
Eugene, OR 97401
Telephone: 503-242-0000

Of Attorneys for Respondents Linn County, Estacada, Oregon City, Ontario, West Linn School Districts and Beaverton School Districts, and Intervenors Oregon School Boards Association and Association of Oregon Counties

DANIEL B. ATCHISON #040424
Office of City Attorney
555 Liberty Street SE Rm 205
Salem, OR 97301
Telephone: 503 588-6003

Attorney for Respondent City of Salem

EUGENE J. KARANDY II #972987
Office of the County Attorney
Linn County Courthouse
104 SW Fourth Avenue, Room 123
Albany, OR 97321
Telephone: 541 967-3840

Of Attorneys for Respondent Linn County

LISA M. FRIELEY #912763
Oregon School Boards Association
PO Box 1068
Salem, OR 97308
Telephone: 503 588-2800

Of Attorneys for Respondents Estacada, Oregon City, Ontario, and West Linn School Districts and Intervenor Oregon School Boards Association

ROB BOVETT #910267
Association of Oregon Counties
1201 Court St. NE Ste 300
Salem, OR 97301
Telephone: 971-218-0945

Of Attorneys for Respondent Linn County

EDWARD F. TROMPKE #843653
Jordan Ramis PC
Two Centerpointe Drive, 6th Floor
Lake Oswego, OR 97035
Telephone: 503 598-5532

Attorney for Respondent Tualatin Valley
Fire & Rescue

W. MICHAEL GILLETTE #660458
LEORA COLEMAN-FIRE #113581
SARA KOBAK #023495
WILLIAM B. CROW #610180
SCHWABE WILLIAMSON & WYATT PC
1211 SW 5th Ave Suite 1900
Portland, OR 97204
Telephone: 503-222-9981

Of Attorneys for Intervenor League of Oregon Cities

MICHAEL D. REYNOLDS
8012 Sunnyside Ave N
Seattle, WA 98103

Petitioner *pro se*