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Appellate Court Records

IN THE SUPREME COURT OF THE STATE OF OREGON

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

v.

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

and

LEAGUE OF OREGON CITIES; OREGON SCHOOL BOARDS ASSOCIATION; CENTRAL OREGON IRRIGATION DISTRICT; and ASSOCIATION OF OREGON COUNTIES;
Intervenors.

S061452 (Control)

PETITION FOR DIRECT JUDICIAL REVIEW OF SB 822 AND SB 861
MORO PETITIONERS' **AMENDED** OPENING BRIEF AND EXCERPT OF RECORD

WAYNE STANLEY JONES,
Petitioner,

v.

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

S061431

June 2014

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; OREGON PUBLIC EMPLOYEES RETIREMENT BOARD; and OREGON PUBLIC EMPLOYEES RETIREMENT SYSTEM,
Respondents.

S061860

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MORO PETITIONERS' OPENING BRIEF

I. STATEMENT OF THE CASE

A. *Nature of the Action*

This case involves a direct challenge to the constitutionality of certain sections of Oregon Laws 2013, chapter 53 ("SB 822") and Oregon Laws 2013, chapter 2 (Special Session)("SB 861"), reducing the cost-of-living adjustment ("COLA") for all retirees of the Public Employees Retirement System[1] ("PERS") and eliminating the Oregon Laws 1991, chapter 796 ("SB 656")[2] benefits for retirees who reside out of state and who are not subject to Oregon personal income tax. Specifically, Petitioners 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 ("Moro Petitioners") allege that sections 1, 3, 5, 7, and 11-17 of SB 822 and sections 1, 3, and 8 of SB 861 impair the obligations of the PERS contract in violation of Article I, Section 21 of the Oregon Constitution and Article I, Section 10 of the United States Constitution, constitute a taking without just compensation in

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[1] The Oregon Public Service Retirement Plan ("OPSRP"), applicable to public employees hired on or after August 29, 2003, is part of the Public Employees Retirement System and is also administered by the Public Employees Retirement Board ("PERB"). *See* ORS 238A.050(1).

[2] SB 656 is codified at ORS 238.366 and 238.368. APP-2-3.

violation of Article I, Section 18 of the Oregon Constitution, or breach the PERS contract such that they are entitled to a remedy. [3] To remedy these constitutional and contractual violations, Moro Petitioners request that the court declare SB 822 and SB 861 to be unconstitutional and void in whole or in part, or in the alternative, declare that petitioners are entitled to damages for breach of contract[4] or just compensation, and award costs and reasonable attorney fees incurred in the prosecution of this action under ORS 652.200 or the common fund doctrine.

B. *Nature of the Judgment Sought to be Reviewed*

There is no judgment sought to be reviewed because this case involves direct judicial review of a legislative enactment.

[3] Petitioners John O'Kief and Michael Smith reside out of state and also challenge SB 822, sections 11-17. Petitioners Brandon Silence and Jin Voek are OPSRP members and challenge SB 822, sections 5 and 7, and SB 861, sections 3 and 8. All other claims are brought on behalf of Moro Petitioners collectively as PERS active members or retirees.

[4] In *Strunk v. Public Employees Retirement Bd.,* 338 Or 145, 225, 108 P3d 1058 (2005), the court recognized that, "normally, this court leaves to the legislature, as the 'most appropriate branch of government in the first instance,' the choice as to which remedy to select when legislation breaches a statutory contract. *Citing Hughes v. State*, 314 Or 1, 838 P2d 1018 (1992). However, under the unique circumstances of that case, the court voided the challenged provisions of the law. This case presents the same circumstances.

C. *Statutory Basis of Jurisdiction*

SB 822, section 19, and SB 861, section 11, expressly confer jurisdiction on the Oregon Supreme Court to determine whether those acts breach any contract between members of PERS and their employers, violate any constitutional provision, or are invalid for any other reason.

D. *Entry of Judgment and Timeliness of Appeal*

SB 822, section 19(2)(a) and SB 861, section 11(2)(a) gave any person who has been or will be adversely affected by the legislation the option to file a petition for direct review with this court within 60 days after the effective date of the legislative acts. The effective date of SB 822 was May 6, 2013, and the effective date of SB 861 was October 8, 2013. Moro Petitioners filed their petition challenging SB 822 on July 1, 2013 and filed an amended petition challenging SB 861 on December 6, 2013. Therefore, Moro Petitioners' petitions for direct review are timely.

E. *Questions Presented*

1. Do SB 822 or SB 861 impair any obligations of the PERS Contract in violation of Article I, section 21 of the Oregon Constitution or in the alternative, breach the PERS Contract?

2. Do SB 822 or SB 861 effect a taking of private property for public use without just compensation in violation of Article I, section 18 of the Oregon Constitution?

3. Do SB 822 or SB 861 impair any obligations of the PERS Contract in violation of Article I, section 10, clause 1 of the United States Constitution or, in the alternative, breach the PERS contract?

F. *Summary of Argument*

The 2013 PERS legislation (SB 822 and SB 861) deprives PERS members of $5.3 billion in benefits. Moro Petitioners are active or retired members of PERS who are receiving or will receive retirement benefits under ORS chapter 238 or 238A and who have been or will be adversely affected by the challenged sections of SB 822 and SB 861.

This court has recognized that the PERS statutes constitute a contract and that the legislature cannot impair or breach an obligation of that contract. *Hughes*, 314 Or at 27. Less than ten years ago, in *Strunk*, 338 Or at 220-225, this court held that the COLA benefit provided by ORS 238.360 was an obligation of the PERS contract. The court's holding in *Strunk* regarding COLA is well-supported by the text, context, and legislative history of ORS 238.360. Applying the same analysis, this court should find that the COLA benefit provided by ORS 238A.210 and the additional benefit adjustments provided by SB 656 contain similarly promissory language and are also obligations of the PERS contract. Any express limitations on those benefits are not applicable here. Therefore, by depriving PERS members of the COLAs and SB 656 benefits as promised under the PERS statutes, SB 822 and SB 861 substantially impair the contracts of Moro petitioners, breach those contracts, or constitute a taking of private of property without just compensation.

This impairment, breach, or taking of Moro petitioners' benefits is also not supported by any valid defense. The record makes clear that the 2013 legislature amended the PERS statutes for the purpose of enhancing the 2013-2015 budget as well as future budgets by lowering the promised benefits to PERS members. This court has held that the breach or impairment of the state's contracts cannot be justified by a legislative determination that it would desire additional funds to spend for other public purposes. *Eckles v. State of Oregon*, 306 Or 380, 399, 760 P2d 846 (1988), *cert dismissed* 490 US 1032 (1989). Federal law has also long recognized that, "If a State could reduce its financial obligations whenever it wanted to spend money for what it regarded as an important public purpose, the Contract Clause would provide no protection at all." *United States Trust Co. v. New Jersey*, 431 US 1, 26, 97 S Ct 1505 (1977). Therefore, the court should declare the challenged sections of both SB 822 and SB 861 to be null and void.

G. *Summary of Material Facts*

In one form or another, Oregon has provided its public employees with a retirement plan, as a contractual benefit of public employment, since 1945. *Strunk*, 338 Or at 157.[5] The public employee members of PERS fall into three general groups: (1) Tier One – public employees who joined the system before January 1, 1996; (2) Tier Two –public employees who joined the system on or after January 1,1996, but before August 29, 2003; and (3) OPSRP—public employees who were employed by a participating public employer on or after August 29, 2003. [6] *Id.* at 158-59; ORS 238A.025. Except as provided otherwise, the rights of Tier One and Tier Two members are governed generally by ORS chapter 238 and the rights of OPRSP members are governed by ORS chapter 238A.[7]

[5] In *Strunk*, 338 Or at 157-163, the court provided an overview and history of PERS derived from the 2003 Special Master's Report (Ex. 15). Petitioners will not review that history but will focus on the changes to the system subsequent to 2003, with liberal citation to the current Special Master Final Report ("SMFR") by Judge Bushong. ER-161-256.

[6] As of the December 31, 2012 actuarial valuation, the system had 62,444 Tier One members, 63,058 Tier Two members, 83,472 OPSRP members, and 122,037 retirees. Ex. 49, p. 2 (ER-140).

[7] *See* Oregon Laws 2003, ch 3 ("HB 2001"); Oregon Laws 2003, ch 67 (HB 2003); Oregon Laws 2003, ch 68 ("HB 2004"); Oregon Laws 2003, ch 625 ("HB 3020"); and Oregon Laws 2003, ch 733 ("HB 2020").

1. *PERS Member Benefits and the 2003 PERS Legislation.*

In addition to creating OPSRP for those hired after August 29, 2003, the 2003 PERS Legislation made several changes to the rights of Tier One and Tier Two members. The most important structural change was the diversion, effective January 1, 2004, of the employee 6 percent contribution from the existing employee accounts in PERS to the newly-established Individual Account Plan (IAP) accounts (ORS 238.200(4); ORS 238A.300 *et seq.*). The IAP is a defined contribution account which pays the member the balance of the account upon retirement (ORS 238A.400). Previously each member's PERS account consisted of the member's contributions to the system (set at 6 percent of salary) and any earnings[8] that PERB had credited to those accounts. *Id.* The amounts in these accounts with a matching amount from employer accounts fund the "Money Match" benefit. See *Strunk,* 338 Or at 360 (discussing different benefit formulas).

[8] This court confirmed in *Strunk*, 338 Or at 204, that Tier One members are entitled to receive no less than the assumed earnings rate (set at 8 percent then) credited annually to their regular accounts. That statutory promise extends throughout PERS membership. In addition, the court recognized that Tier One members' regular account balances currently reflect annual earnings credits that often exceeded the assumed earnings rate. Those prior earnings crediting decisions, whether or not they are deemed to have been overly generous in hindsight, are now final. To the extent that those final crediting decisions are reflected in Tier One members' regular account balances, no less than the assumed earnings rate must be credited annually to those account balances until retirement. *Id.* at 205.

The 2003 Special Master Report noted that the "diversion of member contributions to the IAP will reduce members' future account balances for purposes of employer matching under the Money Match formula." Ex. 15, p. 62. The report predicted that,"[o]n a system-wide basis, the elimination of employee contributions from the Money Match calculation probably will cause the Full Formula option to overtake the Money Match as the most common retirement formula." *Id*.

That prediction proved to be accurate. Since 2003, the percentage of retirements under the Money Match formula has diminished so that by 2012 it was no longer the retirement formula for the majority of new retirements. SMFR, pp. 12-13 (ER-176). As of January 1, 2013, 50 percent of new retirements were under the Full Formula method, and 45 percent were under the Money Match method. The remaining 5 percent retired under the Formula• Plus-Annuity method. ER-145.

PERS's 2012 replacement ratio[9] study, summarized in the February 2014 "PERS: By The Numbers" (ER-139-160), also showed the anticipated decrease in the value of Money Match benefits. The average replacement ratio for all retirees was at its highest, 68 percent, in 2002.

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[9] The ratio of a retiree's initial retirement benefit to his or her last salary before retirement is known as the "replacement ratio." SMFR, p. 13 (ER-117).

ER-145. By 2012, the average replacement ratio for all retirees had decreased to 46 percent. For retirees with 30 years of service or more, the average replacement ratio was 100 percent in 2000; by 2012, that figure had declined to 70 percent.

Regardless of the formula used to determine a retiree's service retirement allowance, PERS historically has increased such allowances through annual COLAs.[10] *Strunk*, 338 Or at 162. COLAs are based on the Consumer Price Index and are capped at two percent per year of each member's allowance. ORS 238.360; ORS 238A.210. If the index increases by more than two percent for the year, then the increase above

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[10] In *Strunk*, 338 Or at 222-25, this court voided those sections of the 2003 PERS Legislation which temporarily withheld annual COLAs from a newly created "fixed service retirement" allowance to recoup the alleged over-distribution of 21 percent earnings to member accounts in 1999, which had been timely challenged by certain employers in the case of *City of Eugene v. State of Oregon*, 339 Or 113, 117 P3d 1001 (2005). The court concluded that although the promise set out in ORS 238.360(1) respecting the application of annual COLAs does not extend to erroneous overpayments included in a member's service retirement allowance, the promise does extend to properly calculated service retirement allowances. The "fixed service retirement allowance" created by the 2003 PERS Legislation was such a "properly calculated" allowance to which the annual COLA applied. Therefore, withholding COLAs from that allowance even temporarily breached the PERS contract. The court, subsequently, allowed PERB to recoup the overpayment of 1999 earnings from retirees under its general overpayment statute (ORS 238.715) in the cases of *Arken v. City of Portland*, 351 Or 113, 263 P3d 975 (2011), and *Robinson v. Public Employees Retirement Board*, 351 Or 404, 268 P3d 567 (2011).

two percent is “banked” for Tier One and Tier Two members and may be added to the member's COLA in later years when the index increases by less than two percent. While varying year to year, in most years since 1971 (when the COLA was initially enacted)[11], the CPI has been over 2 percent. As a result, most retired petitioners have a COLA carryover bank. SMFR, p. 24 (ER-188); ER-40.

Finally, members who retired before 1991 or were PERS members before 1991 receive an increase in benefits under either SB 656 or Oregon Laws 1995, chapter 569 (“HB 3349”).[12] Under SB 656, PERS members receive an increase between 1 and 4 percent depending upon their years of service.[13] Under HB 3349, PERS determines the percentage of PERS members’ benefit attributable to work performed before 1991, multiplies that percentage times 1/.91, and takes the result expressed as a percentage and multiplies that times the member’s benefit amount. Members receive the higher of the two benefits.

[11] *See* Oregon Laws 1971, ch 738, §§11-12 (ER-1-2).

[12] HB 3349 is codified at ORS 238.362 and 238.364. These additional benefits were adopted after the court found that the State’s elimination of the tax exemption was unconstitutional in *Hughes*, 314 Or 1.

[13] They receive 1% for 10-20 years of service, 2% for 20-25 years of service, 3% for 25-30 years of service, and 4% for 30 or more years of service. ER-32-37.

2. *PERS Funding Overview.*

Funding for PERS benefits comes from three sources: (1) Tier One and Tier Two employee contributions made before January 1, 2004[14]; (2) employer contributions, in an amount actuarially determined to be necessary to cover the cost of current and future service retirement allowances; and (3) investment earnings on those contributions. *Strunk*, 338 Or at 157. These assets, taken together, constitute the Public Employees Retirement Fund ("the fund") and are used to pay the costs of the system: member service retirement allowances and administrative expenses. *Strunk*, 338 Or at 157.

a. Unfunded Actuarial Liability.

The fund may have an unfunded actuarial liability ("UAL") at any given time. SMFR, p. 9 (ER-173). The UAL is the amount by which the actuarial accrued liability of the fund exceeds the actuarial value of the fund's assets. PERB addresses the UAL by adjusting employer contribution rates. Those rates are set by PERB in consultation with the PERS actuary to eliminate the UAL over a certain amortization period (for

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[14] As noted above, because all employee contributions have been deposited in IAP accounts since January 1, 2004, employee contributions after that date, are no longer a source of funding for Tier One or Tier Two retirement allowances or OPSRP pension benefits. SMFR, p. 12 (ER-176); see ORS 238.200(4); ORS 238A.300 *et seq.*

the valuation pertinent to this litigation, 20 years). The funded status of the system is often expressed on a percentage basis; for instance on December 31, 2007 the system was 97.1% funded (Ex. 49, p. 13).[15] ER-151.

b. Employer Rates.

Employer rates are expressed as a percentage of salary paid to PERS-covered employees. SMFR, p. 9 (ER-173). PERB sets these employer rates biennially. The PERS actuary calculates individual employer contribution rates for each of the hundreds of participating PERS employers. Rates are based on actuarial valuations conducted with measurement dates in odd-numbered years. The rates are actuarially calculated, using a variety of assumptions and methods. These assumptions include long-term investment return assumptions and life expectancy for retirees. The methods and assumptions used by the actuary are reviewed by PERB biennially. Periodic actuarial analysis

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[15] Since 2001 PERS employers have been authorized to issue revenue bonds to pre-pay pension liabilities. These amounts are deposited into what have become known as side accounts. The funded status of the system is usually expressed both with and without side accounts. Side accounts are discussed in more detail in SMFR at p. 13-14.

presented to the Board includes average rates on a system-wide basis.[16] SMFR, p. 10 (ER-174).

Since 2005 PERS has used a rate collaring approach which limits the amount of change in employer rate in any biennium.[17] Collaring was first applied in response to the adverse 2008 market returns so that subsequent valuations which set employer rates generally indicate where some portion of the employer rate which has been "collared off." See, for example, Ex. 41, p. 9 (2012 Valuation update).

c. Earnings on PERS Fund and Impact on Rates.

The history of the PERS fund earnings, the system funding levels, and system- wide average employer contribution rates are detailed in "PERS: By The Numbers" dated February 2014 (ER-157). SMFR, p. 17 (ER-181). From 2003 to 2007 PERS enjoyed excellent earnings and returned to its well-funded status so that by December 31, 2007 PERS was 97.1% funded (111.5% with side accounts) (Ex. 49, p. 13; ER-151). Correspondingly employer contribution rates dropped during this same period so that average employer contribution rates based on the December

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[16] Unless noted otherwise, references to employer rates are to these average rates.

[17] For a more detailed discussion of collaring see SMFR p. 15 (ER-179-181).

2007 actuarial analysis fell to 12.4% (5.2% with side accounts) (Ex. 49, p. 19; ER-157).

3. *December 31, 2009 Actuarial Valuation*.

In 2008, the PERS Fund regular account suffered a loss of 27.18 percent, consistent with the losses suffered by pension funds throughout the United States due to the economic recession. SMFR, p. 19 (ER-183). The 2008 recession first affected employer rates set by PERB based on the December 31, 2009 valuation. Those rates went into effect on July 1, 2011. The average employer contribution rates, system-wide, for the 2011-13 biennium were 16.3 percent (up from 12.4 percent in the previous biennium)[18], or 10.8 percent with side accounts. This projected increase was limited by rate collaring.

4. *December 31, 2011 Actuarial Valuation*.

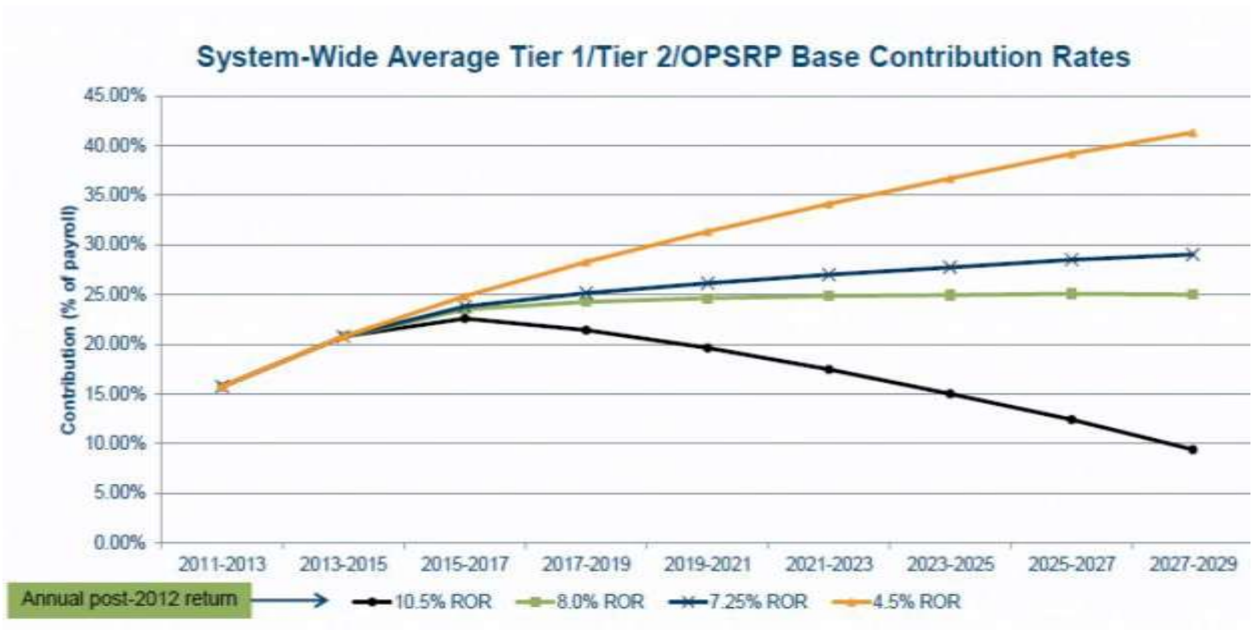
The 2011 valuation presented to PERB on August 28, 2012 continued the process of incorporating the 2008 losses into employer rates, resulting in average employer contribution rates of 21.4 percent of payroll (collared) for 2013-15, a 5.1 percent increase from the 2011-13 rates

[18] Comparing the 2009-2011 employer contribution rate of 12.4% to the range of combined contribution rates paid during the period 1975-2005 shows that the 2009-2011 rate was substantially lower than average and lower than any single year by a substantial margin (Ex. 34, p. 19). The average contribution rate of 16.3% for 2011-2013 was roughly comparable to the 1975-2005 combined contribution rate of the system. (Ex. 18, p. 20).

(SMFR, p. 26; ER-190).[19] The valuation showed that PERS had a UAL of approximately $16 billion and was 82% funded (73% without side accounts).

In a November 30, 2012 presentation to PERB, the PERS actuary presented a chart (shown below) that projected system-wide average base employer contribution rates into the future based on the December 31, 2011 actuarial valuation and various earnings assumptions. SMFR, pp. 27-28 (ER-191-92). If actual earnings were 8 percent (the assumed rate at the time), the projected system-wide average base employer contribution rates would rise to nearly 25 percent by 2017-19, and remain at that level through 2027-29, as shown below.

[19] The un-collared rates for 2013-15 would have been 23.7 percent of payroll (15% with side accounts).



ER-142.

5. *Actuarial Analysis for the 2013 Regular Session*.

In preparation for the 2013 legislative session, PERS asked its actuary to estimate the system-wide average effects of eliminating SB 656/HB 3349 benefits for all PERS retirees who reside outside Oregon. SMFR, p. 28 (ER-192). The actuary's report, dated November 8, 2012, concluded that elimination of those benefits would decrease system-wide average employer rates for the 2013-15 biennium by 0.3 percent, thereby reducing employer contributions to the system by about $55 million for the biennium.

PERS also asked its actuary to estimate the system-wide effects of the modifications proposed in SB 822. SMFR, p. 29 (ER-193). In a report dated March 28, 2013, the actuary estimated that the benefit reductions in SB 822 would reduce the total liabilities of the system by $3.2 billion, and reduce accrued liabilities of the system by $2.6 billion. Both sums were expressed on a present value basis. The report further estimated that projected uncollared employer contribution rates would be reduced by 2.5 percent in the 2013-15 biennium. The report also indicated that the projected $3.2 billion reduction in total liabilities represented a 4.6 percent reduction from the December 31, 2011 valuation. The impact on PERS members varied with the weighted average decrease for current active members at 4.9 percent; for current inactive members, 3.2 percent; and for current retirees, 4.5 percent. *Id.*

6. *The 2013 Regular Session: SB 822 Enacted*.

During the 2013 Regular Session, the legislature passed SB 822, and it became effective on May 6, 2013. Oregon Laws 2013, ch 53 (ER-48-55). The law reduced COLA increases for all PERS participants (active, inactive, retired) and eliminated the SB 656 and HB 3349 benefits for PERS retirees who reside outside Oregon and therefore are not subject to Oregon income taxation. In support of the SB 822 changes, the legislature did not cite any problems with the COLA or SB656/HB3349 benefits. Instead, legislators focused on whether such benefits should be reduced, so that employer costs could be reduced and the savings devoted to schools and other core governmental functions. *See e.g.* ER-58-67; ER-73-80.

a. COLA History and Changes.

From 1964 to 1971, PERS retirement benefits were not directly adjusted for inflation, but PERS retirees received additional payments in what has been referred to as a "13th check system." SMFR, pp. 22-24 (ER-186-188). PERS retirees received these additional checks based on the financial condition of the system. These additional amounts were not added to the base amount of retirees' benefits. During the period this system was in effect the amount paid to retirees increased so that in December 1971 retirees received a payment equal to 3.5 times their regular monthly benefit (Ex. 48, p. 3; ER-132).

In 1971, the legislature enacted Oregon Laws 1971, ch 738, §§ 11-12 (ER-1-2) which provided that monthly retirement allowances payable on or after July 1, 1972, would be adjusted annually to reflect the increase or decrease in the cost of living as reflected by the Consumer Price Index for Portland (CPI), up to a maximum increase or decrease of 1.5 percent of the monthly retirement allowance. In addition, the legislature also granted an *ad hoc* benefit increase of 25 percent for retirees who retired before

January 1968, and 12 percent for retirees who retired after December 1967 and before January 1972. This established a base benefit for retirees consistent with the additional checks they had been receiving (Ex. 48, p. 4; ER-133).

In 1973, the legislature increased the COLA cap to 2 percent. Oregon Laws 1973, ch 695, §1; ER-19-20. Between 1973 and 1989, the legislature also provided additional *ad hoc* increases during times of high inflation (ER-133, 136-37) to protect the purchasing power of retirees. Until the 2003 PERS Legislation's change to COLA (struck down by the court as a breach of contract in *Strunk*), the legislature made only "housekeeping" changes to the COLA statute. *See* Oregon Laws 1989, ch 799 §2 and Oregon Laws 2001, ch 945 §79 (Exs. 52, 57).

For the past 40 years, therefore, all PERS retirees have received a yearly COLA increase capped at 2 percent. In addition, for Tier One and Tier Two members, to the extent that inflation exceeds 2 percent, the additional percentage is banked for use in years in which inflation is less than 2 percent. (Ex. 26; ER-40). Historically, this means that PERS retirees receive the 2 percent COLA increase except in those instances when inflation is lower than 2 percent in their initial years of retirement. (Ex. 48, p. 3; ER-132). OPSRP members since inception have also received a 2 percent COLA but without banking of amounts in excess of 2 percent. See ORS 238A.210 (APP-4).

SB 822 reduced the limitation, or "cap," on COLA from 2.0 percent to 1.5 percent, effective August 1, 2013 and eliminated the bank.[20] SMFR, p. 30 (ER-194). Effective July 1, 2014, SB 822 provided for an annual COLA as follows:

Annual Benefit Amount	Applicable COLA
First $20,000	2.00%
$20,000 to $40,000	1.50%
$40,000 to $60,000	1.00%
$60,000 or more	0.25%

b. SB 656/HB 3349 History and Changes.

Before 1991, PERS retirees' benefits were exempt from the state's income tax. *Strunk*, 338 Or at 176 (*citing* ORS 237.201 (1989)). In 1991, the state began taxing the retirement benefits of PERS retirees. *Id.* (*citing* Oregon Laws 1991, ch 823). At that same time, the legislature also passed SB 656 (Oregon Laws 1991, ch 796; ER-32-37), granting some members a benefit increase from 1 to 4 percent based on their years of service.

[20] Although still referred to as a COLA increase SB 822 (and SB 861) no longer base increases on any measures of the cost of living but simply provide the specified increases.

Retired employees of the state and its political subdivisions challenged the repeal statute (chapter 823) in *Hughes, supra*, 314 Or 1, 838 P2d 1018 (1992). This court decided that (1) PERS members had a contract with the state to receive PERS retirement benefits free from state and local taxation, (2) the repeal amounted to a breach (but not an impairment) of that contract, and (3) "[a]nyone whose PERS benefits are contractually exempt from taxation * * * is entitled to a remedy for the state's breach." *Hughes*, 314 Or at 33.

In *Ragsdale v. Dept. of Rev.*, 321 Or 216, 895 P2d 1348 (1995), *cert*. *den*. 516 US 1011, 116 S Ct 569, 133 L Ed 2d 493 (1995), this court rejected the argument made by federal retirees that SB 656 amounted to a tax rebate for state retirees which violated intergovernmental tax immunity because that rebate was not granted to federal retirees. This court identified several factors supporting a conclusion that the SB 656 benefit increase was "compensation," rather than an unlawful "tax rebate:" (1) the 1991 legislature had obeyed the express dictate of *Davis v. Michigan Dept. of Treasury*, 489 U S 803, 109 S Ct 1500, 103 L Ed 2d 891 (1989) by repealing the PERS exemption; (2) *Davis* and, more generally, the principle of intergovernmental tax immunity, are indifferent to the level of compensation a state pays to its retirees; (3) the 1991 PERS increase was not part of the system of taxation in Oregon but, instead, involved the expenditure of retirement trust funds in the form of increased compensation; and (4) there was "no correlation, either direct or indirect, between state retirees' state tax obligations and the amount of increased PERS retirement benefits" under the 1991 statute. *Ragsdale*, 321 Or at 227-28. The court noted that additional benefits were paid regardless of a retiree's liability for Oregon taxes, including being paid to retirees who did not live in Oregon. *Id.* at 230. The court expressly declined to address plaintiff's arguments pertaining to *Hughes*, because the 1991 statutory amendments were not a legislative reaction to that case. *Ragsdale*, 321 Or at 226.

In 1995, the legislature enacted a second law (HB 3349) that also increased PERS retirees' service retirement allowances. Oregon Laws 1995, ch 569. The 1995 increase sought to fully nullify the tax consequences of work performed prior to 1991 repeal of the tax exemption.[21] *See* Revenue Impact of HB 3349, Legislative Revenue Office, June 6, 1995 (Ex. 54, pp. 67-68). In granting this increase, the

[21] The increase was contingent upon acceptance of the legislation as the class settlement of the *Chess/Stovall* (CC 93C11180; CC 94C10334; SC S43012) case then pending in the Marion County Circuit Court. Ch 569, §§2(1) and (3). A settlement was reached and approved ultimately by the *Chess/Stovall* court. See *Strunk*, 338 Or at 176.

legislature was fully aware that the increase would also be given to those residing out of state and those who paid no state income tax. *See* House State and School Finance Committee May 12, 1995, Tape 227B (testimony of Dick Yates, Legislative Revenue Office) (Ex. 54, p. 15). The increase authorized by HB 3349 was an alternative to the SB 656 increase, and any retiree was entitled to the benefit increase that was the more advantageous of the two. Oregon Laws 1995, ch 569, §3(1). HB 3349 became effective July 14, 1995.

From 1996 until December 31, 2011, when the 2011 Legislative Assembly withdrew HB 3349 benefits prospectively from those retiring after January 1, 2012 (Oregon Laws 2011, ch 653, §2), 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 similarly situated. In fact, non-resident and resident retirees received the same gross monthly service retirement allowance without regard to post-retirement residency since the PERS system first started in 1945. SMFR, p. 25 n 57 (ER-189).

SB 822 eliminated both SB 656 and HB 3349 benefit increases effective January 1, 2014 for all benefit recipients who are not subject to Oregon personal income tax because they do not reside in Oregon.

SMFR, p. 31 (ER-195). Approximately 18,000 PERS retirees (or beneficiaries), or 15% of PERS retirees, are non-residents. (ER-56).

c. Employer Rate Recalculation and Deferral.

SB 822 also required the PERS Board ("PERB") to recalculate the 2013-2015 contribution rates of all employers, and to issue corrected contribution rate orders to employers affected by recalculated rates within 90 days. ER-195. In addition, in a budget note, the legislature "direct[ed]" PERB to defer up to 1.9% of the projected 2013-2015 rate increase for each employer until the 2015-17 biennium. *Id.*

At its May 31, 2013 meeting, PERB directed its actuary to reduce employer contribution rates set as a result of the December 31, 2011 actuarial valuation, by 2.5 percent effective July l, 2013. SMFR, p. 32 (ER-196). That reduction reflected the liability reductions projected as a result of SB 822. The Board also directed the actuary to defer up to 1.9 percent of employer rates, so long as that reduction did not reduce a particular employer's rate below that which had been paid in the 2011-2013 biennium. As a result of PERB's directions, system-wide employer rates were decreased by 4.28 percent and revised rate orders were issued to PERS employers. Those rates went into effect on July 1, 2013, and are the rates in effect for the 2013-15 biennium. The reduced rates were expected to produce an estimated $810 million in system-wide savings for public employers during the 2013-15 biennium. SMFR, p. 33 (ER-197).

7. *Mid-2013 Changes to Actuarial Methods & Assumptions*.

In mid-2013, PERB also selected methods and assumptions to be used in the December 31, 2012 and December 31, 2013 actuarial valuations. SMFR, pp. 20-21 (ER-184-85). When compared to the assumptions and methods used in the previously-conducted valuation, PERB made four notable changes. Those were (1) a reduction in the long-term average annual investment return assumption from 8.00 percent per annum to 7.75 percent per annum;[22] (2) a change in the actuarial cost allocation method from Projected Unit Credit to Entry Age Normal; (3) a modification to the operation of the "Rate Collar" calculation which limits the magnitude of contribution rate changes from biennium to biennium; and (4) a decision to re-amortize the entire Tier One/Tier Two UAL that existed

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[22] Milliman (the Board's actuarial firm) presented analysis of anticipated returns from their economic experts based on the asset allocation of the PERS Fund. SMFR, p. 21 (ER-185). In addition, the Oregon Investment Council (OIC) advisors provided their analysis of anticipated returns. These analyses are based on earnings expectations for each asset class. These projections are then adjusted to take into account several factors, including the volatility of the actual PERS Fund investments. Based on this information, PERB lowered the earnings assumption of the Fund to 7.75 percent.

as of December 31, 2013, over a twenty-year period as a level percent of projected payroll.

The reduction in earnings assumption to 7.75% will lower the retirement allowance for any active or inactive members who are not retired as of January 1, 2014, and who ultimately retire and receive benefits calculated under the Money Match method. SMFR, p. 21 (ER-185). Other than the reduction of Money Match benefits, the change in the assumed rate and the other changes in methods and assumptions will not change the amount of the system's liabilities as of a particular valuation date. Rather, these changes only affect the amount and timing of the contributions necessary to fund the cost of the liabilities that were unfunded as of the valuation date. SMFR at 22 (ER-186).

The changes in actuarial methods and assumptions were adopted by PERB independent of any legislative changes. SMFR, p. 22 (ER-186). The PERS actuary would have recommended these changes to PERB regardless of whether any legislative change had been enacted. These changes enhanced the benefit security of PERS.

PERS has not calculated the discrete effects of each of the changes in methods and assumptions. In general, the projected employer rate reductions resulting from SB 822 are comparable in magnitude to the projected employer rate increases caused by the changes in methods and assumptions for the 2015-17 biennium. ER-186.

8. *Actuarial Analysis for the 2013 Special Session.*

In a report dated September 18, 2013, the PERS actuary estimated the system-wide average effects of the COLA modifications proposed in SB 857. SMFR, pp. 29-30 (ER-193-94). That bill had the same COLA reductions as the reductions ultimately enacted in SB 861. The actuary's report projected that the COLA reductions would reduce the UAL by an additional $2.1 billion and would reduce uncollared base employer contribution rates by an additional 2 percent for the 2013-15 biennium. Ex. 37 (ER-83).

9. *2013 Special Session: SB 861.*

During the 2013 Special Session, the legislature adopted SB 861, and it became effective on October 8, 2013. Oregon Laws 2013, ch 2 (Special Session) (ER-90-93). SB 861 lowered the COLA according to the following chart (Exs. 40; 37; Ex. 60, p. 144): [23]

[23] The passage of SB 861 had no impact on 2013-15 employer rates but the impact on 2015-17 rates will be just sufficient to eliminate the impact of the 1.9% deferral from SB 822.

Yearly Benefit	Senate Bill 822 COLA (No longer in effect after approval of SB 861)	Senate Bill 861(*Ends in 2019)		
		COLA	First Supplemental payment for all benefit recipients*	Second Supplemental payment for benefit recipients whose yearly benefit is $20,000 or less*
<$20,000	2.00%	1.25%	0.25%	0.25%
$20,000-$40,000	1.50%			---
$40,000-$60,000	1.00%			
>$60,000	0.25%	0.15%	$150	

SMFR, p. 31 (ER-195).

SB 861 also provided annual supplementary benefit payments as noted above, to be paid out of the PERS contingency reserve beginning in 2014. Supplementary payments are limited to no more than $150 annually and are estimated to cost $65 million for the six-year period (2014-2019). SMFR, p. 32 (ER-196). The balance in the contingency reserve as of December 31, 2013 was $667.7 million. The contingency reserve balance is not taken into account in setting employer contribution rates, so the SB 861 supplementary payments are not expected to have an immediate effect on employer contribution rates.

After the passage of SB 861 the PERS actuary recalculated advisory 2015-2017 rates, which now show average employer collared rates at

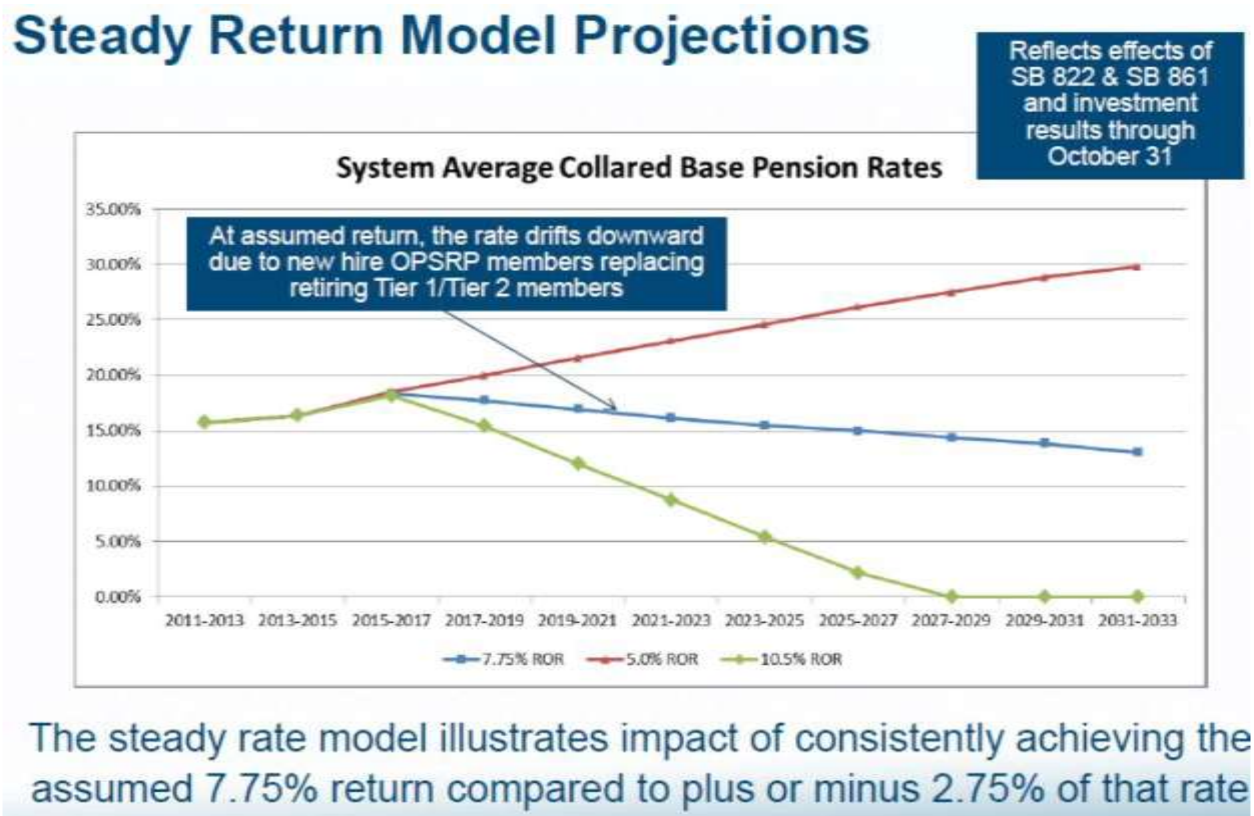
18.7% (12.5% net rates with side accounts) (Ex. 49, p. 19; ER-157).[24] Collaring has deferred approximately 2% of additional hikes, though 2013 returns (15.95%) will lower that amount. Stipulated Facts, Moro ¶36. The 2015-2017 rates will include this collared amount. The 2008 losses, which triggered the rate collar, will be fully absorbed in employer rates and will not have any further effect through the rate collar.

10. *Projected Effect of SB 822 and 861 on UAL and Employer Rates.*

On November 22, 2013, the PERS actuary presented a chart to PERB similar to the one he provided a year earlier leading up to the 2013 legislative session. SMFR, pp. 33-34 (ER-197-98). The chart included all of PERB's changes from the 2012 actuarial valuation as well as 2012 and a substantial part of 2013 earnings (through October 31, 2013). The chart shows rates topping out at approximately 18 percent and if earnings are at the now-assumed rate of 7.75 percent, rates trending downward to approximately 13 percent over the next 8 biennia. As shown in the 2012 chart, higher earnings than the assumption cause rates to decrease more quickly and earnings lower than the assumption cause rates to increase. The chart itself (shown below) attributes the downward trend in rates to the

[24] This rate is only slightly higher than the 1975-2005 total combined contribution rate of the system. (Ex. 34, p. 19).

fact that new hire OPSRP members are replacing retiring Tier One and Tier Two members.



SMFR, p. 34 (ER-198).

Taken together, SB 822 and SB 861 reduced the PERS UAL because the legislation reduced the amount of benefits projected to be paid to members in the future. SMFR, p. 35 (ER-199). Those liability reductions were estimated to total about $5.3 billion, stated on a system-wide, present value basis. *Id.* The PERS UAL as of December 31, 2013 is estimated to be about $8.1 billion (excluding side accounts), and $2.2 billion (including side accounts), taking into consideration the combined effect of SB 822, SB 861, and system earnings for 2012 and 2013 that exceeded the assumed earnings rate of 8 percent. PERS is estimated to be 87 percent funded (excluding side accounts) and 96 percent funded (including side accounts) as of December 31, 2013. The effect on respondents' employer contribution rates is set forth below in the section on "Respondent-Specific Information."

11. *Governor's position on PERS changes*.

During the development of the Governor's Budget in 2012, the Governor was concerned that there may be a budget gap, making it impossible to continue services at the current level. SMFR, pp. 52-55 (ER-216-219). As a result, the Governor's Budget for 2013-2015 presented to the legislature included an $865 million savings from changes to PERS during the biennium. (Ex. 59, p. 385; ER-69).

While the Governor's Chief of Staff, Curtis Robinhold, testified that the Governor was concerned about the benefits driving PERS costs, he acknowledged that the PERS actuary concluded that SB 822 impacted all PERS members, with its heaviest impact on active members. Tr. 301. He also acknowledged that SB 861 was not focused on retirees with high benefits but adversely impacted even members receiving $20,000 or less in annual retirement allowance. Tr. 302. Robinhold acknowledged that the Governor signed both bills knowing their impact. Tr. 302.

12. *Effect of SB 822 and SB 861 on Member Benefits.*

The effect of the changes in projected benefits to be paid to PERS members due to SB 822 and SB 861 is estimated to total $5.3 billion, stated on a system-wide, present value basis. SMFR, p. 35 (ER-199). The effect on Moro Petitioners' benefits is set forth below on "Petitioner-Specific Information."

PERS staff estimates that these COLA changes will result in $60 million to $70 million in projected benefits not being paid in 2013-2015. SMFR, p. 36 (ER-200). The PERS actuary's 2013 "Purchasing Power Study" showed the change in purchasing power of benefits through 2013.[25]

SB 822's elimination of SB 656/HB 3349 benefits for retirees who reside outside Oregon affected 16,545 recipients, 14 percent of all benefit recipients. SMFR, p. 37 (ER-201). This amounted to a system-wide benefit reduction of $2,235,617 per month. This reduction represented 6.097 percent of benefits otherwise paid to this population, who received a total of $34,417,234 per month after these reductions. PERS staff

[25] *See* Ex 48 (ER-130-138). The study included the impact of SB 822 on benefits paid in 2013 (SB 861 had no impact on 2013 benefits), but it does not project the impact of future inflation or COLA increases on retiree benefits.

estimates that the elimination of SB 656/HB 3349 benefits will result in savings of about $60 to $70 million through 2015.

The combined effect of changes in projected member benefits due to SB 822 and SB 861, and 2013 PERB decisions regarding assumptions and methods to be used in calculating liabilities and contribution rates, yields a $5.1 billion present value (as of July 1, 2013) decrease in projected employer contributions for the twenty-year period from July 2013 to June 2033. SMFR, p. 37 (ER-201). Additional projected contribution savings subsequent to June 2033 are also anticipated due to the SB 822 and SB 861 changes.

13. *Impact of SB 822 and SB 861 on Moro Petitioners*.

The petitions to this court by Moro Petitioners contained affidavits supported by actuarial analysis showing the extent of their losses as a result of the changes to COLAs and SB 656 benefits. That analysis was made a part of the record before the Special Master (Exs. 1-14). The state performed a similar actuarial analysis for each of the Moro Petitioners with comparable results (Exs. S9-S25). The Special Master did not select one or the other of these analyses but rather incorporated both into his overview, no doubt at least in part because of the similar results of each of these analyses. SMFR, pp. 58-72 (ER-222-236).

The individual analyses of loss vary widely depending on the particular circumstances of each petitioner. Those individuals who have higher benefits will correspondingly have higher losses. Because the statutes lower the amount of COLA in each succeeding year, the losses are greater for those individuals whose life expectancies were greater at the time of the legislative enactment. Finally, and perhaps not quite so obviously, because the statutes do not index the cut-back thresholds for inflation, those active members who are furthest from retirement will suffer greater losses upon retirement. *See e.g.* Exs. 11 and 13.

Different measures of loss also produce significantly different results. For instance, Petitioner Everice Moro has the lowest loss of nominal dollars of $68,573 while Petitioner Brandon Silence shows a loss in nominal dollars of $1,260,580. However, when the state converted these nominal dollars to a present value, it showed a loss for Brandon Silence, a young, active fire fighter who will suffer his damages in the distant future, of only $14,527. In contrast Eugene Ditter, who is a retired fire fighter, shows a state-calculated present value loss of $132,943.[26] The losses suffered by

[26] The state performed a present value analysis using PERS's current earnings assumption of 7.75% to convert nominal dollars to present value. However the PERS actuary agreed that while the use of the 7.75% earnings assumption from PERS is appropriate when discussing PERS's projected savings, it may not be the most appropriate measure when

Moro Petitioners are consistent with losses suffered by PERS members in general. PERS calculates the total benefits lost at a present value of $5.3 billion valued at December 31, 2011. At that time PERS had 329,987 members (including active, inactive, and retired; Ex. 25, p. 2) so average present value loss would be about $16,000.

Instead of using a present value analysis the Petitioners' actuary calculated a year-by-year and overall percentage loss of benefits for each of the Petitioners.[27] Again these revealed significant variations, with Petitioner O'Kief showing a 2.83% loss of benefits and Petitioner Voek showing a 16% loss of benefits.[28] A year-by-year review of the Petitioners' analyses shows that benefit losses start at a relatively low amount and increase over time, so, for example, by the final year of his retirement Brandon Silence is projected to lose 33% of his benefit.[29] Two of the Moro

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discussing the loss suffered by an individual member. An individual member who wished to duplicate lost benefits by the purchase of an annuity would more likely, according to the PERS actuary, find those annuities available at approximately a 4% earnings rate. A present value analysis based on a 4% earnings assumption would substantially increase the valuation of the loss suffered by the individual Petitioners. Tr. 61-62.

[27] The state's percentage analysis shows comparable loss.

[28] The PERS actuary expressed reservations about the use of an overall percentage loss of benefits but agreed that a percentage analysis on a year-by-year basis was appropriate.

[29] Because the life expectancy of any individual Petitioner is unknown all of the analyses done both by the Petitioners' actuary and the state's

Petitioners reside out of state and have asserted a claim for the loss of SB 656 benefits. Petitioner O'Kief shows a nominal dollar loss of $65,320, converted by the state to $21,095 in present value dollars, with a loss of 2.83% of projected benefits (Ex. S25, p. 1). Petitioner Smith shows a nominal dollar loss of $41,907 reduced to a present value of $26,566 with a 3.69% loss of projected benefits (Ex. S25, p. 2).[30]

This percentage analysis is comparable to that submitted in the *Strunk* case, analyzing for each of the individual petitioners therein the impact of the 2003 legislation. Ex. 15 pp. 96-107. A comparison of the projected percentage losses for the 2003 legislation shows that total losses were generally higher for *Strunk* Petitioners. However, when broken into their components, the percentage losses suffered by the *Strunk* Petitioners for each of the 2003 legislative enactments are comparable to or less than the amounts projected to be lost by the Moro Petitioners due to the 2013 legislation. Regardless of the metric used, it is clear that the Moro

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actuary rely on the assumptions used for life expectancy by PERS. Those individual Petitioners who live beyond their life expectancy will suffer additional loss while those who die early may take small consolation from the fact that they will suffer lower losses due to SB 822 and SB 861.

[30] The Special Master's charts show a column for the calculation of both the SB 656 and HB 3349 benefits. However the state limited its analysis solely to the loss of SB 656 benefits (Ex. S25, p. 1-2).

Petitioners have suffered significant and substantial losses as a result of the passage of SB 822 and SB 861.

14*. Impact of SB 822 and SB 861 on Respondents.*

Of the Respondents, only the City of Portland, Linn County, and four school districts (Bend, Estacada, Ontario, and Oregon City) presented information regarding the impact of SB 822 and SB 861 on their rates and budgets. SMFR, pp. 81-92 (ER-245-256). The extent of the impact varied; however, they all indicated that they intended to use the savings from the legislation to make-up budgetary losses they had incurred and to provide their services to the public. None of the respondents presented information regarding the cost of their scheduled rates increase for 2013-2015 prior to legislative action.

According to the information presented by the City of Portland, before SB 822 and 861, its rates were scheduled to go up approximately 50 percent to 13.74 percent for Tier One/Two employees, 11.92 percent for OPSRP general service employees, and 14.65 percent for general service employees. SMFR, pp. 90-92 (ER-255-56). As a result of the legislation, the City's rate for 2013-2015 is 4.4 percent less for both Tier One/Two and OPSRP employees. The 4.4% reduction represents a savings of $12 million or 0.453 percent of the City's $2.65 billion budgeted expenditures for 2013-2014.

Similarly, Linn County indicated that before the legislation, its net contribution rates for 2013-2015 were scheduled to go up to 18.06% for Tier One/Two employees, 16.23 percent for OPSRP general service employees, and 18.96 percent for OPSRP police and fire employees. SMFR, pp. 88-89 (ER-252-53). As a result of the legislation, however, those rates were reduced by 2.47 percent. The 2.47 percent reduction represented a savings of approximately $835,682 in the County's 2013-2014 budget.

Finally, the Bend, Estacada, Ontario, and Oregon City School Districts reported that, before the legislation, their 2013-2015 net employer contribution rates were set to go up by a range of 5.68 percent to 6.77 percent. SMFR, pp. 81-87 (ER-245-61). As a result of the passage of the legislation, they all experienced a 4.4 percent reduction in their net employer contribution rates. The 4.4 percent reduction represented a savings of the following amounts:

School District	Dollar Savings From Bills	Total Formula Revenue 2013-2014	Savings as % of Total Formula Revenue
Bend La-Pine	$3.4 million	$125,865,191	2.7
Estacada	$421,212	$21,042,967	2.0
Ontario	$465,690	$21,626,242	2.2
Oregon City	$1.7 million	$63,291,797	2.7

ER-245-51; Exs 65-68. In addition to any savings generated by changes in PERS, school districts received a substantial higher allocation in state school funding in the 2013 session. Compare generally Exs. 65-68.

15. *Oregon's Economy and Financing Education.*

a. Economic Conditions in General.

Thomas Potiowsky, former State Economist, provided an overview of the current state of the Oregon economy, with particular reference to revenue issues.[31] SMFR, pp. 39-45. The state of Oregon is highly dependent on income tax, which is the most volatile source of revenue through the business cycle. While Oregon is a relatively high taxation state when only personal income tax is included, the same is not true when comparing total Oregon general fund revenue to that of other states. Oregon is a state with a relatively-lower tax burden when compared with others, with overall taxes 11.8% lower per capita than the United States

[31] Mr. Tapogna, called as a witness by the Respondents, indicated he was in substantial agreement with Potiowsky. Tr. 198.

average. SMFR, p. 41. Oregon is ranked 33rd for state taxes as percentage of income. State tax as a percentage of state productivity shows Oregon at 14.8% below the national average.

Oregon's economy and, hence, revenue were adversely affected by the 2008 recession, but we are in the fifth year of a recovery resulting in significant increases in revenue. As an example, the 2013-15 budget shows a 14% increase over 2011-13, one of the largest recent increases. SMFR, p. 42 (ER-206).

b. Public School Financing

Property taxes are the primary source of funding in Oregon for local governments and until 1990 were the primary source of funding for K-12 education. SMFR, pp. 43-45 (ER-203-209; ER-221-22). The combination of Ballot Measures 5, 47, and 50 passed by the voters in the 1990s not only placed substantial limits on the collection of property tax but also shifted the substantial burden of supporting K-12 education to state government. The overall impact of Measures 5 and 50 effectively caused a $13 billion reduction in property taxes in the 2011-2013 biennium. Measure 5 shifted the primary support for K-12 education to the state budget and K-12 education has not done particularly well in the competition for state budget dollars. Both human services and public safety have increased their share of general fund dollars while funding for K-12 has remained relatively flat. If general fund spending on education had increased at the same rate as population growth, approximately $4.25 billion more in state funding would have gone to K-12 education between 1999 and 2015. Oregon invests less in education than nearly every other state as a percentage of the total state budget. In 2012 only Maine and Wyoming spent a smaller percentage of their state budgets on education than Oregon. SMFR, p. 45 (ER-209).

Changes to Oregon's PERS benefits which lower employer contributions do not make any fundamental changes to Oregon's revenue system and ultimately will not resolve Oregon's K-12 funding issue. SMFR, p. 58 (ER-222).

II. FIRST ASSIGNMENT OF ERROR

SB 822 §§1, 3, 5, 7, and 11-17 and SB 861 §§ 1, 3, and 8 impair the COLA and SB 656 benefit obligations of the PERS contract in violation of Article I, Section 21 of the Oregon Constitution or in the alternative, breach those terms of the PERS contract.

A. *Standard of Review*

In *Strunk*, 338 Or at 155, the court recognized that,

> "For these proceedings, the legislature has directed this court to determine all issues as original matters in this court. To comply with that directive, this court appointed a special master to conduct the trial of all factual issues and to assemble the record. We now conduct a *de novo* review of the evidentiary record

> and a plenary review of the legal issues presented." *Strunk*, 338 Or at 155.

With regard to "order of review," the court affirmed that when it is presented with multiple bases for disposition, it addresses state constitutional law claims before considering the federal claims. *Strunk*, 338 Or at 171 *citing State v. Kennedy*, 295 Or 260, 262, 666 P2d 1316 (1983).

B. *Preservation of Error*

Moro Petitioners preserved this assignment of error through their First, Fourth, Fifth, Eighth, Ninth, and Twelfth Claims for Relief in their original and amended petitions.

C. *Argument*

1. *Legal Standard*.

Article I, Section 21, of the Oregon Constitution provides in relevant part: "No law * * * impairing the obligations of contracts shall ever be passed." The provision is applicable to both state and private contracts. *Eckles*, 306 Or at 390. Whether a law violates the provision, requires a two-step analysis: (1) is there a contract; and (2) has the law in question impaired any obligation of that contract. *Hughes,* 314 Or at 14.

General principles of contract law govern both inquiries, even where the state is alleged to be a party to the contract. However, the following additional rules apply: (1) a state contract will not be inferred from legislation that does not unambiguously express an intention to create a contract; (2) the Contract Clause does not limit the state's power of eminent domain; and (3) the state may not contract away its "police power." *Id*.

In determining whether a particular statute unambiguously expresses an intent to be contractual in nature, "the context in which the * * * statute is enacted is of primary importance." *Id*. at 25. The statute must not be examined in isolation but rather, the analytically proper approach is to examine it within the broader context of the Act into which it is enacted. *Id*. Where the Act itself is found to be supported by the requisite contractual intent, "[e]very valuable privilege given by the [Act], * * * is a contract which cannot be changed by the Legislature, where the power to do so is not reserved in the * * * [Act]." *Id*. at 24, *citing The Piqua Branch of the State Bank of Ohio v. Knoop*, 57 US 369, 379-380, 14 L Ed 977 (1853); *see also Strunk*, 338 Or at 183, n 34 ("We decline respondents' invitation to construe certain of the statutory provisions at issue * * * in isolation. Rather, as we address petitioners' contentions, we must view the wording of all the statutory provisions at issue in the context of their collective operation").

The contractual obligation may not be avoided by reliance on the "police power" doctrine, where the police power alleged to be implicated is the state's inherent power to enact laws and regulations to protect the vital interests of the people. *Eckles*, 306 Or at 399. For, as this court has emphasized,

> "The 'police power' is indistinguishable from the state's inherent power to enact laws and regulations; the existence of the power cannot explain the extent to which the power is constitutionally limited. * * * [T]he state cannot avoid a constitutional command by 'balancing' it against another of the state's interests or obligations, such as protection of the 'vital interests' of the people. Limits on the contractual obligations of the state must be found within the language or history of Article I, Section 21, itself." *Id.* (citations omitted).

The language and history of Article I, Section 21, have been found not to allow the "police power" doctrine to be stretched so far as to permit the state to disregard a statutory financial guarantee to persons or corporations participating in a state insurance system to remedy a financial crisis in the name of protection of the vital interests of the people. *Eckles*, 306 Or at 399.

Finally, with regard to the second step of the analysis (*i.e.*, whether the legislation impairs a contractual obligation), the key is to determine whether the state has eliminated any contractual obligation. *See e.g.*, *Eckles*, 306 Or at 399-401. A contractual obligation consists of the legal duties imposed on the contracting party by operation of law. *Id*. at 400. These legal duties include the requirement that a breaching party compensate the non-breaching party for its failure to perform pursuant to the terms of the contract. *Id*. If the law eliminates a basis for the contractual liability, there is an impairment. *Hughes*, 314 Or at 31-32. If the basis for contractual liability continues to exist but the law mandates non-performance, there is a breach. *Id*.

For the reasons explained further below, the COLA provisions of ORS chapter 238 and 238A and the SB 656 benefit provisions of ORS chapter 238 are contractual in nature and protected by Article I, Section 21 of the Oregon Constitution. SB 822 §§1, 3, 5, 7, and 11-17 and SB 861 §§ 1, 3, and 8 impair those obligations of the PERS contract in violation of Article I, Section 21 of the Oregon Constitution or in the alternative, breach those terms of the PERS contract. Therefore, the court should declare these sections of SB 822 and SB 861 to be unconstitutional and void in whole or in part, or in the alternative, award damages for breach of contract, and award Moro Petitioners' costs and reasonable attorney fees incurred in the prosecution of this action under ORS 652.200 and/or the common fund doctrine.

2. *COLAs and SB 656 Benefits are Contractual Terms of the PERS Contract.*

Whether the PERS statutes create contractual obligations that are entitled to protection under Article I, Section 21, can no longer be reasonably disputed. As recently as in the *Strunk* case, this court reaffirmed that the "accepted proposition of the contractual nature of PERS is an essential background" to any inquiry. *Strunk*, 338 Or at 183. Indeed, for almost 70 years, Oregon has recognized that public employees acquire vested right in their pensions. *See Oregon State Police Ass'n v. State*, 323 Or 356, 371, 918 P2d 765 (1996)("The common thread running through the Oregon cases * * * is that the state may undertake binding contractual obligations with its employees, including benefits that may accrue in the future *for work not yet performed*. Moreover, the cases recognize that the PERS pension plan is an offer for a unilateral contract which can be accepted by the tender of part performance by the employee."); *Hughes*, 314 Or 1, 20, 838 P2d 1018 (1992)("We hold that the legislature intended and understood that PERS constituted an offer, by the state to its employees, for a unilateral contract."); *Taylor v. Mult. Dep. Sher. Ret. Bd.*, 265 Or 445, 450-51, 510 P2d 339 (1973)("We conclude * * * that Oregon has adopted not only the contractual concept of pensions, but, also, the concept that contractual rights can arise prior to the completion of the service necessary to a pension."); *Crawford v. Teachers Retirement Fund Ass'n*, 164 Or 77, 87, 99 P2d 729 (1940)("[U]nder the plan authorized by the statute, plaintiff voluntarily contributed a substantial part of her salary to this fund, contractual relations with the association were created. * * *

[W]hen there had been full performance on the part of the plaintiff, in compliance with the by–laws then governing the association, her rights became vested and no subsequent change in the by–laws could interfere with or impair such rights. Any other rule would utterly destroy all stability and security in the retirement fund plan under consideration."). Therefore, the only remaining question is whether ORS 238.360 (Tier One/Two COLA), ORS 238A.210 (OPSRP COLA), and ORS 238.366 and 238.368 (SB 656 benefits) constitute terms of that PERS statutory contract. As explained below, based on the text, context, and legislative history of these provisions, the clear answer to that question is "yes."

a. Tier One and Tier Two COLA is Contractual.

In fact, this court need only go back to its decision in *Strunk*, 338 Or 220-225, to confirm that ORS 238.360 (Tier One/Two COLA) constitutes a term of the PERS statutory contract. In *Strunk*, the court reviewed the text and context of ORS 238.360 (2001), and recognized that, "[t]he legislature enacted that statute in 1971, and its substance has remained unchanged, notwithstanding other interim amendments. *Id.* at 220. Following a review of these factors, the court concluded that: (1) "the general promise embodied in ORS 238.360(1) (2001) was part of the statutory PERS contract" (*id.* at 221); (2) "the promise does extend to properly calculated service retirement allowances" (*id.* at 222); (3) "the elimination of annual COLAs from the 'fixed' service retirement allowance, as set out in Oregon Laws 2003, chapter 67, section 10(3), is inconsistent with the legislature's promise set out in ORS 238.360(1) (2001)(*id.* at 223); and (4) "by precluding application of annual COLAs to "fixed" service retirement allowances chapter 67, section 10(3), amounts to a directive from the legislature to PERB to breach the promise set out in ORS 238.360(1) (2001)" (*id.* at 224). To remedy that breach, this court declared that the "part of Oregon Laws 2003, chapter 67, section 10(3), that provides, '[t]he fixed service retirement allowance may not be adjusted under ORS 238.360,' to be void." *Strunk*, 338 Or at 225. For all the same reasons it articulated in *Strunk* this court should also find that the remainder of ORS 238.360 is a term of the PERS statutory contract and that by reducing the cap and eliminating the CPI bank, SB 822 and SB 861 impair those obligations of the PERS contract.

i. *Text of ORS 238.360.*

The text of ORS 238.360 (2011) (APP-1) expressly provided in relevant part that:

> "(1) As soon as practicable after January 1 each year, the Public Employees Retirement Board *shall* determine the percentage increase or decrease in the cost-of-living for the previous

> calendar year, *based on the Consumer Price Index (Portland area–all items) as published by the Bureau of Labor Statistics of the U.S. Department of Labor for the Portland, Oregon, area*. Prior to July 1 each year the allowance which the member or the member's beneficiary is receiving or is entitled to receive on August 1 for the month of July *shall* be multiplied by the percentage figure determined, and the allowance for the next 12 months beginning July 1 adjusted to the resultant amount.
>
> "(2) Such increase or decrease *shall not exceed two percent* of any monthly retirement allowance in any year and no allowance shall be adjusted to an amount less than the amount to which the recipient would be entitled if no cost-of-living adjustment were authorized.
>
> "(3) The amount of any cost-of-living increase or decrease in any year 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." (Emphasis added).

As the court recognized in *Strunk* 338 Or at 221, the language of ORS 238.360 is promissory in nature. It not only evinces a "clear legislative intent to provide retired members with annual COLAs on their service retirement allowances, whenever the CPI warrants such COLAs" up to a maximum of 2 percent, but also an intent that CPI in excess of the 2 percent maximum "shall be accumulated * * * and included in the computation" of COLA in succeeding years.

These provisions must be read not "in isolation" but rather "in the context of their collective operation." 338 Or at 183, n 34. That "collective operation" calls for an annual COLA up to a 2 percent maximum with the ability to bank CPI above the maximum.

More importantly, as discussed further below, the COLA was enacted during a period of high inflation. Therefore, by requiring PERS to bank anything above the 2 percent maximum, the legislature would have understood that the chances of a decrease in an allowance was in all likelihood limited. In fact, from 1963 to 2012, the CPI has never been negative. Ex. 48, p. 7 (ER-136). Indeed, the record establishes that in most years since 1971, the CPI has been over 2 percent. SMFR, p. 24 (ER-188). As a result, most retirees have a COLA carryover bank. Ex. 48, p. 2 (ER-131); Ex. 26 (ER-40).

ii. *Legislative History of COLA.*[32]

Before 1971, PERS retiree benefits were not adjusted for inflation. SMFR, pp. 22-23. From 1964 to 1971, PERS retirees received additional payments in what has been referred to as a "13th check system." *See*

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[32]Legislative history is presented here simply to provide the court the historical background for its review of the "text" above and the "context" below. Moro Petitioners understand that the court will "consult it after examining text and context, even if the court does not perceive an ambiguity in the statute's text," if it "appears useful to the court's analysis." *State v. Gaines*, 346 Or 160, 172, 206 P3d 1042, 1050 (2009).

ORS 237.198 (1969); Oregon Laws 1963, ch 608, §9. PERS retirees received these additional checks based on the financial condition of the system. *Id*. In 1971, when the legislature enacted the annual COLA, it gave the first of what came to be called "*ad hoc* increases" by permanently increasing all retirees' pensions in an amount consistent with this prior system of benefits. Ex. 48, p. 4 (ER-133).

In addition, with the passage of Oregon Laws 1971, chapter 738 §§11-12, the legislature created the current COLA scheme (annual adjustment based on CPI with a maximum and banking of CPI above the maximum), providing a 1.5 percent COLA for every monthly retirement allowance payable "[o]n and after July 1, 1972." The 1971 version of the statute expressly provided, in relevant part, as follows:

> "(1) On and after July 1, 1972, every monthly retirement allowance payable to or on account of any person who has retired or who will retire as a member of the system *shall* be adjusted annually to reflect the percentage increase or decrease in the cost of living for the previous calendar year. However, such increase or decrease *shall not exceed* one and on-half percent of any monthly retirement allowance in any year and no allowance shall be adjusted to an amount less than the amount to which the member would be entitled if no cost of living adjustment were authorized.
>
> "(2) As soon as practicable after January 1 each year, the Public Employees' Retirement Board *shall* determine the percentage increase or

> decrease in the cost of living for the previous calendar year, *based on the Consumer Price Index (Portland area-all items) as published by the Bureau of Labor Statistics of the U.S. Department of Labor for the Portland, Oregon area*. Prior to July 1 each year, the allowance which the member is receiving or is entitled to receive on August 1 for the month of July *shall* be multiplied by the percentage figure determined, and subject to section (1) of this section, the member's allowance for the next 12 months beginning July 1 to the resultant amount.
>
> "(3) The amount of any cost of living increase or decrease in any year in excess of the maximum annual retirement allowance adjustment *shall be accumulated* from year to year *and included in the computation* of the increases and decreases in succeeding years." (Emphasis added.) ER-1-2.

The COLA provision was a part of the "public employes retirement package, providing increased benefits." Ex. 50, p. 5 (ER-3). PERS' summary of the bill (Ex. 50, pp. 83-85; ER-11-13) described the COLA proposal as follows:

> "The most important post-retirement increase benefit is an amount adjustment applicable to all PERS members who are retired after 1972. It allows an annual increase or decrease of no more than 1-1/2 percent of the current total service retirement benefit of a retired employee, based upon the increase or decrease in the Consumer Price Index for the preceding year. In no event can a declining CPI reduce the retired member's service benefits below those to which he would have been entitled if no such cost-of-living adjustment had been adopted.

> "Under current trends, this appears to assure an annual increase in service retirement benefits of 1-1/2 percent as long as current inflationary increases continue.
>
> "The improvements indicated are all of a type which are becoming the accepted standard for retirement systems in either the public or private sector. Since HB 1397 does not envision any change in employee contributions, the entire cost must be financed from employer contributions. * * *
>
> "As proposed by HB 1397, the [total] package will cost the employer some 7.4 percent.* * * Although this major package of retirement benefit increases can be financed within the state service for 1971-73 with little or no added costs above those already budgeted, it must be emphasized that some local governments will face increased costs as early as 1972-73."

PERS Director James McGoffin testified that, "The Board felt that under the evaluations they would be able to recommend one and a half automatic ongoing CPIs, Consumer Price Index post retirement increase." (Ex. 50, pp. 18-19; ER-4-5). He was invited by the legislative committee to "go through that 1 and a half percent increases." Ex. 50, p. 27 (ER-7). He explained the operation of the COLA scheme as follows:

> "It is a 1 and a half percent increase. Whatever the cost of living change is, if it exceeds 1 and a half, there's a 1 and a half percent increase would be granted. * * * So, say it increased 3 percent per year, 1 and a half percent would be used, and the increase would be there. The extra one and a half percent * * * would be carried forward to be considered in the following year with whatever took

> place. * * * [T]he meaning or purpose of the benefit is to take account of what has happened to the cost * * * of living in the interval of time, and the idea of putting a maximum on this is to set some basis of control as to cost of the benefit."

Information provided by the PERS Actuary (Ex. 50, p. 91; ER-17) confirmed that:

> "This will provide, then, a permanent base for all pensions and will do away with the necessity of distributing excess interest to pre-1968 pensioners and will additionally provide all our pensioners with an annual cumulative increase of 1 ½ percent per year. In further explanation, were the index to go up to 3 percent in 1972, in 1973 a retirant would receive 1 ½ percent increase. In 1973, if it were 3 percent, he would receive 1 ½ percent of the 1973 computed base."

In 1973, the CPI was 6.53 percent (Ex. 48, p. 7; ER-136), and the legislature increased the maximum for the COLA to 2 percent and made no other changes. Oregon Laws 1973, ch 695, §1; ER-19-20. Due to high inflation, employees had pushed for removal of the maximum altogether. However, the PERS Director and Actuary counseled against it. PERS Director McGoffin testified that PERS was willing to support an increase of up to 2 and a half percent but in a "fiscally responsible" way with a maximum and a minimum. (Ex. 51, p. 25; ER-21). Therefore, the bill was amended and the Committee Chair explained that:

> "The original bill contained a cost of living escalator. Presently PERS law contains a one and a half percent maximum cost of living escalator fee that is tied to the Consumer Price Index in the Portland area, and it says that by any amount that the Portland CPI raises that the benefit of employees in the year following who are retired will be increased by a similar amount, up to a maximum of 1 and a half percent. The proposal was to the bill * * * to raise to whatever the increase in the Consumer Price Index might be * * * and the actuary warned us earlier when he was here that he was not able to determine a cost factor for an unlimited Consumer Price Index escalator. He recommended that it be capped at some level and proposed 3 percent, a 2.5 percent, and the Oregon State Employees Association and others recently proposed a 2 percent level, so it increases only one half of 1 percent.
>
> "As originally written, we weren't quite able to determine what the price would be, but it would be in excess of nine tenths of 1 percent payroll if it's reduced to only 2 percent for an increase of one half of 1 percent. That cost would be three tenths of 1 percent."

Ex. 51, pp. 87-88; ER-26-27. Based on these cost considerations, the legislature increased the COLA to 2 percent. However, it retained to itself the option to address inflation above the 2 percent through "*ad hoc* increases."

Subsequently, between 1973 and 1989, the legislature provided additional "*ad hoc* increases" during times of high inflation to protect the purchasing power of PERS retirees (Ex. 48, p. 4; ER-133); however, the legislature has made only "housekeeping" changes to the COLA statute. See Oregon Laws 1989, ch 799 §2 and Oregon Laws 2001, ch 945 §79. (Exs. 52, 57). In 1989, for "easier reading," the legislature removed the original section 1 which provided for both the annual adjustment and the 2 percent cap and separated the two concepts into current sections 1 and 2. (Ex. 52, p. 17). In addition, the legislature clarified that COLAs are also payable to beneficiaries of retirees. *Id*. In 1995, the statute was renumbered from ORS 237.060 to ORS 238.360. Finally, in 2001, the legislature removed the old ORS chapter 237 words "current service" in front of "contributions of the public employers" from section 4 of the statute to clarify that the COLA would be funded from the usual employer contribution rates set by the actuary under ORS 238.225. (Ex. 57).

With the exception of the 2003 PERS Legislation's temporary COLA suspension (voided by this court in *Strunk*), therefore, PERS retirees have received a 2 percent COLA increase for the last 40 years.[33] To the extent that inflation exceeds 2 percent, the additional percentage has been banked. Ex. 26; ER-40.

[33] PERS retirees have generally received the 2 percent increase, except in instances when inflation is lower than 2 percent in the initial year of retirement. *See generally* Ex 48, p. 7, Ex. 26. The current PERS assumption for inflation is 2.75 percent. SMFR, p. 24 (ER-188).

iii. *Context of ORS 238.360.*

In *Strunk*, 338 Or at 222, after concluding that ORS 238.360 was a term of the PERS contract, this court held that the only limitation on that promise was ORS 238.715, which allows PERS to recover overpayments. Therefore, the COLA promise encompassed in ORS 238.360 extends only to properly calculated service retirement allowances." *Id.* There is no question here that Moro Petitioners are receiving "properly calculated service retirement allowances." The fact that some of these "properly calculated service retirement allowances" might be based on prior earnings crediting decisions which some might deem to have been overly generous is not something which this court can now take into account. As the court explained in *Strunk*, 338 Or at 204-205, "Tier One members' regular account balances currently reflect annual earnings credits that often exceeded the assumed earnings rate. Those prior earnings crediting decisions, whether or not they are deemed to have been overly generous in hindsight, are now final."

Therefore, based on the text, context, and legislative history of ORS 238.360, the court should conclude that the COLA scheme enacted by the 1973 legislature consisting of the CPI, 2 percent maximum, and bank of any CPI above the maximum are contractual terms of the PERS contract.

b. OPSRP COLA is Contractual.

Other than the option of banking COLA above the maximum, the OPSRP COLA scheme provided in ORS 238A.210 functions almost identically to the Tier One/Two COLA scheme and is similarly promissory. Through ORS 238A.470, the legislature expressly retained to itself the authority to change OPSRP "as long as the change applies only to benefits attributable to service performed and salary earned after the date the change is made."[34] Accordingly, OPSRP members have a contractual right to COLA benefits attributable to service performed and salary earned prior to the enactment of any change to the ORS 238A.210 COLA scheme. As explained further in Section II.C.3.b, SB 822 and SB 861 make no attempt to protect such COLA benefits.

i. *Text of ORS 238A.210.*

The text of ORS 238A.210 (APP-4) expressly provides as follows:

> "(1) As soon as practicable after January 1 each year, the Public Employees Retirement Board

[34] In *Hughes*, 314 Or at 24 this court cited *Piqua Bank*, 57 U S at 379-80 for the long-recognized proposition that, "Every valuable privilege given by the charter * * *, is a contract which cannot be changed by the Legislature, where the power to do so is not reserved in the charter." ORS 238A.470 is an example of such an express reservation of rights.

> *shall* determine the percentage increase or decrease in the cost of living for the previous calendar year, *based on the Portland-Salem, OR-WA, Consumer Price Index for All Urban Consumers for All Items, as published by the Bureau of Labor Statistics of the United States Department of Labor*. Before July 1 each year, the board shall adjust every pension payable under ORS 238A.180, 238A.185 and 238A.190, every disability benefit under ORS 238A.235 and every death benefit payable under ORS 238A.230 by multiplying the monthly payment by the percentage figure determined by the board. If a person has been receiving a pension or benefit for less than 12 months on July 1 of a calendar year, the board *shall* make a pro rata reduction of the adjustment based on the number of months that the pension or benefit was received before July 1 of the year. The adjustment *shall be made* for the payments payable on August 1 and thereafter.
>
> "(2) An increase or decrease in the benefit payments under this section *may not exceed two percent* in any year. A pension or death benefit may not be adjusted to an amount that is less than the amount that would have been payable if no cost-of-living adjustment had been made since the pension or death benefit first became payable."

The language of ORS 238A.210 is similar to ORS 238.360 and is, therefore, similarly promissory. That promise encompasses an annual COLA based on CPI up to a maximum of 2 percent.

ii. *Context of ORS 238A.210.*

As noted above, the context of ORS 238A.210 includes ORS 238A.470 (APP-5), which allows the legislature to make changes, "as long as the change applies only to benefits attributable to service performed and salary earned after on or after the date the change is made." APP-5. The context supports petitioners' position that when the legislature used promissory language derived from ORS 238.360 for ORS 238A.210, it intended to create contract rights and only reserved to itself the right to make changes prospectively so long as the change preserved the benefits attributable to service performed and salary earned before the date of the legislative change.

iii. *Legislative History of 238A.210.*

The legislative history of ORS 238A.210 and ORS 238A.470 also support petitioners' position that the legislature only retained to itself the ability to change OPSRP COLA prospectively and only so long as benefits attributable to service performed and salary earned before the date of legislative change were preserved. For example, the Staff Measure Summary for HB 2020 from the House Committee on PERS from the 2003 Regular Session expressly noted that the bill provides for "cost of living limited to two percent" and specifies that "the Legislative Assembly * * * may make changes to the system at any time, as long as the change applies to benefits accruing on or after the effective date of the change." APP-7. Similarly, the Staff Measure Summary for HB 2020 from the

Senate Committee on General Government also noted that the bill, "sets cost of living adjustment annually not to exceed two percent in any year," and "[d]eclares nature of contract rights and that only benefits attributable to future service may be changed." APP-15; see also APP-13.

Based on the text, context, and legislative history of ORS 238A.210, therefore, the court should find that OPSRP COLA is contractual term of the PERS Contract and requires an annual COLA based on CPI up to a 2 percent maximum until the legislature changes the COLA scheme in a manner consistent with its reserved powers, i.e., in a manner which protects COLA benefits attributable to service provided and salary earned before the date of the change.

c. SB 656 Benefits are Contractual.

As explained above, SB 656 provides an adjustment of benefits for Tier One members from 1 to 4 percent based on years of service. As with the COLA statutes, the language of SB 656 is promissory in nature. The only limitation on that benefit retained by the legislature at enactment was that the benefit would not be paid "in a tax year in which retirement benefits payable under the system are exempt from Oregon personal income taxation." Oregon Laws 1991, ch 796, §12. As explained further below, the legislature has not reenacted the tax exemption for retirement benefits payable under the system. Therefore, this reservation of right is non-applicable and the contractual right to receive SB 656 benefits continues.

i. *Text of SB 656.*

The text of SB 656 is lengthy and is included at pages 32 to 37 in the Excerpt of Record. Section 2, the operative section at issue, provided benefits from 1 to 4 percent based on years of service above 10 years using promissory language, which expressly provided, in relevant part, as follows:

> "(1) Upon retirement of an employee who is a member of the system and computation of the member's service retirement allowance * * *, the board *shall add* to the amount of the allowance, * * *, an additional amount equal to the percentage increase provided in subsection (4) of this section. * * *" (Emphasis added.)

SB 656, Section 6 provided similar benefits to those who retired before January 1, 1991. Again, the language used is mandatory and promissory in nature. It provides those with more than 10 years of service in the system an increase between 1 and 4 percent depending upon their years of service. As this court recognized in *Ragsdale*, 321 Or at 221:

> "The benefits are not calculated on actual or even potential tax liability. That is to say, there is no mathematical correlation between taxes and the benefits created in 1991. Some state retirees who will be required to pay state income taxes on their PERS retirement benefits will receive no additional benefits

> under the 1991 law. Conversely, some state retirees who will pay no state income taxes will receive additional benefits."

Finally, there is nothing in the text of the operative sections which indicates that the legislature intended to deny these additional benefits to those retirees who moved out of state.

To the contrary, in *Ragsdale*, 321 Or at 229-30, this court expressly recognized that retirees residing out of the state of Oregon <u>are</u> entitled to receive SB 656 benefits. In *Ragsdale*, this court distinguished SB 656 benefits from a 1991 benefit which the Montana Supreme Court had found constituted discriminatory taxation in *Sheehy v. Public Employees Retirement Div.*, 262 Mont 129, 864 P2d 762 *reh den* (1993). This court explained its reasoning as follows:

> "The Sheehy court's conclusion that the Montana adjustment is a partial tax rebate that violated federal law relied heavily on two features of the Montana enactment: (1) that only retirees who are Montana residents will receive the benefit, and (2) that the retirement benefits at issue are funded solely by the Montana general fund.
>
> "In contrast, under Oregon Laws 1991, chapter 796, every state retiree who qualifies for benefits (based on years of service) will receive the benefits, *regardless of the state retiree's residency*. Moreover, the challenged provisions of Oregon Laws 1991, chapter 796, do not appropriate money from the Oregon general fund. Rather, the increased PERS retirement benefits are funded by contributions from all PERS employers to the PERS

> retirement trust fund. Or Laws 1991, ch 796, § 3" (Emphasis added). *Ragsdale*, 321 Or at 230

Subsequently, the court reaffirmed this analysis of SB 656 in *Vogl v. Department of Revenue*, 327 Or 193, 212, 960 P2d 373 (1998), when it analyzed whether HB 3349 benefits constituted a tax rebate, noting: "We emphasize that our holding necessarily is confined to the 1995 statute. We do not overrule *Ragsdale* or its analysis of the 1991 law."

ii. *Context of SB 656(2).*

Part of the context of SB 656(2) includes Section 12. Section 12 limits payment of SB 656 benefits "in any tax year in which retirement benefits payable under the Public Employees Retirement System are exempt from Oregon personal income taxation." However, there is no dispute that Oregon has never reinstated the ORS 237.201 (1989) and ORS 316.680 (1)(d) (1989) exemption from personal income taxation for PERS benefits. In fact, even after federal law mandated the enactment of Oregon Laws 1997, chapter 839, §10 (currently codified at ORS 316.127(9)) providing that, "[r]etirement income received by a nonresident does not constitute income derived from sources within this state unless the individual is domiciled in this state)," PERS has continued to pay SB 656 benefits to all PERS retirees, including to those who have moved out of the State of Oregon.[35] Thus, it appears that PERS' reading of Section 12 over the past 17 years has been the same as petitioners in that PERS recognized Section 12 to cover only the situation where the State reinstated the exemption from taxation for all PERS benefits which existed prior to 1991. In the absence of the reinstatement of that exemption, SB 656 benefits are owed to eligible retirees regardless of their state of residence.

For all these reasons, the court should conclude that SB 656 did not intend to deny benefits to out-of-state residents and that until the exemption for all retirement benefits payable from the system is reinstated, SB 656 remains a contractual term of the PERS contract for all eligible retirees, including out of state retirees who may not pay Oregon taxes.

3. *The Challenged Sections of SB 822 and SB 861 substantially impair or breach the COLA and SB 656 obligations of the PERS Contract in violation of Article I, Section 21.*

In *Strunk*, 338 Or at 170, this court cited *Eckles* and *Hughes* and explained the difference between an impairment and a breach as follows:

> "First, in *Eckles*, this court clarified that the contracts provision of Article I, section 21, prohibited the impairment of a contractual obligation. *Eckles*, 306 Or at 395, 760 P.2d 846. As to the determination whether newer legislation amounts to an impairment

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[35]The SMFR found that approximately 16,546 recipients have moved out of the state. ER-201.

> of a preexisting statutory contractual obligation, the court focused on whether the legislation would change or eliminate the state's obligation under that contract. *Id*. at 399–400, 760 P.2d 846. By contrast, the court explained that legislation that mandated a breach on the state's part of such a contractual obligation—but did not change or eliminate the obligation itself—did not contravene Article I, section 21, although, in accordance with that constitutional provision, such legislation ordinarily would require payment of damages resulting from the breach. *Id*. at 400–02, 760 P.2d 846."

Here, SB 822 and SB 861 change or eliminate the nature of the COLA (Tier One/Two and OPSRP) and SB 656 benefits. Therefore, the court should find an impairment. In addition, in *Strunk*, 338 Or at 206, this court confirmed that it "has yet to determine whether *substantiality* of an impairment of a contractual obligation is required to show a violation of Article I, section 21." (Emphasis added). However, even if it were to find such a requirement existed under Article I, Section 21, as explained further below, the annual and lifetime impact of the changes made by SB 822 and SB 861 on Moro petitioners are clearly "substantial."

a. Tier One/Tier Two COLA Change.

SB 822, Section 1, changed the 2 percent maximum for COLA for the year 2013 to 1.5 percent. In addition, SB 822, Section 3, as amended by SB 861, Section 1, eliminated the CPI up to a maximum of 2 percent and banking of CPI above the maximum for allowances made after July 1, 2014.

After July 1, 2014, under SB 861, Section 3, PERS retirees will now only be eligible to receive an adjustment of 1.25% if their yearly pension or benefit is $60,000 or less and if their pension or benefit is more than $60,000, $750 plus 0.15 percent of the amount exceeding $60,000. For a limited duration (i.e., until December 1, 2019), PERB must also pay a supplementary payment of 0.25 percent up to a maximum of $150 to all retirees and a second 0.25 percent supplementary payment to those retirees receiving pension benefits of $20,000 or less annually. *See* SB 861, Section 8; ER-92. The adjustment thresholds are not indexed for inflation.

According to Moro Petitioners' expert these changes to Tier One/Two COLA impact petitioners as follows:

Petitioner	SB 822 Loss	SB 861 Loss
Everice Moro	1.2% ($8,101)	10.2% ($68,573)
Terri Domenigoni	3.0% ($28,797)	10.5% ($101,315)
Charles Custer	4.2% ($44,287)	6.9% ($72,200)
John Hawkins	3.30% ($32,572)	9.20% ($91,371)
Michael Arken	4.48% ($59,767)	11.06% ($147,540)
Eugene Ditter	13.6% ($458,474)	15.7% ($530,421)
John O'Kief,jb	10.7% ($187,356)	15.7% ($296,532)
Michael Smith[3]·	8.4% ($55,256)	9.6% ($68,344)
Lane Johnson	2.8% ($31,418)	12.4% ($140,867)
Greg Clouser	7.4% ($157,492)	13.8% ($294,914)
Alison Vickery	3.2% ($38,389)	12.2% ($147,862)

See 8MFR, pp. 58-72 (ER-222-236); Exs. 3-14. The percentage losses incurred by Moro Petitioners are similar to the range of losses incurred by the petitioners in *Strunk (compare* Ex. 15, pp. 96-110) which were found to be a substantial impairment by this court. 338 Or at 206.

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[36] Percentage loss includes 2.83 percent loss attributable to tax adjustment also. (Ex. 825 p.1). Nominal dollar loss is attributable solely to COLA

[37] Percentage loss includes 3.69 percent loss attributable to tax adjustment also. (Ex. 825 p. 2). Nominal dollar loss is attributable solely to COLA.

b. OPSRP COLA Change.

SB 822, Section 5, changed the 2 percent maximum for COLA for the year 2013 to 1.5 percent. In addition, SB 822, Section 7, as amended by SB 861, Section 3, eliminated the CPI up to a maximum of 2 percent for allowances made after July 1, 2014, providing the same 1.25 percent and 0.15 percent adjustments and supplementary payments through 2019 discussed above for Tier One/Two PERS members. As with the Tier One/Two adjustments, the OPSRP adjustments are not indexed for inflation. The SB 822 ad SB 861 changes also contain no express provisions intended to protect COLA "benefits attributable to service provided and salary earned before the date of the change," as required by ORS 238A.470.

According to Moro Petitioners' expert, these changes to the OPSRP COLA impact petitioners as follows:

Petitioner	**SB** 822 Loss	**SB** 861 Loss
Brandon Silence	19.7% ($1'107,583)	22.5% ($1,260,580)
Jin Voeks	11.8% ($366,416)	16.0% ($497,419)

Again, the percentage loss attributable to the changes is similar in range to that found by this court in *Strunk,* 338 Or at 206, to be a "substantial impairment."

c. SB 656 Benefit Change.

As explained above, the SB 656 term of the PERS Contract obligated PERS to be provide eligible PERS members an additional 1 to 4 percent in benefits depending upon their years of service. As this court recognized in *Ragsdale*, 321 Or at 230, "every state retiree who qualifies for benefits (based on years of service) will receive the benefits, *regardless of the state of retiree's residency*." (Emphasis added).

SB 822, Sections 11-17, however, eliminate SB 656 benefits "if the Board receives notice * * * that the payments made to the person under this chapter are not subject to Oregon personal income tax under ORS 316.127(9)." As noted above, ORS 136.127(9) provides that "[r]etirement income received by a nonresident does not constitute income derived from sources within this state unless the individual is domiciled in this state." In other words, SB 822, Sections 11-17 deny eligible PERS members SB 656 benefits solely based on their out-of-state residence. The benefits are only reinstated the "the first day of the calendar year following receipt of notice" by PERB that the "payments to the person * * * are subject to Oregon personal income tax under ORS 316.127(9)," *i.e.*, the retiree is once again "domiciled within this state."

According to PERS' own calculations (Ex. S25, pp. 1-2) based on assumptions used by Moro Petitioners' expert, these changes to SB 656 benefits impact petitioners as follows:

Petitioner	SB 656 Benefit Loss
John O'Kief	2.83% ($65,319.51)
Michael Smith	3.69% ($41,906.71)

These numbers are higher than the temporary loss of COLA voided by the court as a breach in *Strunk* and lower than the percentage loss for 2003 changes to the earnings rate voided as a substantial impairment by the court in *Strunk,* 338 Or at 206. The numbers are also consistent with PERS calculations that the combined effect of elimination of the SB 656/ HB 3349 benefits on average is approximately 6.097 percent. SMFR, p. 37 (ER-201).

Simply put, the changes to SB 656 benefits, at a minimum, breach the PERS Contract, and the changes to Tier One/Two and OPSRP COLA substantially impair obligations of the PERS contract. As explained further below, this impairment or breach is not supported by any cognizable defense under Article I, Section 21 of the Oregon Constitution.

4. *The impairment or breach of the COLA and SB 656 obligations of the PERS Contract is not supported by any cognizable defense under Article I, Section 21.*

Respondents' "public purpose" constitutional defense reflects a common constitutional theme characterized by the tension between the Contract Clause and the state's police powers. In discussing these legal theories, there are a few basic principles that must be recognized.

Under the federal Contracts Clause analysis, a substantial impairment of contract rights may be justified if the impairment is both reasonable and necessary to serve an important public purpose. *United States Trust Co. v. New Jersey*, 431 US 1, 27, 97 S Ct 1505 (1977). However, this court has never adopted this type of balancing test under the Oregon Constitution.

In fact, in *Eckles*, this court rejected the application of any such balancing test as a means of justifying a state's impairment of its own contractual obligations under the Oregon Constitution. 306 Or at 398-99. *Eckles* involved legislation that directed the state treasurer to transfer millions of dollars from the Industrial Accident Fund to the state general fund despite the fact that the Industrial Accident Fund is, by statute, declared to be a trust fund maintained exclusively for certain workers compensation purposes. The transfer legislation was enacted to close a gap in the state budget. *Id*. at 382. The petitioner in *Eckles* brought a challenge to the legislation under the Contract Clause. In discussing the proper Contract Clause analysis, this court observed that the United States Supreme Court, in addressing contract clause challenges under the federal constitution, employs a balancing analysis which considers the "inherent police power of the State 'to safeguard the vital interests of its people.'" *Id*. at 398 (*quoting Energy Reserves Group v. Kansas Power & Light*, 459 US 400, 410, 103 S Ct 697 (1983)). Then, acknowledging that the existing financial crisis might qualify as a vital state interest, this court rejected the application of a balancing test, at least insofar as the state was one of the contracting parties:

> "The need to resolve the financial crisis that induced the Legislative Assembly to pass the Transfer Act could perhaps be described as a 'vital interest' of the state, but we doubt that the 'police power' doctrine could be stretched so far as to permit the state to disregard a financial guarantee to persons or corporations who participate in its state insurance system. In any event, this court has emphasized in recent years that the 'police power' is indistinguishable from the state's inherent power to enact laws and regulations; the existence of that power cannot explain the extent to which the power is constitutionally limited. * * * Moreover, the state cannot avoid a constitutional command by 'balancing' it against another other of the state's interests or obligations, such as protection of the 'vital interests' of the people. * * * Limits on the contractual obligations of the state must be found

> within the language or history of Article I, section 21, itself." *Id*. at 398-99 (internal citations omitted).

To the extent any doubt remained after *Eckles*, this court put it to rest in *Hughes*. Citing *Eckles*, the *Hughes* court again noted that the so-called "police power" is nothing more than the state's inherent power to enact laws, and that although the state may not contract away its so-called "police power," that rule "does not embrace the 'balancing analysis' currently employed by the Supreme Court of the United States in its analysis of the Contract Clause in Article I, Section 10, clause 1 of the Federal Constitution." 314 Or at 14, n 16.

The point is that the exercise of the so-called police power, even in the vital interest of the state and its citizens, cannot operate to carve out certain contract rights from the constitutional protections provided by the Contract Clause and thereby render those rights unprotected. After all, the police power is not a constitutional grant of power, but merely refers to the plenary power of the state to enact laws. *Eckles*, 306 Or at 399; *see also* Hans A. Linde, "Without Due Process," 49 Or L Rev 125, 147-48 (Feb 1970) ("No constitution, state or federal, grants Oregon or any other state a 'police power.' There simply is no such thing. What Oregon has, as a state, is plenary power to make and administer law, by means of constitutional institutions and subject to constitutional limitations.")

(emphasis in original). It is the constitution that curtails the state's ability to enact laws, and not the other way around.

As a result, before this court reaches the issue of whether any economic hardship would justify impairing the State's contractual obligations, it should consider whether such a balancing is proper in the first instance. Based on *Eckles* and *Hughes*, this court should find that no balancing is proper, particularly given that the state was acting as an employer and contracting party in offering PERS benefits in exchange for public employment.

Second, even if this court considers the "public purpose" evidence under the federal balancing approach, as discussed further below in Section IV.C.4, the state's impairment of its own contracts must be held to a higher standard than the state's impairment of private contracts. As shown below, the evidence here fails to satisfy that higher standard. As in *Eckles*, the legislature here was acting purely based on budgetary concerns. It wanted to reach a budget goal, and it did that by raiding PERS dollars to pay for other basic services.

III. SECOND ASSIGNMENT OF ERROR

SB 822 §§1, 3, 5, 7, and 11-17 and SB 861 §§ 1, 3, and 8 take private property (COLAs and SB 656 benefits) for public use without just compensation in violation of Article I, section 18 of the Oregon Constitution.

A. *Standard of Review*

Petitioners incorporate by this reference their discussion above in Section II.A.

B. *Preservation of Error*

Moro petitioners preserved this assignment of error through their Third, Seventh, and Eleventh Claims for Relief in their original and amended petitions.

C. *Argument*

1. *Legal Standard.*

Under Article I, Section 18 of the Oregon Constitution, "[p]rivate property shall not be taken for public use * * * without just compensation." Article I, Section 18, was modeled after the federal takings clause. *Dunn v. City of Milwaukie*, 355 Or 339, *5 (2014), *citing Coast Range Conifers v. Board of Forestry,* 339 Or 136, 144, 117 P3d 990 (2005)(discussing federal roots of Article I, Section 18). The United States Supreme Court has recognized that there is a nearly infinite variety of ways that government action or regulation can affect property interests. *Arkansas Game and Fish*

Com'n v. U.S., 133 S Ct 511, 518, 184 L Ed 2d 417 (2012). Because of that, no "magic formula" has been identified to enable federal courts to determine, in every variety of case, whether a given interference with property is a taking. *Id.* This court has generally recognized, however, that, property is taken, for purposes of Article I, section 18, where there has been "destruction, restriction or interruption of the necessary use and enjoyment" of that property for a public purpose. *Hawkins v. City of La Grande*, 315 Or 57, 68, 843 P2d 400 (1992)(quoting *Moeller v. Multnomah County*, 218 Or 413, 431, 345 P2d 813 (1959)). Although most cases arising under the takings clause involve the state's exercise of its eminent domain powers over real property, personal property, too, is protected. 315 Or at 67. Fundamental legal interests in property, such as the right to possess, use, and dispose of property, are also protected. *See Cereghino et al v. State Highway Com.*, 230 Or 439, 445, 370 P2d 694 (1962). But whether the invasion is to real property or personal property, and to the physical property or the intangible but essential rights of ownership in it, the one principle that holds true is that the government's conduct must be "tantamount to a public appropriation" of property, both in nature and in degree. *Dunn,* 355 Or 339, *4 *citing Coast Range Conifers,* 339 Or at

147)(discussing various tests and observing that, under them, government act must be “tantamount to a public appropriation of private property”).

Therefore, as explained further below, the court should find that petitioners have a property interest in their COLAs and SB 656 benefits. The challenged sections of SB 822 and SB 861 constitute a taking of private property for public use without just compensation. Accordingly, petitioners are entitled to just compensation in an amount equivalent to the loss they have suffered as a result of the elimination of the annual COLA based on a CPI up to a two percent maximum with banking above the 2 percent maximum for Tier One/Two members and SB 656 benefits for eligible employees.

2. Petitioners have a Property Interest in their COLAs and SB 656 Benefits.

Petitioners incorporate by this reference their discussion above in Section II.C.2. The U.S. Supreme Court has recognized that, contract rights are a form of property and as such may be taken for a public purpose provided that just compensation is paid. *U.S. Trust Co. of New York v. New Jersey*, 431 US 1, 19 n 16, 97 S Ct 1505, 1516, 52 L Ed 2d 92 (1977) *citing Contributors to Pennsylvania Hospital v. Philadelphia*, 245 US 20, 38 S Ct 35, 62 L Ed124 (1917); *see El Paso v. Simmons*, 379 US 497, 533-534, 85 S Ct 577, 597, 13 L Ed 2d 446 (1965) (Black, J., dissenting). In the context of family law cases, this court has also recognized that even employees with non-vested interest in their PERS pension benefits have a "property interest" in that benefit. *In Re Marriage of Richardson*, 307 Or 370, 377, 769 P2d 179 (1989). The court should, therefore, find that petitioners have a property interest in their PERS COLAs and SB 656 benefits.

3. *The Challenged Sections of SB 822 and SB 861 constitute a taking private property for public use without just compensation.*

In *Brown v. Legal Found. of Washington*, 538 US 216, 220, 123 S Ct 1406, 155 L Ed 2d 376 (2003), the U.S. Supreme Court was called on to determine whether the State of Washington's use of interest on lawyers' trust accounts (IOLTA) to pay for legal services provided to the needy constituted a "taking" and if so what "just compensation" was due. With limited discussion, the court found that using the interest "in providing legal services to literally millions of needy Americans certainly qualifies the * * * distribution of these funds as a 'public use'" within the meaning of the Fifth Amendment. 538 US at 232. However, no "just compensation" was owed because plaintiffs could not present any evidence to show that that they personally suffered any financial losses from a correct application of the IOLTA program because only funds that cannot earn net interest for the client must be deposited in an IOLTA account . *Brown*, 538 US at 224.

Similarly, in *Eckles*, although this court recognized that, "The need to resolve the financial crisis that induced the Legislative Assembly to pass the Transfer Act could perhaps be described as a 'vital interest' of the state" (306 Or at 399), no just compensation was owed because, plaintiff failed "to prove that he was damaged by the transfer of funds." *Eckles*, 306 Or at 403.

Unlike the plaintiffs in those cases, Moro Petitioners have established substantial financial loss attributable to the SB 822 and SB 861 changes to their COLAs and SB 656 benefits. Petitioners incorporate herein their discussion above in Section II.C.3. Furthermore, the legislative history records for SB 822 and SB 861 make clear that the purpose of the 2013 changes was to save the State and local jurisdictions money so that they could provide their regular services to the general public. *See* Ex. 59, p. 578 (ER-80) ("making more funds available for schools and other employers participating in PERS to devote to their core governmental functions"); Ex. 60, p. 166 (ER-98) ("massive layoffs in schools"); Ex, 60, p. 171 (ER-103) ("thousands of people with mental health issues" and "the people we have to protect the public from" through our "public safety system."). Therefore, the court should find that petitioners have established "public use" and are entitled to "just compensation" for the losses they have incurred.[38]

IV. THIRD ASSIGNMENT OF ERROR

SB 822 §§1, 3, 5 ,7 and 11-17 and SB 861 §§ 1, 3, and 8 impair the COLA and SB 656 benefit obligations of the PERS contract in violation of Article I, Section 10, clause1 of the United States Constitution or in the alternative, breach those terms of the PERS contract..

A. *Standard of Review*

Petitioners incorporate by this reference their discussion above in Section II.A.

B. *Preservation of Error*

Moro petitioners preserved this assignment of error through their Second, Fourth, Sixth, Eighth, Tenth, and Twelfth Claims for Relief in their original and amended petitions.

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[38] Even if the court were to take a "present value" approach to those losses, this court recognized in *The Matter of Marriage of Richardson*, 307 Or at 378, that the "actuarial present value" for defined benefits is measured, "by determining the amount of money presently needed to purchase an annuity which would pay a particular monthly amount for the life expectancy of the retired employee." The PERS Actuary testified that the market rate for an individual annuity would be approximately 4 percent. Tr. 60.

C. *Argument*

1. *Legal Standard.*

The Contract Clause of the United States Constitution states, “No State shall * * * pass any * * * Law impairing the Obligation of Contracts.” US Const, Art I, § 10, cl 1. Whether a state law violates the Contract Clause is governed by a three-step inquiry. The first inquiry concerns “whether the state law has, in fact, operated as a substantial impairment of a contractual relationship.” *RUI One Corp. v. City of Berkeley*, 371 F3d 1137, 1147 (9th Cir. 2004) (quoting *Allied Structural Steel Co. v. Spannaus*, 438 US 234, 244, 98 S Ct 2716, 57 L Ed 2d 727 (1978) and *Home Bldg. & Loan Ass'n v. Blaisdell*, 290 US 398, 411, 54 S Ct 231, 78 L Ed 413 (1934). This threshold inquiry itself has three components: (1) “whether there is a contractual relationship” *Id*. (*Gen. Motors Corp. v. Romein*, 503 US 181,186, 112 S Ct 1105, 117 L Ed 2d 328 (1992)(quoting *Allied Structural Steel Co*., 438 U S at 244, 98 S Ct 2716)); (2) whether a change in the law impairs that contractual relationship; and (3) whether the impairment is substantial. *Id*. at 186.

If this three-component threshold inquiry results in a finding that a law has substantially impaired a contractual relationship, a court must address the second inquiry, which concerns whether “the State, in justification, has a significant and legitimate public purpose behind the regulation, such as the remedying of a broad and general social or economic problem" to guarantee that "the State is exercising its police power, rather than providing a benefit to special interests." *RUI One Corp.*, 371 F3d at 1147 (quoting *Blaisdel*, 54 S Ct 231).

The final inquiry concerns "whether the adjustment of the rights and responsibilities of contracting parties is based upon reasonable conditions and is of a character appropriate to the public purpose justifying the legislation's adoption." *RUI One Corp*, 371 F3d at 1147 (quoting *U.S. Trust,* 431 US at 22 and *Blaisdel*, 54 S Ct 231). "[W]hen a state is itself a party to a contract, courts must scrutinize the state's asserted purpose with an extra measure of vigilance." *McGrath v. Rhode Island Ret. Bd.*, 88 F3d 12, 16 (1st Cir 1996) *citing U S Trust*, 431 U S at 26 ("[C]omplete deference to a legislative assessment of reasonableness and necessity is not appropriate because the State's self-interest is at stake."). Indeed the State is "not free to consider substantial contractual impairments on a par with other policy alternatives." *State of Nev. Employees Ass'n, Inc. v. Keating*, 903 F2d 1223, 1228 (9th Cir 1990).

> "A governmental entity can always find a use for extra money, especially when taxes do not have to be raised. If a State could reduce its financial obligations whenever it wanted to spend money for

> what it regarded as an important public purpose, the Contract Clause would provide no protection at all."

U.S. Trust, 431 U S at 26. "An impairment may not be considered necessary if there is 'an evident and more moderate course' of action that would serve Defendants' 'purposes equally well * * *.'" *Univ. of Haw. Prof'l Assembly v. Cayetano*, 183 F3d 1096, 1107 (9th Cir 1999)(*quoting U.S. Trust*, 431 U S at 31). In *Southern California Gas Co. v. City of Santa Ana*, 336 F3d 885, 897 (9th Cir 2003), the Ninth Circuit Court of Appeals noted at that time that, "[N]o Ninth Circuit or Supreme Court case ha[d] found a statute or ordinance necessary when the law in question altered a financial term of an agreement to which a state entity was a party."

For the reasons explained further below, the court should find that COLAs and SB 656 benefits are also contractual terms of the PERS Contract under federal law. The challenged sections of SB 822 and SB 861 substantially impair or breach the COLA and SB 656 obligations of the PERS Contract in violation of Article I, Section 10 of the United States Constitution. The impairment of the COLA and SB 656 obligations of the PERS Contract is not necessary and reasonable to support any public purpose. Therefore, the SB 822 and SB 861 are unconstitutional and must be voided in whole or in part.

2. COLAs and SB 656 Benefits are Contractual Terms of the PERS Contract under federal law.

Federal law controls whether an agreement constitutes a contract for purposes of Contract Clause analysis. *Romein*, 503 US at 187; *see also State of Nev. Employees Ass'n, Inc. v. Keating*, 903 F2d 1223, 1227 (9th Cir1990). Here, petitioners' claims are supported by express and promissory statutory language. Petitioners incorporate by this reference their discussion above in Section II.C.2. Indeed, the Tier One/Two COLA language has already been found to be contractual by this court in *Strunk*, 338 Or at 221. Federal courts accord "respectful consideration and great weight to the views of the State's highest court * * *." *Robertson v. Kulongoski*, 466 F3d 1114 (9th Cir 2006) *citing Romein*, 503 US at 187, 112 S Ct 1105. Therefore, petitioners have also established a contract right under federal law.

3. *The Challenged Sections of SB 822 and SB 861 substantially impair the COLA and SB 656 obligations of the PERS Contract.*

Total destruction of contractual expectations is not necessary for a finding of substantial impairment. *Energy Reserves Grp., Inc. v. Kansas Power & Light Co.*, 459 US 400, 411, 103 S Ct 697, 704, 74 L Ed 2d 569 (1983) *citing US Trust*, 431 U S at 26–27. "An impairment of a public contract is substantial if it deprives a private party of an important right, thwarts the performance of an essential term, defeats the expectations of the parties, or alters a financial term." *City of Santa Ana*, 336 F 3d at 890 (internal citations omitted). The changes made to COLAs and SB 656 benefits are "substantial" under any of these tests. Petitioners incorporate by this reference their discussion above at Section II.C.3. Not only have Moro Petitioners established substantial personal financial losses attributable to the changes effected by SB 822 and SB 861 (i.e., between $68,573 to $1,260,580), but also the record establishes that PERS calculates the total benefits lost at a present value of $5.3 billion valued as of December 31, 2011. ER-199. Therefore, average present value loss for the 329,987 members (including active, inactive, and retired) in the system at that time (Ex. 25, p. 2) would be approximately $16,000. The court should, therefore, find that the challenged sections of SB 822 and SB 861 substantially impair the COLA and SB 656 obligations of the PERS Contract.

4. *The impairment or breach of the COLA and SB 656 obligations of the PERS Contract is not reasonable or necessary to support any public purpose defense under Article I, Section 10.*

To determine reasonableness, the court looks at the extent of the impairment as well as the public purpose to be served. *See United States Trust Co.*, 431 U S at 29. On review, the court balances "the contractual rights of the individual against the essential attributes of sovereign power necessarily reserved by the States to safeguard the welfare of their citizens." *Cayetano*, 183 F3d at 1107 *citing Association of Surrogates & Supreme Court Reporters v. New York*, 940 F2d 766, 771 (2d Cir 1991). An impairment may not be considered necessary if there is "an evident and more moderate course" of action that would serve Defendants' "purposes equally well," *see United States Trust Co.*, 431 US at 31, because "[t]he contract clause of the Federal Constitution limits the ability of a State, or subdivision of a State, to abridge its contractual obligations without first pursuing other alternatives." *See Cayetano*, 183 F3d at 1107.

For example, in *Cayetano*, 183 F3d at 1108, the Ninth Circuit found that the State of Hawaii failed to demonstrate that a statute delaying issuance of payroll checks was reasonable and necessary to fulfill an important public purpose in light of Hawaii's budgetary crisis because:

> "Although perhaps politically more difficult, numerous other alternatives exist which would more effectively and equitably raise revenues." Other options available to Defendants were a federal maximization project (to obtain additional reimbursements from the federal government), additional budget restrictions, the repeal of tax credits, and the raising of taxes. Defendants have not explained why it is reasonable and necessary that the brunt of Hawaii's budgetary problems be borne by its employees."

Similarly, in analyzing the support for the 2003 PERS Legislation, in *Strunk*, 338 Or at 210, this court explained that:

> "First, we emphasize that we are not dealing here with legislation that impairs private contracts. Instead, we are dealing with a statutory contract. In other words, it is one of the parties to the contract (the state) that now is attempting to rely on a change in circumstances to permit it to alter its contractual obligations in a constitutional manner. In that light, we note that the Special Master made, among others, the following recommended findings:
>
> • "Oregon's state tax burden currently is approximately .7 percent less than the national average."
>
> • "[T]here is little voter willingness to raise taxes to provide additional government revenues."
>
> • The "capital downturn" from 2000 through 2002, although causing a greater impact on state tax revenues than previous economic downturns over the past two decades, "did not compare in magnitude or duration to the Great Depression of the 1930s."
>
> To be sure, the Special Master's report contains other recommended findings that demonstrate that the state's recent fiscal status is both serious and has resulted in substantial detriments to the provision of governmental services across the state. We accept all those findings. Taken together, however, they do not justify a rewriting of the assumed earnings rate guarantee in a manner that would result in the elimination of earnings both promised and actually credited over time to Tier One members' regular accounts."

Like respondents in *Strunk*, respondents here have failed to show how changes to the COLA and SB 656 benefits are justified by economic crisis or are reasonably tailored and necessary to resolve any public purpose. Evidence presented by petitioners' expert Thomas Potiowsky establishes that at the time the legislature took action, Oregon was in its fifth year of recovery from the 2008 recession. ER-206. The 2013-2015 budget showed a 14 percent increase over 2011-2013, one of the largest recent increases. ER-206. Changes made to PERS which lower employer contribution rates do not make fundamental changes to Oregon's revenue system and ultimately will not resolve Oregon's K-12 funding issue. ER-222. In short, "[b]ecause this fourth component requires careful judicial scrutiny in all events, it is clear that a state must do more than mouth the vocabulary of the public weal in order to reach safe harbor; a vaguely worded or pretextual objective, or one that reasonably may be attained without substantially impairing the contract rights of private parties, will not serve to avoid the full impact of the Contracts Clause." *McGrath*, 88 F3d at 16.

V. CONCLUSION

For the foregoing reasons, the court should declare SB 822 and SB 861 to be unconstitutional and void in whole or in part, or in the alternative, declare that petitioners are entitled to damages for breach of contract or just compensation, and award Moro Petitioners' costs and reasonable attorney fees incurred in the prosecution of this action under ORS 652.200 or the common fund doctrine.

Dated this 26th day of June, 2014.

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

Brief length

I certify that (1) this brief complies with the word-count limitation in ORAP 5.05(2)(b) and the May 14, 2014 order of the court allowing Moro Petitioners to file a brief not to exceed 20,000 words; and (2) the word-count of this brief (as described in ORAP 5.05(2)(a)) is 19,895 words.

Type size

I 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).

Dated this 26th day of June, 2014.

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CERTIFICATE OF FILING

I certify that on June 26, 2014, I filed the original of this MORO PETITIONERS' **AMENDED** OPENING BRIEF AND EXCERPT OF RECORD by electronic filing with the Appellate Court Administrator, Appellate Court Records Section, by using the court's electronic filing system pursuant to ORAP 16.

CERTIFICATE OF SERVICE

I hereby certify that I served the foregoing MORO PETITIONERS' **AMENDED** OPENING BRIEF AND EXCERPT OF RECORD upon the following individuals on June 26, 2014, by using the court's electronic filing system pursuant to ORAP 16 or by regular email on June 26, 2014:

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I hereby certify that on June 26th, 2014, I served two true copies of this MORO PETITIONERS' **AMENDED** OPENING BRIEF AND EXCERPT OF RECORD by United States Postal Service, first class mail with postage prepaid, on:

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DATED this 26th day of June, 2014.

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