

Where You When the Lights Went Out?
by
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Many Oregon PERS Retirees are just waking up to the fact that the PERS they knew and loved is no longer that loveable, responsible, guardian angel we once thought it was.

To give you some perspective on how PERS changed from an member-friendly advocacy group, to a member-hostile, employer-friendly organization, a bit of history is in order. This history is necessarily selective and incomplete, but reflects important cross-currents over the past 14 years that bring us to today. You will, after reading this epistle, have a far better idea of what is going on, why it is going on, and why you are suddenly a “victim” instead of a proud retiree. While the document is somewhat long and dense, it is hardly complete and it is hardly thorough. It is the briefest overview of circumstances that came to pass in what one informed participant called “...**the** most complex public employee pension system in the United States, then (in 2003) and now (in 2007)”.

The current PERS situation traces itself to the Hughes decision by the Oregon Supreme Court in 1991. The Hughes case itself traces to an obscure US Supreme Court case - Davis v Michigan - settled in 1988. In the Davis case, a group of federal employees sued the state of Michigan because it was taxing federal pensions, while giving State of Michigan public employee retirements a free ride. This case immediately affected Oregon, as our public employee pensions were also free of Oregon State Income Tax. Not surprisingly, the federal retirees sued Oregon and the 1991 Legislature passed legislation that would start taxing PERS pensions effective 10/1/91. This case really galvanized PERS members and retirees, the public employee unions, and the organizations speaking for non-represented employees including the judiciary. The PERS Coalition formed as did an organization called OPRI - Oregon PERS Retirees Incorporated. These groups, OPRI, PERS Coalition, Oregon State Police Officers Association and others filed a case in the Oregon Supreme Court captioned Hughes v State of Oregon. They argued that public employers entered into a contract with public employees who were members of PERS to NOT tax PERS benefits in retirements. The Supreme Court agreed with the plaintiffs that, indeed, the Legislature had caused a breach in the PERS

contract in complying with the Davis decision, but that the state had no choice as federal law superseded state law in this instance. As a remedy for the breach, the Supreme Court suggested to the defendants that alternatives were all monetary - damages for the breach, or holding federal retirees harmless from Oregon State taxes. The federal employees joined the suit, hoping that the Legislature, now faced with solving this problem would decide against taxing them instead of offering some form of monetary offset to public retirees. The Legislature did not immediately leap into action, dragging its feet through several sessions and several more lawsuits before it finally agreed on a resolution. Pre-1992 PERS retirees would get monetary compensation to offset their loss of benefits due to their taxation. They developed a fix that would award PERS retirees a "benefit adjustment" of some amount ranging from 0% to 9.9% depending on the length of service prior to October 1991 relative to service after that date. The fix was named the HB 3349 adjustment, and that adjustment appears on the Notice of Entitlement of anyone who worked for a PERS-covered employer prior to October 1991.

In the meantime, a number of unhappy non-PERS people were beginning to sense that PERS was very lucrative for members and a money pit for taxpayers. This group consisted of Don McIntire (of Ballot Measure 5 fame), Bill Sizemore (ditto and more), Bob Tiernan (a tenacious libertarian legislator from the same Lake Oswego district now represented by Greg Macpherson), and Alan Stonewall (an actuary specializing in retirement plans). They worked and planned together, trying to get the Legislature to tackle the "runaway" PERS benefits. When the Legislature balked in 1993, they brought Ballot Measure 8 to the 1994 general election. Ballot measure 8 would have made the 6% "pick up" illegal, and would have taken away the Tier 1 rate guarantee. The Measure passed in the general election, but was thrown out in its entirety by the Oregon Supreme Court in the OSPOA (Oregon State Police Officers Association v State of Oregon) case in 1996. (As an aside Governor Ted Kulongoski was in the Attorney General's office when Ballot Measure 8 passed, and was subsequently elected to the Supreme Court when the case was litigated. He voted with the minority against PERS members and in favor of Ballot Measure 8. That SHOULD have been a clue about his support later as Governor, but no one took him seriously).

PERS retirees were given lump sum adjustments to rectify the situation created by the the taxation of their benefits since 1991.

Subsequent retirees received a benefit increment adjustment for time served prior to the ruling in Hughes (October 1991). By 1997, PERS retirees were “whole” again. One crucial detail in this story. In its infinite wisdom, the 1995 Legislature decided that the HB 3349 adjustment to future retirees should be borne entirely by employers, not by taxpayers. This decision resulted in the first enormous jolt to employer rates for PERS members in 25 years. This galvanized the employers in the same way Davis and Hughes galvanized PERS members and retirees. Employer complaints fell on deaf ears.

Anyone sentient in 1997 should have seen that the public and the employers were angry with the PERS retirement system, and although they had been defeated in Court and in the Legislature, they were extremely popular in the court of public opinion. They had no intention of giving up. They laid low until early 2000, when the PERS Board made a couple of really stupid public gaffes. First, the PERS Board commissioned Frank Russell, a nationwide pension advisory firm, to examine their reserving policy - how well were they prepared to meet a sudden and severe downturn in the market? PERS had its gain-loss reserve set at 18 months of an economic downturn. At its February 2000 Board meeting, the PERS Board formally adopted the Russell company’s recommendation to raise the Gain-Loss reserve to 30 months as the long bull market was beginning to show signs of weakness. The following month (March 2000), the PERS Board credited Tier 1 Regular accounts 20% interest from a 24.9% actual earnings base for the 1999 calendar year. The difference between actual earnings and earnings paid resulted in the gain-loss reserve being raised from 18 months to 23 months. The PERS Board also specifically declined to put any money in the Contingency Reserve. On the surface, there seemed nothing wrong with the Board’s actions. But looking back in retrospect, it was this peculiar concentration of events that set the present set of circumstances in motion like a freight train coming straight at PERS members and retirees. The employers pounced like caged animals. They immediately contested the 1999 earnings allocation as excessive, and accused the PERS Board of abusing its statutory discretion in two areas: (1) failure to fund the Gain Loss reserve to 30 months, as they had agreed to do the month before; and (2) failure to allocate any funds to the Contingency Reserve. This immediately put the 1999 earnings allocation in limbo - a fact not revealed to retiring PERS members in the period following the filing. Indeed, Judge Lipscomb wouldn’t have needed to do anything

at the point of filing. The mere act of filing the contest by the employers suspended the 1999 earnings crediting decision and left it “pending” instead of “final”. The challenge was filed by the Eugene Water and Electric Board (EWEB) and the City of Eugene along with a number of other employers. This litigation became known as the City of Eugene case. Without getting deep into the nuances of the case, the bottom line is that PERS lost the case and in October 2002, Judge Paul Lipscomb issued his opinion, which was scathing, to say the least, of the PERS Board. In January 2003, he vacated the 1999 earnings decision - another fact carefully kept from PERS members and retirees - and ordered the PERS Board to revisit the 1999 earnings order, the reserve allocation, and come back to the Court and explain what they were doing and why.

Armed with the results of an Interim Legislative PERS Taskforce Report, completed in 12/2002, the 2003 Legislature introduced dozens of bills to reform PERS. In the end, a number of these ended up as law, albeit in a revised form. HB 2001 reformed PERS so that the PERS Board no longer had the authority to pay out greater than the assumed rate (then 8%) to Tier 1 Regular accounts unless all reserve accounts were fully funded and remained so for 3 consecutive years. (This is why it is unlikely that Tier 1 active members will ever see more than 8% paid to their regular accounts in the next two dozen years. It is a nearly impossible bar to clear.) HB 2005 reduced the size of the PERS Board from 12 members to 5, with the majority (3) coming from the private sector. One member was to come from a PERS employer, and one member was a non-management PERS-covered employee. This completely changed the balance of power on the Board. It also resulted in a complete turnover of the entire Board. No member of the new Board came from the old Board, so all institutional memory was lost in this changeover. HB 2020 and its companion HB 3020, created a ‘Tier 3’ for new employees hired on or after August 28, 2003. This Tier is far less generous than Tiers 1 and 2. The brutal bills were HB 2003 and HB 2004. HB 2004 altered the actuarial tables. It mandated that PERS implement immediately (July 1, 2003) modern, updated actuarial tables for all active employees, and are required to update actuarial tables in January of odd-numbered (Legislative) years. To soften the blow, the Legislature also introduced a concept known as the “lookback”, which was intended to protect those employees close to retirement. For those interested, please email me at:

feldesmanm@gmail.com and I will explain the nuances of the “lookback”; it is non-trivial and affects a small number of individuals.

Lost in all the incredible detail of the PERS legislation was a minor change that allowed PERS, for the first time in history, to seek outside legal counsel in all matters involving finances and benefit litigation in which the Attorney General’s office - all employees of which are PERS members - might have a conflict of interest.

HB 2003 was a massive bill, intended as a response to the Lipscomb findings in the City of Eugene case. Without getting into the extensive history or details, HB 2003 demanded:

- that the 1999 overpayment (the difference between the paid 20% and the corrected 11.33%) be taken from active employee accounts by reducing the Tier 1 rate guarantee to as low as 0% until the overpayment was paid
- that “window retirees” (those who retired from April 1, 2000 and March 1, 2004) “repay” their fair share by foregoing (freezing) COLA adjustments until their correct benefit (the amount calculated after adjusting for the 1999 at 11.33% instead of 20%) surpassed the “incorrectly paid benefit” (the benefit computed using 20%).
- that employers be given the option to renegotiate the “pickup” of the employee 6%
- that future employee contributions be directed to an “Individual Account Program” (IAP) that earns market rates and has no guarantee
- it also set the 1999 earnings rate at 11.33% instead of 20% and directed PERS on how to collect overpayments from retirees. (This is a very controversial part of the bill and has been subject to a number of lawsuits.
- that PERS freeze the cost of living increases for “window retirees” from July 1, 2003 forward until an “adjusted benefit” (a benefit defined to be what the member WOULD have gotten had 1999 been credited at 11.33% instead of 20%) surpassed the “fixed benefit” (a legislatively defined benefit said to be being paid to retirees as of 7/1/03 or actual date of retirement and based on the 20% earnings rate for 1999).

The Legislature also used a “fast track” mechanism to direct any constitutional challenges to the legality of the 2003 PERS legislation to the Oregon Supreme Court, bypassing the normal chain of evidence gathering.

In August 2003, eight different plaintiff groups filed constitutional challenges to the Legislature’s actions in, particularly, HB 2003 and HB 2004. The Supreme Court took these cases and consolidated them into a single filing that is collectively referred to as the “Strunk case.” The

Supreme Court also appointed a Special Master, Judge David Brewer of the Oregon Court of Appeals, to hold a fact-finding hearing and gather the evidence necessary for the Court to make its rulings. The Special Master hearings took several weeks, were open to the public, and were eye-opening to those in attendance. By this time, PERS has shifted alliances from the plaintiffs (PERS members) to the defendants (the State of Oregon, the public employers) and it was this single act of defiance that led long-time PERS followers to conclude that the PERS Board and the entire PERS organization no longer represented the interests of public employees and retirees, but had shifted its allegiance to the employers, the State of Oregon, and the Legislature.

The Oregon Supreme Court ruled on March 8, 2005 in the “Strunk case.” Its findings were a mixed bag. The Court held that PERS could **not** pay less than the “assumed interest rate” at any time, thus derailing the legislature’s attempt to use rate-shifting as a mechanism for recovering alleged overcrediting. The Court also held it was a breach of contract for PERS to be paying any retirement benefit to which a COLA did not attach. It ordered PERS retirees to be restored to their position as of 7/1/03 and then adjusted forward. The Court also used a clever bit of reasoning to come to its findings. It pointed out that the Legislature hoist itself on its own petard. When the Legislature defined “fixed” and “adjusted” benefits, they inadvertently created two benefit classes that didn’t exist in the prevailing PERS statutes. The Court called this to the defendants’ attention and noted that not only can’t PERS have a benefit that doesn’t have a COLA, the Legislature has defined a new benefit for retirees that “cannot be said to contain any errors.” This language will become very important in the remainder of this summary.

In between the Supreme Court’s hearings on the Strunk case and its final ruling on the Strunk case, PERS entered into a settlement agreement with the non-State plaintiffs in the City of Eugene (aka “Lipscomb”) case. This agreement contained what investment bankers like to call “poison pill” clauses. PERS basically admitted that its 1999 Board behaved badly in paying the 20% instead of 11.33% and agreed to remedy the situation immediately. The settlement agreement also defined a new mechanism for calculating the variable match and made the new methodology effective for retirements taking place on or after 7/1/04. The settlement agreement also contained clauses that stated that in the event that the Supreme Court invalidated either of two parts of the Legislation (HB 2003 and HB 2004),

that a more punitive remedy would go into effect. Consequently, when the Supreme Court invalidated one section that concerned the non-State plaintiffs in the City of Eugene cases, the poison pill clause went into effect. This section, in particular, that was of concern was the COLA freeze. It was pretty clear to all that PERS had no authority to freeze retiree COLAs. When the Supreme Court pointed this out, PERS was left with few alternatives for collecting the overpayment from retirees. Of course, Judge Lipscomb, for all his negative effects on PERS members, made one positive observation and recommendation in his final ruling. He specifically advised PERS (and, by implication, the Legislature) to stay away from retirees. He thought that going after retiree benefits would be a legal minefield fraught with difficulty. How prescient he turned out to be.

PERS was bound and determined to recover from retirees. As a result, they invoked ORS 238.715 - the collections statute - to ground their argument. PERS went back and used the reasoning developed in the Legislature's HB 2003 to create two benefits - "fixed" and "adjusted". Instead of withholding the COLA from the "fixed" until the "adjusted" surpassed it, PERS used clever sleight of hand to make the "fixed" become the "adjusted" benefit. If you are interested in how they did this, email me. In any case, this redefinition instantly made debtors out of most retirees because by all accounts most retirees were being paid more than they were supposed to be paid, according to PERS logic. In September 2005, the PERS Board met and decided on the mechanics of going about collecting this debt. By some bizarre timeline, all retirees (money match, formula, formula + annuity, lump sum) would be invoiced for amounts they had been overpaid and they would have either 60 days to pay the lump sum amount they owed or, in the case of monthly recipients, could accept an actuarial reduction of monthly benefits designed to recover the amount owed over their lifetime. In addition, the invoice would also adjust the monthly benefit up or down depending on where the adjusted benefit was with regard to the actual benefit being received. To date, about 70% of "eligible" PERS retirees have been invoiced, although only a small handful have actually begun repaying their debt. All, however, who have been billed have had their monthly benefit adjusted.

Shortly after PERS announced its decision to go forward with what they call the "Strunk/Eugene Remediation Plan", the PERS Coalition filed a lawsuit against PERS arguing that PERS was again breaching the retiree contract. This argument was based on the clear language of the Supreme

Court ruling in which the Court argued that the Legislature had, wittingly or otherwise, defined a new benefit (the “fixed benefit”) that cannot be said to contain any errors. This case is called the Arken case and is named after Mike Arken, President of the AFSCME Retiree Chapter. The Arken case follows a complex line of logic, but it all comes down to the wording of the Supreme Court’s decision in the consolidated Strunk case. This case, filed in Multnomah County Circuit Court in October 2005 was heard in Judge Henry Kantor’s courtroom in late 2005, and a preliminary decision announced in June 2006. Subsequently, there was a status conference held on August 16, 2006 and parties are now awaiting a final ruling.

Concomitantly a second case was also filed with the Arken case. This was also filed by the PERS Coalition, but under the auspices of a different attorney, as the lead Coalition attorney, Greg Hartman, had a conflict of interest. This case - called the Robinson case - focuses on a very complex part of the statute resulting when HB 2003 was enacted into law. This section, called Section 14b, describes the mechanisms PERS is supposed to use if the City of Eugene case goes against members and retirees. The particular section dwells on exactly what PERS may do with respect to retirees to collect moneys owed to PERS. At issue is whether the language is mandatory and exclusive, whether the language is permissive and expands the range of options PERS has, or some other hybrid. Judge Kantor’s initial ruling interpreted the section as mandatory and exclusive. As a result, Judge Kantor nullified PERS collection notice on legal grounds and ordered PERS to cease and desist collection efforts.

At the August 16 status conference, the PERS Coalition raised a number of points on reargument of the Arken case. Judge Kantor had mooted a significant number of the Arken claims on the grounds that his ruling in the Robinson case made them moot. The PERS Coalition argued, in return, that the two cases were very different, rest on entirely different claims of law, and are similar in terms of who they effect, but that their effects are quite different in HOW they get to the final conclusion. Judge Kantor agreed with the PERS Coalition, unmooted those claims ruled moot in his initial findings and promised a clearer set of findings when he issued his final ruling. In the meantime, PERS’ lawyers told Judge Kantor that they had been complying with his injunction, but then informed him and the others in the Courtroom that the Judge’s original order lacked specificity to cover the OTHER area where PERS was operating on retiree benefits. They boldly told him that they had ceased all collection efforts as

instructed, but they would continue to adjust benefits as part of their collection efforts. They asserted that Judge Kantor's original order only covered collections and lacked the specificity to prevent PERS from adjusting benefits. Judge Kantor noted PERS claim and promised greater specificity in his final ruling.

So here we are, at Thanksgiving 2007, more than 5 years after Judge Lipscomb issued his initial findings in the City of Eugene case. Since then, the City of Eugene case has been mooted first and then vacated, meaning that it has no legal standing whatsoever. The Supreme Court has told PERS what to do and PERS appears to be ignoring the Court. PERS lawyers have flaunted their ability to twist and contort the law to mean whatever PERS wants it to mean, and members daily walk to their mailboxes to find notices of benefit adjustments that will take place in scarcely two or three days. We all hope that before the first snow storm of this winter wreaks havoc on Portland, Judge Kantor will break the current impasse and tell PERS once and for all what it can and can't do. The wait is agonizing for many. And the sad part of this is that even if Judge Kantor stops PERS dead in its tracks, the whole sorry mess will begin again the moment PERS files its appeal to the Oregon Court of Appeals.

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Everything needed to document all events described herein can be found in the massive Oregon PERS Document Library, for which this overview was written. If this overview has helped you better understand the current PERS situation, please consider making a small (or large) donation to further the development costs of this extensive and valuable resource.