IN THE SUPREME COURT OF THE STATE OF OREGON

CITY OF EUGENE, a municipal corporation, Petitioner-Respondent, Cross-Respondent (Group 2), v. STATE OF OREGON, PUBLIC EMPLOYEES RETIREMENT BOARD, Respondent-Respondent, Cross-Respondent #1, Cross-Appellant #2, and KAREN JENKINS, DIANE DAVIDSON, ARLYN STEPPER, GARY GILLESPIE, ANN MONTAGUE, JUDITH ANN SUGNET, GARY NAUTA, and ROGER GARVER, Intervenors-Appellants, Cross-Respondents (Group 2).	Marion County Circuit Court No. 99C-12794 Supreme Court No. S50617 INTERVENORS-APPELLANTS' OPENING BRIEF
LANE COUNTY, CITY OF EUGENE, MULTNOMAH COUNTY, CITY OF PORTLAND, CITY OF ROSEBURG, CITY OF HUNTINGTON, and CANBY UTILITY BOARD, municipal corporations, Petitioners-Respondents, Cross-Respondents (Group 2), v. STATE OF OREGON, Respondent-Respondent, and STATE OF OREGON, by and through Public Employees Retirement Board, Respondent-Respondent, Cross-Respondent #1, Cross-Appellant #2, and	Case No. 99C-12838

January 2004

KAREN JENKINS, DIANE DAVIDSON, ARLYN STEPPER, GARY GILLESPIE, ANN MONTAGUE, JUDITH ANN SUGNET, GARY NAUTA, and ROGER GARVER,

Intervenors-Appellants, Cross-Respondents (Group 2).

CITY OF EUGENE, a municipal corporation, by and through Eugene Water & Electric Board,

Case No. 99C-20235

Petitioner-Respondent, Cross-Appellant #1, Cross-Respondent (Group 2),

v.

STATE OF OREGON, PUBLIC EMPLOYEES RETIREMENT BOARD,

Respondent-Respondent, Cross-Respondent #1, Cross-Appellant #2,

and

KAREN JENKINS, DIANE DAVIDSON, ARLYN STEPPER, GARY GILLESPIE, ANN MONTAGUE, JUDITH ANN SUGNET, GARY NAUTA, and ROGER GARVER,

Intervenors-Appellants, Cross-Respondents (Group 2).

ROGUE RIVER VALLEY IRRIGATION DISTRICT, a municipal corporation,

Case No. 00C-16173

Petitioner-Respondent, Cross-Respondent (Group 2),

v.

STATE OF OREGON, PUBLIC EMPLOYEES RETIREMENT BOARD,

Respondent-Respondent, Cross-Appellant #2.

INTERVENORS-APPELLANTS' OPENING BRIEF

Appeal from the January 16, 2003 and April 23, 2003 Judgments
of the Circuit Court of the State of Oregon
for the County of Marion
The Honorable Paul Lipscomb, Circuit Court Judge

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APPELLANT'S OPENING BRIEF

I. STATEMENT OF THE CASE

A. Nature of the Action

This is an appeal of the 1998 and 2000 orders setting contribution rates, brought by public employer petitioners to challenge in certain particulars the administration of the Public Employees Retirement System (PERS) by the Public Employees Retirement Board (PERB). Intervenors are members of PERS.

B. Nature of Judgment Sought to be Reviewed

Intervenors appeal from the trial court's judgment sustaining certain of petitioners' challenges.

C. Statutory Basis of Jurisdiction

The basis of this court's jurisdiction is HB 2409, 2003 Or. Laws, Ch. 537, § 1.

D. Dates of Entry of Judgment and Filing of Notice of Appeal

The trial court's judgment was entered January 16, 2003. Intervenors filed Notice of Appeal to the Court of Appeals on January 21, 2003. Thereafter the Court of Appeals dismissed the appeal by order dated March 6, 2003 because the appeal was premature in that the trial court had not ruled on a pending motion for a new trial. After ruling on the motion the trial court entered judgment on April 23, 2003 and intervenors appealed on May 20, 2003. Thereafter this appeal was removed to this court by operation of HB 2409, 2003 Or. Laws, Ch. 537, § 1, and this court's order of July 29, 2003.

E. Record on Appeal

The record consists of :

(a) Trial court file.

(b) Record on summary judgment.

(c) Transcripts of pre-trial and post-trial hearings.

(d) Transcript of trial. The transcript of June 10, 2002, reflecting discussion between the court and counsel, is referred to herein as "Vol. I." The transcript of June 10, 2002, reflecting testimony, is referred to as "Vol. II." The transcript of June 12, 2002 is referred to as "Vol. III." The transcript of June 13, 2002 is referred to as "Vol. IV." The transcript of June 14, 2002 is referred to as "Vol. V."

(e) Exhibits. Petitioners' trial exhibits are numbered between 1 and 43. Respondent's trial exhibits are numbered between 101 and 124. Intervenor's Exhibit 201 is a list of summary judgment exhibits offered and accepted into evidence at trial. Tr. Vol V, pp. 121-122.

F. Questions Presented on Appeal

1. Did the trial court err in holding that PERB mismanaged PERS by:

   a) Requiring employers to match earnings allocated to members' variable accounts when calculating the *money match* benefits?

   b) Failing to use updated mortality tables?

   c) Failing to fund a contingency reserve?

   d) Failing to use 1999 earnings to fully meet a 30-month funding goal for the gain/loss reserve?

2. Did the trial court err in:

   a) Refusing to compel production of opinions issued by the Department of Justice to PERB which may have set legal limits on PERB's exercise of discretion?

b) Admitting evidence of economic events which occurred after the 1998 and 2000 rate orders?

c) Allowing petitioners to amend their petition after trial to assert new theories without permitting respondents and intervenors to put on additional evidence to meet the new claims?

G. Summary of Argument

1. PERS properly interpreted ORS Chapter 238 when it required employers to match earnings on members' variable accounts when calculating the *money match* benefit. The trial court failed to defer to the implementation by PERS of legislation it sponsored or to defer to the agency in administering a complex pension system. Instead the trial court construed the statute to reach a result which seems to lower employer rates but which, in fact, yields absurd results.

2. PERB properly exercised its discretion when it:

a) Promulgated an administrative rule and determined actuarial equivalency factors consistent with that rule. PERB properly followed its mandate from the Legislature to protect the tax-qualified status of the system, its mandate from this court to protect members' contractual rights, and its mandate from a federal court which ordered use of certain mortality tables.

b) Determined there was no need to fund a contingency reserve. PERB had absolute discretion as to how much to fund this reserve. In any event, petitioners proved no harm by the failure to fund a contingency reserve. The trial court lacked subject matter jurisdiction.

c) Used 1999 earnings to fund the gain/loss reserve at 72.4% of the 30-month goal. PERB exercised reasoned and proper discretion when it made this decision, balancing conservative plan administration with the fundamental unfairness of substantially reducing benefits of members nearing retirement.

3. The trial court erred in refusing to compel production of legal opinions directing PERB or setting limits on its discretion regarding adoption of an administrative rule relating to actuarial factors. The Department of Justice and outside tax counsel advised PERB as to its legal requirements in setting actuarial factors. It was not an abuse of discretion for PERB to follow these opinions to protect the tax-qualified status of the system. The trial court should have had the benefit of the opinions themselves before reviewing PERB's discretion.

4. The trial court erred in admitting evidence of economic events which occurred after the rate orders at issue.

5. The trial court erred in allowing petitioners to amend their petition after trial to assert new theories without permitting respondents and intervenors to put on additional evidence to meet the new theories.

H. Summary of Facts

1. Statement of Facts Relating to First Assignment of Error (Employer Match of Variable Earnings)

Original Annuity – 1945

In 1945 the Oregon Legislature created the Public Employees Retirement System. Until changed by 1967 legislation the PERS retirement benefit was an annuity based on the

value of a member's account plus an equal matching annuity funded by the employer.[1] Former ORS 237.147.

Pension Plus Annuity - 1967

In 1967 the Legislature created a new form of PERS retirement benefit to replace the traditional annuity benefit. The new benefit was to be calculated as (a) the sum of an annuity based on the value of a member's account; and (b) a pension provided by employer contributions based on final average salary and years of service. Former ORS 237.147, as amended by 1967 Or. Laws Ch. 622, § 13. This benefit calculation became known as *pension plus annuity*.[2]

Money Match - 1969

In 1969 the historical matched annuity was reinstated as a minimum benefit which became known as *money match*. Former ORS 237.147(2)(b).

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[1]In all examples in this brief it is assumed for the purpose of illustration that $1,000 in a PERS account will be annuitized at $8.50 per month.

Illustration #1: Assume: a retiring employee had $100,000 in his account, which would generate an annuity of $850 per month. Under the traditional pre-1967 calculation the employee would have received a total of $1,700 per month ($850 based on his account plus $850 match by the employer).

[2]**Illustration #2.** Assume: (a) employee had $100,000 in his account which would generate an annuity of $850 per month; (b) employee had 30 years of service and final average salary of $40,000 per year. Under *pension plus annuity* employee would have received a total monthly benefit of $2,050 ($850/month based on the member's account plus $1,200 based on the formula, $40,000 x 30 years of service x 1%).

Full Formula - 1981

In 1981 the Legislature added a new method of calculating retirement benefits, commonly referred to as *full formula*.[3] Former ORS 237.147, as amended by 1981 Or. Laws Ch. 761, § 4. Members retiring under *full formula* receive a retirement benefit based entirely on years of service and final average salary without regard to the amount in their individual accounts. In the same legislation the Legislature provided that the *pension plus annuity* benefit would be a minimum for all PERS participants who joined the system prior to the establishment of the *full formula* benefit. *Money match* continued to be a minimum benefit for all PERS participants. At retirement PERS calculates each of these alternatives and the member receives the highest monthly benefit.

Details relating to the implementation of these alternative methods of benefit calculation are included within the argument on the First Assignment of Error below.

2. Statement of Facts Relating to Second and Third Assignments of Error (Actuarial Equivalency Factors)

Calculation of monthly retirement benefit payments requires the annuitization of member account balances. Tr. Vol. I, p. 106; ORS 238.300(1). To perform this annuitization PERB adopts "actuarial equivalency factors" based on assumptions about the mortality of the membership, the future earnings of the fund, and the legal issues which impact those assumptions. These factors were reviewed from time to time. The industry standard for review is every 10 years. Tr. Vol. IV, p. 178.

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[3] **Illustration #3:** Assume: (a) employee had 30 years of service and final average salary of $40,000 per year. Under *full formula* employee would receive $20,040 per year ($40,000 x 30 years of service x 1.67%), or $1,670 per month.

A concise history of the PERS actuarial equivalency factors is contained in actuary[4] Mark Johnson's report to PERS on July 27, 1995, Ex. 112D, and report on August 8, 2001, Ex. 1, ER-5. This history is summarized as follows and is further explained in Mr. Johnson's testimony. Tr. Vol. IV, pp. 174-180; 190-194.

January 1, 1978 Simplification of Factors. At the time that Milliman was appointed PERS actuary the actuarial factors were contained in a large notebook containing 41 separate tables. Beginning with retirements effective in 1978 PERB replaced the tables with two tables, one for male and one for female members. In doing so PERB recognized that what it gained in simplicity it lost in precision. Averaging a factor provides a more generous benefit to some and a less generous benefit to others but PERB's approach was to use averaging to achieve simplicity.

July 1, 1978 Unisex Mandate. In *Henderson v. State of Oregon*, 405 F Supp 1271 (D. Or. 1975), plaintiffs challenged PERB's use of separate male and female factors in the calculation of pension benefits. United States District Judge Solomon ruled in plaintiffs' favor and defendants appealed. While the matter was pending before the Ninth Circuit the United States Supreme Court decided *City of Los Angeles Department of Water and Power v. Manhart*, 435 US 702, 98 S Ct 1370 (1978), holding that retiring males and females must be awarded the same monthly benefit if they have an equal account balance and are the same age at retirement. Thereafter the parties settled *Henderson* and entered into a stipulated judgment which provides:

> "Defendant Public Employees Retirement System is permanently enjoined and restrained from the use of sex-

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[4]ORS 238.630(3)(b) requires PERB to arrange for actuarial service for the system. Milliman USA has been providing actuarial services to PERS since 1976. Mark Johnson has been the principal actuary performing those services since approximately 1981. Tr. Vol. III, pp. 27-28.

> segregated life expectancy tables in calculating 'refund annuity' retirement allowances prospectively only for members retiring effective July 1, 1978, and, thereafter, shall provide a monthly 'refund annuity' retirement allowance to female members retiring after that date which is identical to the 'refund annuity' retirement allowance males of the same age and amount of contributions received prior to that date. Defendant shall have no obligation to recalculate 'refund annuity' retirement allowances to female members already retired or retiring before July 1, 1978." Ex. 116; Tr. Vol. III, pp. 115-16; ER-7.

This judgment required PERS to use a single table of actuarial equivalency factors based only on male life expectancy,[5] and PERS complied.

1980-1991. Between 1980 and 1991 PERB reviewed mortality tables on several occasions, recognizing that life expectancies were increasing. At the same time, however, the assumed interest rate increased.[6] The impact of the increase in the assumed interest rate essentially offset the opposite impact of increased longevity. The actuary put together a simple illustration for PERB. Exhibit 1 contains the illustration:

> "In simple terms, the following example provides an explanation.
>
> " A $1,000 account balance converts to $7.75 per month based on 7.0% interest and a 20 year life expectancy, and
> " A $1,000 account balance converts to $7.75 per month based on 7.5% interest and a 22 year life expectancy."

Therefore, except for the implementation of new options, no revisions were made between 1980 and 1991 to the actuarial equivalency factors due to the offsetting effect of mortality and earnings assumptions.

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[5]This process is known as "topping up." Tr. Vol. IV, p. 178.

[6]At the time of the *Henderson* case, the PERS earnings assumption was 7%; this assumption increased to 7.5% in 1979 and 8% in 1989. Tr. Vol. IV, p. 179.

1992 - 1999. In 1992 PERB completed a review of actuarial equivalency factors and adopted new factors for some retirement options. Tr. Vol. IV, p. 190; Ex. 112D, p. 5. PERS compared the existing actuarial equivalency factors with new factors based on 1991 blended[7] mortality and updated earnings assumptions. To protect members' contractual rights, the tax qualification of the system and compliance with *Henderson*, PERB allowed the existing factors to act as a floor and adopted only those new factors which would not decrease benefits.

In November 1993 PERB adopted OAR 459-05-055. The rule requires the consulting actuary to perform an actuarial equivalence study following each biennial actuarial valuation to review the actuarial factors. The rule formalized the previously-adopted policy that PERB will not adopt any new actuarial factors which would result in lowering an active member's benefit.

In 1996 PERB amended OAR 459-005-0055 to permit the adoption of new factors for members joining the system on or after January 1, 1999. Tr. Vol. IV, p. 194; Ex. 111A, p. 5. These factors were based on updated earnings and blended mortality assumptions. The rule also provided that these actuarial tables would be updated from time to time but only on a prospective basis so that each segment of an individual's pension would be calculated under the actuarial assumption in effect during that segment.

At the time of trial PERB was studying new methods of calculating actuarial factors and exploring options which would permit the use of updated mortality tables while protecting the contract rights of members and the tax-qualified status of the plan. Ex. 37.

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[7]Blended mortality assumptions are based on some combination of male and female life expectancies. The only time that PERB has ever utilized male-only mortality assumptions was in adopting actuarial equivalencies directly in response to the *Henderson* decision.

3. Statement of Facts Relating to Fifth Assignment of Error (Contingency Reserve)

Former ORS 238.670(1) provided:

> "At the close of each calendar year, the board shall set aside, out of interest and other income received through investment of the Public Employees Retirement Fund during the calendar year, such part of the income as the board may deem advisable, not exceeding seven and one-half percent of the combined total of such income, which moneys so segregated shall remain in the fund and constitute therein a reserve account. Such reserve account shall be maintained and used by the board to prevent any deficit of moneys available for the payment of retirement allowances, due to interest fluctuations, changes in mortality rate or, except as provided in subsection (3) or (4) of this section, other unforeseen contingency."

In the early years of PERS there was a concern whether enough cash would be available to pay benefits because the system granted pension credits of up to 20 years of service prior to the establishment of PERS (OCLA 90-715) but did not have corresponding contributions for those years of service. The PERB minutes of December 17, 1948 show that PERB itself recommended to the Legislature the establishment of the contingency reserve and suggested the language ultimately adopted. Ex. 201 (Intervenors' Summary Judgment Ex. 4). PERS has not allocated any funds to the contingency reserve since 1978. Ex. 117; ER-36.

4. Statement of Facts Relating to Sixth and Seventh Assignments of Error (Gain/Loss Reserve)

ORS 238.670(3) provides:

> "The board may set aside, out of interest and other income received through investment of the fund, such part of the income as the board considers necessary, which moneys so segregated shall remain in the fund and constitute one or more reserve accounts. Such reserve accounts shall be maintained

> and used by the board to offset gains and losses of invested capital. ***"

The reserve established pursuant to ORS 238.670(3) is commonly known as the gain/loss reserve.

ORS 238.255 provides that for each year employee regular accounts will be credited with at least the amount of the assumed interest rate.[8] This "guarantee" is only applicable to "Tier One" members, those who joined the system prior to 1996. ORS 238.430. PERB has used the gain/loss reserve to provide funds for the payment of the guaranteed amount to Tier One accounts in years when earnings are not sufficient to pay the full amount.

ORS 238.670(5) requires PERB to report to the Legislature each year its preliminary determination of the distribution of earnings within the system. On January 11, 1996 PERB reported to the Emergency Board that as a result of low earnings in 1994 the balance in the gain/loss reserve on December 31, 1995 was only 28% of PERB's goal. That goal was to maintain a balance in the gain/loss reserve sufficient to credit the assumed earnings rate to members' accounts and other appropriate reserves for 24 consecutive months in which there were no fund earnings. PERB proposed crediting additional amounts to bring the gain/loss reserve to 65% of its goal. Ex. 106F, p. 2.

A history of the gain/loss reserve is contained in a memo from David Bailey to the members of PERB, dated November 24, 1997. Ex. 41. At that time the stated goal of PERB was to maintain an 18-month reserve. This goal was adopted by PERB on February 11, 1997 and replaced the previous 24-month goal.

On January 22, 1998 PERB reported to the State Emergency Board relating to the 1997 distributions. Ex. 106D. PERB explained:

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[8]Since 1989 the assumed interest rate has been set at 8%. Tr. Vol. IV, p. 179.

> "*** [the] stated goal of the PERS board is to maintain a balance in the Gain-Loss Reserve sufficient to distribute the assumed earnings rate to Tier One regular member accounts, and the Employer and Benefits-In-Force Reserves, for one-and-one-half years in which there are no Fund earnings."

In February 2000 the board adopted a 30-month goal. Ex. 106C, p. 2. It expressly notified the Legislature that its proposed 1999 distribution would only bring the funding level of the gain/loss reserve to 73.5% of the goal. Ex. 106C, p. 3.

II. FIRST ASSIGNMENT OF ERROR

> **First Assignment of Error:** The trial court erred in granting petitioners' motion for summary judgment on Count Two of the First Claim for Relief and in ruling that PERB violated ORS 238.260(12) and ORS 238.300(2)(a) by requiring employers to match all earnings allocated to members' variable annuity accounts.

A. Preservation of Error

Petitioners, respondents and intervenors filed cross-motions for summary judgment. The trial court granted petitioners' motion in part. After trial the court expanded on its ruling in its October 7, 2002 Opinion and Order.

The pertinent portions of the record are as follows:

> "Petitioners' Motions for Summary Judgment are allowed in part ***." July 31, 2001 Opinion and Order on Cross Motions for Summary Judgment, p. 25.

> "During 1996 through 2000, the PERB caused benefits to be calculated in a way that required employers to match variable annuity account earnings at the time members retired. This caused the PERB to increase petitioners' employer contributions rates for 1998 and 2000 above what those rates would have been had the PERB authorized the correct calculation of variable annuity account benefits." Finding of Fact No. 2, January 16, 2003 Judgment.

> "ORS 238.260(12) and ORS 238.300(2)(a) require that the PERB initially calculate the variable annuity account earnings

> on the same basis as the regular annuity account earnings, and both the regular account and variable account annuities must then be compiled together to determine the regular service requirement allowance under all retirement alternatives before that retirement allowance is subjected to ORS 238.260(12)'s adjustment for participation in the variable. The PERB has misinterpreted and violated the requirements of ORS 238.260(12) and ORS 238.300(2)(a) by requiring petitioners to match the amount of earnings allocated to members' variable annuity accounts." Conclusion of Law No. 2, January 16, 2003 Judgment.

B. Standard of Review

The standard of review is error of law.

C. Argument

1. <u>Introduction</u>

The trial court granted petitioners' motion for summary judgment on Count Two of the First Claim for Relief, but not on grounds suggested by any of the parties. Petitioners asserted that when calculating *money match* benefits the employers were not required to match <u>any</u> of the investment earnings on either regular or variable accounts. Respondents and intervenors argued that PERB has interpreted the statutes correctly.

Rather than follow the teachings of *PGE v. BOLI*, 317 Or 606, 859 P2d 1143 (1993), and *Springfield Education Association v. School Dist.*, 290 Or 217, 621 P2d 547 (1980), giving deference to PERB's longstanding implementation of a statute which it presented to the Legislature, the trial court found a way to reach a result it found desirable, namely to relieve employers of the obligation to match the "excess" earnings in an employee's variable account when calculating the *money match* benefit.

The trial court cobbled together a statutory interpretation creating a limitation on the amount of earnings to be matched. To reach this result the court required PERB to invent a fiction and calculate earnings on a member's variable account as if the funds were actually

invested in the regular account. The court then required that this fiction be treated as if it were incorporated into statutory language. While the trial court described its approach as "elegant," its analysis and conclusions are flawed and lead to absurd results.

2. Pre-1982 system

The trial court focused on language the 1981 Legislature adopted when it added the *full formula* benefit to the existing PERS system. The context of that new language will be established by examination of the then-existing forms of PERS benefits.

The traditional (pre-1967) PERS retirement benefit was an annuity based on the value of a member's account which was then matched by an equivalent annuity funded by the employer. This benefit was eliminated in 1967 but then reinstated in 1969 as a *minimum* benefit. 1969 Or. Laws, Ch. 650, § 7; ORS 237.147(2)(b), now ORS 238.300(2)(b)(A). This form of benefit has come to be known as "*money match.*" Ex. 2, p. 2

Illustration #1: Assume: a retiring employee had $100,000 in his account, which would generate an annuity of $850 per month. Under the traditional pre-1967 calculation the employee would have received a total of $1,700 per month ($850 based on his account plus $850 match by the employer).

In 1967 the Legislature created a new form of PERS retirement benefit calculated as the sum of (a) an annuity based on the value of a member's account and (b) a pension provided by employer contributions based on final average salary and years of service. This

benefit calculation became known as *pension plus annuity*.[9] 1967 Or. Laws, Ch. 622, § 16; former ORS 237.155(1).

Illustration #2. Assume: (a) employee had $100,000 in his account which would generate an annuity of $850 per month; (b) employee had 30 years of service and final average salary of $40,000 per year. Under *pension plus annuity* employee would have received a total monthly benefit of $2,050 ($850/month based on the member's account plus $1,200 based on the formula, $40,000 x 30 years of service x 1%).

3. 1981 legislation

In 1981 the Legislature added a new method of calculating retirement benefits, commonly referred to as *full formula*.[10] Under *full formula* members receive a retirement benefit based entirely on years of service and final average salary without regard to the amount in their individual account. 1981 Or. Laws, Ch. 761, § 4.

Illustration #3: Assume: (a) employee had 30 years of service and final average salary of $40,000 per year. Under *full formula* employee would receive $20,040 per year ($40,000 x 30 years of service x 1.67%), or $1,670 per month.

Rather than pass a stand-alone statute to define the new *full formula* benefit, the 1981 Legislature chose to engraft the new benefit onto the existing statutory frame. The existing statute already defined the annuity based on the individual's account (former

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[9]At the same time that the Legislature created the *pension plus annuity* benefit it also created an option for members to participate in a variable account program, an equity investment account. In order to assure that members receive the value of their variable accounts when calculating the member annuity portion of the *pension plus* annuity benefit the Legislature provided that for all purposes provisions which applied to the regular account would apply to the member's variable account. 1967 Or. Laws, Ch. 622, § 24, ORS 237.197, now ORS 238.260(13).

[10]The 1981 law also phased out *pension plus annuity* by limiting it to persons with service before August 21, 1981. ORS 238.300(2)(b)(B). *Money match* remained as a minimum benefit.

ORS 237.147(1)) and the employer-provided pension (former ORS 237.147(2)(a)). The 1981 legislation did not amend ORS 237.147(1), which defines the employee annuity, but did re-define the pension under ORS 237.147(2) to be:

> "An amount which, when added to the sum of the annuity under subsection (1) of this section and the annuity, if any, provided on the same basis and payable from the variable annuity account, both annuities considered on a refund basis, results in a total of [full formula calculations]."

The employer-provided pension was no longer to be calculated independently from the member account value, as it was under *pension plus annuity*; now it was to be calculated as the amount necessary to increase the member-provided annuity to the *full formula* benefit. Though the new language adopted by the Legislature is awkward the mathematical calculations are straightforward, as illustrated below.

Illustration #4. Assume: (a) employee has an account of $100,000 which generates a monthly annuity of $850; (b) employee has 30 years of service and final average salary of $40,000. Under *full formula* (Illustration #3) employee will receive a monthly retirement benefit of $1,670. The employer-funded portion of this benefit will be $820 ($1,670 less $850).

When the Legislature created the variable account option for members in 1967 it recognized that a PERS participant who took the risk of investment in the variable program would likely accrue a higher annuity than those who elected to leave their money in the more conservative general account. ORS 238.260(1). Under *pension plus annuity* or *money match* increases or decreases in the amount of an employee's account due to participation in the variable program produce a higher or lower annuity, thereby affecting the overall benefit. However, the *full formula* calculation did not allow the increases or decreases in the value of the member's account caused by participation in the variable program to flow through to the

benefit. Without some adjustment the newly-created *full formula* benefit would ignore any enhanced (or reduced) value of the risk-taking member's annuity resulting from variable account participation; an increase in a member's annuity would simply result in a lowering of the employer-provided pension without affecting the total benefit provided by the *full formula* calculation.

To address this undesirable result the Legislature included an adjustment for participation in the variable account. This adjustment to the total monthly benefit is based on the difference between the actual value of the variable account and the value of what the member's account would have been had there been no participation in the variable account. 1981 Or. Laws, Ch. 761, § 6, ORS 237.197(12), now ORS 238.260(12), hereinafter "subsection 12". This adjustment can either increase or decrease a member's pension benefit depending on the performance of the variable account.

Illustration #5. Assume: (a) employee is entitled to a monthly benefit of $1,670 under *full formula*; (b) employee invested an equal amount in the regular and variable accounts; (c) at retirement the employee has $50,000 in the regular account and $60,000 in the variable account; (d) the subsection 12 adjustment based on the $10,000 difference between these two amounts yields an increase of $85 per month ($10,000 x 8.5/1,000). The total monthly retirement benefit for this member will be $1,755 ($1,670 plus $85).

This is how PERS has consistently calculated the benefit. See, for example, PERS Member's Handbook 2000, April 17, 2001 Orr Aff., Ex. 7, p. 23; ER-51.

The Legislature also recognized that there was another class of participants unfairly affected by the creation of the *full formula* benefit. Between January 1, 1956 and December 31, 1967 PERS members were required to make contributions on up to $4,800 of salary. However, members were permitted, but not required, to make contributions on salary

received in excess of $4,800 per year. Because the *full formula* calculation does not depend upon the amount in a member's account, without adjustment those members who made extra contributions would receive no benefit from those contributions if they retired on *full formula*. The Legislature addressed this inequity by providing in subsection 12 for a similar adjustment for those individuals who had made excess contributions.

Illustration #6. Assume: (a) employee will retire under *full formula*; (b) employee made extra contributions to his account between 1956 and 1967; (c) all of employee's money was invested in the regular account with $100,000 attributed to required contributions and an additional $5,000 attributed to the excess contributions made. An additional $42.50 per month ($5,000 x 8.5/1000) will be added to the *full formula* monthly benefit.

It is therefore clear that the subsection 12 adjustments were found necessary and appropriate for the implementation of *full formula*. The adjustments for these two classes of members were to be made "notwithstanding any other provision of this chapter."

At the same time that the Legislature added the *full formula* benefit it also provided that for those PERS members who had service prior to the effective date of the act *pension plus annuity* would remain unchanged as an alternative minimum benefit (1981 Or. Laws, Ch. 761, § 4, ORS 237.147(2)(b)(B), now ORS 238.300(2)(b)(B)). *Money match* continued unchanged as a minimum benefit for all PERS participants. There is nothing to suggest that the Legislature intended to give the adjustment provided by subsection 12 to persons who retired under either the minimum *money match* or *pension plus annuity* alternative calculations. Indeed, providing subsection 12 adjustments for those who retire on *money match* or *pension plus annuity* would make no sense, as the formulas themselves already adjust to reflect increases or decreases in the amount of a member's account. The Legislature specifically described these latter benefits as minimums, leaving as the only

logical conclusion that the subsection 12 adjustments do not apply to them. While subsection 12 does not expressly state that the adjustments are only to be applied to *full formula*, the legislative history and context of the provision also make clear that conclusion, as will be shown.

4. Legislative history of subsection 12 adjustments

At the trial court's request petitioners on June 22, 2001 supplied legislative history materials which form part of the record on summary judgment.

Paul C. Hart, the independent consulting actuary, in a letter dated January 21, 1981 to James McGoffin, director of PERS (ER-16), explained the provisions of the proposed legislation (SB 149), including the following:

> "4. Voluntary contributions in 1956 through 1967–Certain PERS members made voluntary contributions on salary in excess of $4,800 per year during the period January 1, 1956 through December 31, 1967. This bill provides for an adjustment *to the full formula benefit* by converting the accumulated value of these voluntary contributions to an additional monthly benefit." (emphasis added)

At the conclusion of the letter Mr. Hart summarizes the financial impact of the adoption of full formula as follows:

> "The effect on aggregate employer contribution rates of the full formula and all other changes in the bill except the additional benefits from excess voluntary contributions (item 4 on page 2 of this letter): -.02% of payroll.
>
> "Effect on aggregate employer contribution rates of the additional benefits from excess voluntary contributions: +.05% of payroll.
>
> "Total net effect of SB 149: +.03% of payroll."

The staff measure analysis for SB 149-B (ER-13) summarizes the function and purpose of the measure as reported out, as follows:

> "*This measure replaces the present annuity with a full formula pension factor* ***. Individuals who participate in the variable annuity account or who between January 1, 1956 and December 31, 1967 contributed on amounts of salary in excess of the then-$4,800 limit will have their benefits adjusted accordingly." (emphasis added)

In testifying before the Senate Committee on Insurance, Banking and Retirement on February 6, 1981, Mr. Hart explained:

> "There is a group of people *** who made excess voluntary contributions at a period of time in the past when they were allowed to do so ***. [SB 149] includes a special provision for them which says that, in terms of calculating the pension, they will get the *full formula plus an additional amount equivalent to what their excess contributions would buy for them,* since that is taking money which they had contributed in addition to their required contributions. It puts them in a position where they feel they're being treated equally." (emphasis added)
> ER-22-23

5. <u>Trial court's interpretation of ORS 238.260(12) adjustments</u>

PERB has never applied the subsection 12 adjustments to the retirement benefits of a member retiring under the minimum benefits provided by either *money match* or *pension plus annuity* and none of the parties suggested that it should. Nevertheless, the trial court ruled that the subsection 12 adjustments must be applied to all forms of retirement benefits. While ORS 238.260(12) does not expressly state that the adjustments are limited to *full formula* benefits, the section was adopted as part of the *full formula* statute of 1981. These subsection 12 adjustments are intended to address possible inequities to certain classes of employees caused by retirement under *full formula*, as discussed above.

The subsection 12 adjustments were not intended to add a new benefit onto the one already provided to members in the variable account retiring under *money match* or *pension plus annuity*, and yet the trial court reasoned as follows:

> "While PERS currently applies this approach [comparing variable account with results had member been only in regular account] to ORS 238.260(12) and ORS 238.300(2)(a) when calculating the 'full formula' benefit, it does not follow the same statutory procedure when utilizing any other retirement alternative. However, the statute itself neither makes, nor allows, inconsistent treatment of the interplay of these two statutory subsections depending on which retirement option is being calculated. Rather each retirement option must be calculated under a consistent interpretation of the same statutory language." July 31, 2001 Opinion and Order, pp. 10-11; ER-62-63.

Other than the statutory language itself the trial court only relies upon the February 6, 1981 testimony of actuary Paul Hart for the proposition that the subsection 12 adjustment must be made to all calculations of retirement benefits. ER-126. Mr. Hart stated,

> "The bill also includes a provision which would protect the people who have participated in the variable in the past and would protect those people participating in the variable in the future. PERS would actually maintain two accounts for them. One would be the actual variable account and the other would be what their account would have been if they had been in the regular general account of the system rather than the variable. At retirement, then, their full benefit would be either reduced or increased by either the excess investment earnings out of the variable or the rate by which the variable didn't match the general account. So there would still be the opportunity for the employee to get the same differential out of the variable that he or she can get out of the existing law." ER-23.

The trial court took this response out of context. The question posed was how participation in the variable account would be affected by retirement under *full formula*. In that context Mr. Hart explained that PERS would create two separate calculations and then make an adjustment for the differential against the *full formula* benefit. The trial court mistakenly thought that PERS maintains two accounts even if retirement is under one of the other methods.

In referring to Exhibit 1 to the affidavit of Jacqueline P. Reep, the trial court reflected this misconception. ER-126. The exhibit explained PERS' procedure for the subsection 12 adjustment. It states:

> "*The variable adjustment is used only on the Full Formula calculation.* This adjustment is based on a comparison of the member's variable account as if he/she had never been in the variable to the actual variable account. The variable at variable rate is compared to the variable at regular rate." (emphasis added).

The trial court ignored the first sentence of the quoted material!

By applying the subsection 12 adjustment to all forms of benefit many retirees would receive an unintended increase in their retirement benefits, as illustrated below.

Illustration #7. Assume: (a) employee receives a greater benefit under *money match* than under *full formula*; (b) employee has invested an equal amount in the regular and variable accounts; (c) at retirement employee has $50,000 in the regular account and $60,000 in the variable account. Employee would receive a *money match* pension of $1,870 per month, based on an employee annuity of $935 per month ($110,000 x 8.5/1000) and an employer match of $935 per month. This amount would be increased under subsection 12 by an addition of $85 per month ($60,000 less $50,000 x $8.5/1000).

Apparently the trial court did not wish to create an enhanced benefit for some members, but to avoid this result it created a mystifying interpretation of ORS 238.300.

6. Trial court's interpretation of ORS 238.300

The trial court did not undertake its review of the statutory language with a careful analysis of the administrative agency's interpretation of these laws; instead, without reference to any of the arguments of the parties, the trial court announced its own

interpretation of the statute and "force fit"[11] that interpretation into the statutory scheme. The foundation for the trial court's decision rests on two unstable pillars.

The first pillar is the court's conclusion that the phrase "notwithstanding any other provision of this chapter" requires the subsection 12 adjustments to be applied to *all* forms of retirement benefit calculation under PERS.

The second pillar is the court's conclusion that the Legislature never intended employers to match the "excess" earnings in an employee's variable account when calculating the *money match* benefit. This remarkable finding of legislative policy is woven throughout the court's opinion but is not supported by any reference to legislative history nor any analysis of the PERS statute.

After announcing the underpinnings for its opinion the trial court undertook the task of "force-fitting" the 1981 *full formula* language into the existing statutory scheme. The court turned its attention to the legislative language (what is now ORS 238.300(2)(a)) defining the employer-provided pension portion of the *full formula* calculation as

> "an amount which, when added to the sum of the annuity under subsection (1) of this section and the annuity, if any, provided on the same basis and payable from the Variable Annuity Account*** results in a total of [the full formula]."

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[11]The court's own term.

> "This kind of pre-emptive statutory language ['notwithstanding any other provision of this chapter'] is essentially a legislative mandate to the courts to force fit, if necessary, the new provision into the existing legislative scheme." October 7, 2002 Opinion and Order, p. 8. ER-124.

The trial court focused on the phrase "provided on the same basis," and concluded that it is ambiguous.[12] No sooner did the trial court cite *PGE v. BOLI*, 317 Or 606, 859 P2d 1143 (1993), as the proper guide to analysis of ambiguous statutory terms than it departed from the teachings of the case. The court concluded that "in order to yield the intended effects of the overall statutory scheme when the variable account concept was tacked onto the pre-existing retirement options," the phrase "provided on the same basis" must mean that initially the two accounts are calculated as if both had actually been invested in the regular account.[13]

Rather than apply *PGE v. BOLI*, the court used circular reasoning and returned to the discovered policy of "no match on excess variable earnings" as the rationale for its interpretation. The court then borrowed the variable account/regular account comparison used for subsection 12 adjustments and judicially inserted it into the *full formula* statute to define the phrase "on the same basis." The court does not explain why if this was the Legislature's intent it resorted to the code phrase "on the same basis" to trigger this comparison, instead of simply utilizing the identical language of subsection 12.

If the phrase "provided on the same basis" is ambiguous the court should have followed the precepts of *PGE v. BOLI*, and examined the text and the context of the entire

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[12]Even if ORS 238.300(2)(a) is ambiguous the amount of the employer-provided pension which this language describes is easily derived as the difference between the amount of the employee annuity and the *full formula* calculation, as shown in Illustration #4.

[13]The trial court had a mistaken understanding of the historical relationship between the variable account and the alternative benefit formulas utilized by PERS. The variable account was created in 1967 along with the *pension plus annuity* benefit. Full formula was established in 1981. Only *money match* might be considered as pre-dating the variable account although *money match* was removed from the system in 1967 and then added back into the system in 1969 as a minimum benefit. Thus, the trial court's statement that the variable account had to be "tacked onto" the existing benefit structure (ER-61) is not a correct historical account. How this factual error affected the court's analysis is not clear.

PERS statute. The actual language of ORS 238.300(2)(a) refers to the employee's contribution toward the payment of the *full formula* benefit to include:

> "The annuity, if any, *provided* on the same basis and payable from the Variable Annuity Account, ***." (emphasis added)

An annuity deriving from the contributions to the variable annuity account would be "provided" on the same basis as the annuity from the regular account if the benefit from the variable annuity were calculated using the same actuarial factors as are used in calculating the annuity from the regular account. The word "provided" cannot possibly be referring to the method of calculating the employer's match under *money match*. The *money match* derives from an entirely separate portion of the statute, one not affected by the 1981 Amendment.

However, the court's construction of the phrase "on the same basis" which it used to define the employer-provided portion of the *full formula* benefit does not reach the court's desired result, as shown by the next example.

Illustration #8. Assume (a) employee is entitled to $1,670 per month under *full formula* before subsection 12 adjustment; (b) employee has invested an equal amount in the regular and variable accounts; (c) at retirement employee has $50,000 in her regular account and $60,000 in her variable account. The employee's annuity calculated under ORS 238.300(1) is $935 per month ($110,000 x 8.5/1,000). The employer-funded pension calculated under the trial court's approach is $820, the difference between the *full formula* benefit ($1,670) and the amount the employee-funded annuity would have been if all money had been invested in the regular account ($100,000 x 8.5/1,000=$850) ($1,670 less $850 = $820).

At this point in the court's analysis the math does not work. The employee annuity, $935, and the employer-provided benefit of $820 do not add up to the calculated *full formula* benefit of $1,670 per month. The trial court then reasons that to bring things back into balance the Legislature must have intended that the employee annuity should also be calculated as if all moneys were invested in the regular account. While this approach brings the math in line, it requires the judicial insertion of the code phrase "on the same basis" into the calculation of the employee annuity, despite the fact that the 1981 legislation made no change to the method of calculation of the employee annuity.

The next illustration shows the court's final product in the calculation of the *full formula* benefit.

Illustration #9. Assume (a) employee is entitled to $1,670 per month under *full formula* before subsection 12 adjustment; (b) employee has invested an equal amount in the variable and regular accounts; (c) at retirement employee has $50,000 in her regular account and $60,000 in her variable account. Under the trial court's approach the employee's annuity calculated under ORS 238.300(1) is $850 per month (100,000 x $8.5/1,000). The employer-funded pension would be the difference between the *full formula* benefit and the employee annuity, $1,670 less $850 = $820 per month. Now applying the subsection 12 adjustment ($110,000 less $100,000 x $8.5/1,000) adds an additional benefit of $85 to reach a total of $1,755 per month.

The trial court's method of calculation of *full formula* in Illustration #9 reaches, not surprisingly, an identical final result as the PERS process of calculation of *full formula* in Illustration #5. In each illustration the employer pays $905 per month. It was not the court's intention to change the outcome of the *full formula* calculation -- only to change the outcome

of the *money match* calculation to avoid an employer match on the additional earnings in the variable account.

After ratcheting down the calculation of the employee annuity to exclude "excess amounts" in the variable account the trial court would then apply the subsection 12 adjustment to restore the value of the excess earnings without requiring a match. The trial court's method for the calculation of a *money match* benefit is illustrated below.

Illustration #10. Assume: (a) employee invested an equal amount in the regular and variable accounts; (b) retires with $50,000 in the regular account and $60,000 in the variable account. Under the trial court's approach the employee annuity is $850 per month ($100,000 x 8.5/1,000) which is matched by a $850 employer benefit and then adjusted under subsection 12 by $85 per month ($60,000 less $50,000 x $8.5/1,000) for a total monthly benefit of $1,785. This contrasts with the calculation of *money match* by PERS, as follows.

Illustration #11. Assume: (a) employee invested an equal amount in the regular and variable accounts; (b) employee retires with $50,000 in the regular account and $60,000 in the variable account. Under the PERS calculation the employee annuity would be $935 per month with an equal employer match for a total benefit of $1,870 per month. No subsection 12 adjustment is made to a *money match* calculation. Compare, e.g., PERS Member's Handbook 2000 p. 23, ER-51, with p. 24, ER-52.

While the trial court reached its desired result, it cannot be supported by the statutory language, the legislative history, or the long unchallenged interpretation of the law by PERB. The trial court was quick to rely upon the "intended effects" of the statutory scheme and the "overall policy" of the statute, but did not state where it found or derived these policies. Simply stated, the trial court re-wrote the statutes (in contravention of ORS 174.010) to design a system more favorable to the employers and to achieve the court's ideals of

economic fairness. Not only was this interpretation derived without regard to recognized methods of statutory construction, but, as will be discussed below, it actually leads to absurd conclusions quite different from those the court expected.

7. The courts should defer to PERB's interpretation of the 1981 legislation

The most fundamental flaw in the court's analytical process was its failure to examine the agency's own interpretation of the statute and to determine whether that interpretation was a reasonable construction of an ambiguous statute.

> "It is axiomatic that the construction a department places on a law over a period of time, although not conclusive, is persuasive on the courts." *Lafferty v. Newbry*, 200 Or 685, 688, 268 P2d 589 (1954).
>
> "***[W]e accord considerable weight to the views of an agency concerning the interpretation of statutes with which it deals on a regular basis." *Fast v. Western Transportation Co.*, 288 Or 193, 198, 604 P2d 400 (1979).

In particular, this court defers to agency interpretation when statutory terms are drawn from a technical vocabulary which takes its meaning from a particular science, industry, trade or occupation in which the agency has genuine expertise. *McPherson v. Employment Division*, 285 Or 541, 549, 591 P2d 1381 (1979).

The legislative history shows that PERS was closely involved in the presentation of SB 149 and in the explanation of it. Indeed, SB 149 was introduced at the request of PERS. See Summary of Legislative History Materials, ER-12. The executive director and the PERS actuary explained the provisions of the proposed law to the Legislature. Once the changes were enacted PERS immediately began implementing them; it defies logic to suggest that the PERS board, staff, and actuary did not understand the intent of the enactment. PERS consistently implemented the changes for many years until this challenge.

The phrase "on the same basis" is an "inexact" term under *Springfield Education Assn. v. School Dist.*, 290 Or 217, 224-25, 621 P2d 547 (1980).[14] The Legislature has made a complete policy statement, although its precise meaning may not be obvious. Under *Springfield*,

> "[W]here the applicability of the term is not certain, its meaning is not a question of lexigraphy, but rather a question of the policy which is incorporated in the legislative choice of that word." *Id.* at 226.

The processes of administrative application of such terms and judicial review must be performed to effectuate the complete legislative policy judgment which such terms represent. *Id.* The question for the court is whether the agency action is within the legislative policy which inheres in the statutory term.

> "An agency interpretation may be given an appropriate degree of assumptive validity if the agency was involved in the legislative process or if we infer that it has expertise based upon qualifications of its personnel or because of its experience in the application of the statute to varying facts." *Id.* at 227-28.

As the Court of Appeals noted in *Jeld-Wen, Inc. v. EQC*, 162 Or App 100, 105, 986 P2d 582 (1999), an inexact term under *Springfield* is not necessarily ambiguous under *PGE*. Rather, the inexactitude may simply indicate that the Legislature left the specific application of its policy to the administrative agency.

> "Under *Springfield* and *PGE*, when a term is both inexact and ambiguous, the administrative process may assist both in applying the legislative policy to the specific situation and in resolving the overall ambiguity in the term. In complying with its obligations under *Springfield*, the agency may describe the practical application of the term in a way that will suggest the meaning that the legislature intended in using it. Under both cases, this court has the responsibility for

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[14]A more thorough discussion of *Springfield* is contained in the argument on the Third Assignment of Error, *infra*.

> construing the statute, but we do so in the context of the agency's initial authority to act under it. ***" *Id.*

The trial court here ignored the teachings of *Springfield*. The phrase "on the same basis" is an inexact and ambiguous term. Although the Legislature has completely stated its meaning, the phrase must be examined in context of the 1981 legislation and the overall statutory scheme to reach a proper interpretation. Along the way the trial court should have given great deference to PERB's interpretation because PERB was involved in the legislative process of submitting and explaining the 1981 amendments and because it has particular expertise and experience in the administration of the complex public employee pension system.

By failing to defer to the agency with the authority, expertise and resources to implement the complex retirement system, the trial court took it upon itself to find a creative interpretation. The result is perhaps not unexpected. By failing to consider all of the consequences of its decision the court has actually created unintended benefits for thousands of members.

8. <u>The trial court's interpretation yields unintended consequences</u>

The trial court sought to avoid increases in *money match* benefits caused by the employer match of excess earnings on employee contributions to the variable account. Ironically, the court's force fit of the 1981 *full formula* language into the entire PERS system leads to unintended increases in benefits that the court labored so hard to avoid. For example, members who made excess contributions to the PERS fund between 1956 and 1967 and who retired under *money match* (not *full formula*) will now be entitled to an additional payment. Nothing in the trial court's opinion considers how a *money match* benefit would be

calculated for those individuals, but under the court's interpretation they would be entitled to the extra increase based on subsection 12, as illustrated below.

Illustration #12. Assume: (a) employee will retire on a *money match* benefit; (b) employee made extra contributions to his account between 1956 and 1967; (c) all of employee's money was invested in the regular account with $100,000 attributed to required contribution and an additional $5,000 attributed to the excess contributions made. Employee will be entitled to a *money match* pension in the total amount of $1,785 per month based on an employee annuity of $892.50 ($105,000 x 8.5/1,000) and an employer match of an additional $892.50. Employee will be entitled to a further subsection 12 adjustment on the excess contributions of $5,000 in the amount of $42.50 per month ($105,000 less $100,000 x 8.5/1,000) for a total benefit of $1,827.50.

As Illustration #12 demonstrates, under the court's interpretation those individuals who made excess contributions to the plan are entitled to an additional adjustment under subsection 12, an adjustment which has never been made under the PERS system. Under the court's interpretation members who made excess contributions to the plan and who have retired since 1981 have been underpaid by the system, as they have not received subsection 12 adjustments. Presumably they would all be entitled to make claim for them.

In addition the court's interpretation will also lead to additional payments for those members who had service in the system prior to 1981 and retire on either a *money match* or *pension plus annuity* benefit. When the *full formula* statute was passed in 1981 the Legislature protected the rights of those who were already in the system by providing that as a minimum benefit they would receive

> "***for a member who made contributions before August 21, 1981, the equivalent of a pension computed pursuant to this

> subsection as it existed immediately before that date."
> ORS 238.300(2)(b)(B).[15]

For a member who had service in the system before 1981 PERS was required to calculate as a minimum pension under *pension plus annuity* and *money match* as they existed prior to the 1981 amendments. The court's extended analysis of the statutory language is based entirely on the 1981 amendments. Regardless of how the court construes those amendments they cannot be applied to those who were in the system prior to 1981. *Pension plus annuity* and *money match* benefits must each be calculated for those members without regard to the 1981 amendments just as PERS has always calculated them. However, under the court's interpretation of subsection 12 they must receive yet an additional adjustment based on the difference in value between their regular and variable accounts. Once again the court's interpretation leads to the conclusion that a class of retirees has been underpaid by PERS and a class of persons who will be retiring will be entitled to a windfall, as demonstrated in the next illustration.

Illustration #13. Assume: (a) employee will retire on a *money match* benefit; (b) employee made contributions prior to August 21, 1981; (c) employee invested an equal amount in the regular and variable accounts; (d) all variable account earnings occurred after January 1, 1982;[16] (e) at retirement employee has $50,000 in the regular account and $60,000 in the variable account. Employee will be entitled to a *money match* pension in the total

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[15]The trial court noted that the legislative history of 1981 Or. Laws, Ch. 761 is silent as to the intended effect of the variable adjustment on the *money match* and *pension plus annuity* retirement alternatives, other than to "grandfather in" those options to preserve them as alternatives to the full formula benefit. July 31, 2001 Opinion and Order, p. 14, ER-66. However, when the court indicated that its approach worked fine for those who retire on *pension plus annuity* it neglected the operation of ORS 238.300(2)(b)(B).

[16]The subsection 12 adjustment only applies to variable account earnings after January 1, 1982. ORS 238.260(12)(a).

amount of $1,870 per month based on an employee annuity of $935 ($110,000 x 8.5/1,000) and an employer match of an additional $935. Under the trial court's ruling employee will also be entitled to a further subsection 12 adjustment on the excess variable account earnings of $10,000 for an additional benefit of $85 per month, yielding a total payment of $1,955.

It is not the position of the intervenors that PERS members who retired under *money match* have been underpaid because of a failure to properly credit the subsection 12 adjustment. Rather intervenors are pointing out that the court's holding leads to a result that would permit thousands of retirees to claim an absurd entitlement to additional benefits.

D. Conclusion

PERS presented the 1981 *full formula* amendments to the Legislature. As is clear from the legislative history, the subsection 12 adjustments were necessary and appropriate for implementation of *full formula* but they were never intended to apply to the alternative minimum retirement options of *money match* and *pension plus annuity*. While the language PERS presented omitted to expressly limit the adjustments to *full formula*, the meaning and intent were clear. Nevertheless, the trial court seized upon the omission to develop its own method of calculating benefits. By failing to defer to PERB's unique ability to administer its own complex statutes the trial court ignored the professional and technical expertise residing within the system and available through outside advisers, leading to creation of unintended bonuses for thousands of retirees.

The trial court treated the phrase "provided on the same basis" as if it were an encrypted message hidden within the PERS statute for discovery by some future treasure hunter. In reaching its epiphany the trial court derived legislative intent from unexpressed language of the statute and uncommunicated explanations in the legislative history materials. The court also ignored PERS's own interpretation of its own amendment. If this court

affirms the trial court PERS will be forced to make substantial additional payments to members who were in the system before 1981. This could should reverse the trial court and hold that PERB correctly interpreted the statute.

III. SECOND ASSIGNMENT OF ERROR

Second Assignment of Error: The trial court exceeded its limited jurisdiction under the Administrative Procedures Act when it declared invalid OAR 459-005-0055.

A. Preservation of Error

In Count Seven of the First Claim for Relief petitioners asserted that PERB was using "inaccurate" mortality tables to compute benefits. The trial court ruled in favor of petitioners, holding that PERB was applying a rule, OAR 459-005-0055, which exceeded statutory authority.

The pertinent portions of the record are as follows:

> "4. During 1996 through 2000, the PERB directed PERS staff to calculate retirement benefits for PERS members by applying the actuarial equivalency factors rule set forth in OAR 459-005-0055. Application of that rule resulted in the use of outdated mortality factors which did not reflect then current life expectancies of PERS members, resulting in payment of retirement benefits in amounts greater than the 'actuarial equivalent of accumulated contributions by the member and the interest thereon credited at the time of retirement.' The PERB's payment of retirement benefits greater than permitted by ORS 238.300 caused the PERB to establish 1998 and 2000 employer contribution rates for Petitioners that were higher than those rates would have been if the PERB had calculated benefits using updated mortality factors reflecting then current member life expectancies which produced the "actuarial equivalent of accumulated contributions by the member and the interest thereon credited at the time of retirement" as required by ORS 238.300." Finding of Fact No. 4, January 16, 2003 Judgment.

> "4. ORS 238.300 requires that the PERB determine and provide to a member at the time of normal retirement a refund annuity which is the 'actuarial equivalent of accumulated contributions by the member and the interest thereon credited at the time of retirement.' The PERB violated ORS 238.300 by applying OAR 459-005-0055, which results in payment of refund annuities to members that are greater than the "actuarial equivalent of accumulated contributions by the member and the interest thereon credited at the time of retirement." OAR 459-005-0055 is invalid in that it does not comply with the requirements of ORS 238.300. The PERB violated the statutory requirements of ORS 238.300 in refusing to update its mortality tables and abused its discretion in failing to follow the legislative mandate to maintain "actuarial equivalency" when determining retirement benefits. The PERB has a duty to comply with the statutory mandate of ORS 238.300 immediately and fully." Conclusion of Law No. 4, January 16, 2003 Judgment

B. Standard of Review

The standard of review is only to determine if the agency's actions are within the range of discretion allowed by the general statutory policy. *Springfield Education Assn. v. School Dist.*, 290 Or 217, 229, 621 P2d 547 (1980).

C. Argument

1. <u>The trial court's jurisdiction was limited</u>

This case presented a challenge to rate orders. ORS 183.484(5)(b) limits the role of the court. It provides:

> "The court shall remand the order to the agency if it finds the agency's exercise of discretion to be:
>
> > "(A) Outside the range of discretion delegated to the agency by law;
> >
> > "(B) Inconsistent with an agency rule; *** or
> >
> > "(C) Otherwise in violation of a constitutional or statutory provision."

Because in this case the agency's order (a) was within the discretion granted by ORS 238.255 and ORS 238.630(3)(g); (b) complied with and was consistent with the agency's rule; and (c) was consistent with ORS 238.630(3)(h), the court had no authority under ORS 183.484(5) to remand the order to the agency.

2. Petitioners brought no challenge to the administrative rule

Petitioners alleged that OAR 459-005-0055 results in higher retirement benefits. Third Amended Petition, ¶¶ 152, 153, and 155. Nevertheless, petitioners did not petition[17] to have the administrative rule declared invalid under ORS 183.400(2), which provides:

> "The validity of any applicable rule may also be determined by a court, upon review of an order in any manner provided by law or pursuant to ORS 183.480 *or upon enforcement of such rule or order in the manner provided by law.*" (emphasis added)
>
> "Only when a party places a rule's validity at issue in a separate civil action may circuit courts determine a rule's validity." *Hay v. Dept. of Transportation*, 301 Or 129, 138, 719 P2d 860 (1980).

3. Even if the court could have examined the validity of the administrative rule in the absence of pleadings requesting such a review, the court did not properly do so here

Review of an administrative rule under ORS 183.400 is very limited. The reviewing court only examines the rule to determine whether it complies on its face with applicable constitutional and statutory requirements. *Oregon Newspaper Publishers v. Dept. of Corrections*, 329 Or 115, 118, 988 P2d 359 (1999). If the rule complies any further challenge must be on an "as applied" basis. *Id.* at 119. See, also, *AFSCME Local 2623 v. Dept. of Corrections*, 315 Or 74, 79, 843 P2d 409 (1992).

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[17]Petitioners did argue in their Post-Trial Brief that the court should declare the rule to be invalid. Petitioners/Plaintiffs' August 8, 2002 Post-Trial Brief, p. 39.

ORS 183.400(4) authorizes the court to declare the rule invalid "only if it finds that the rule *** exceeds the statutory authority of the agency." In *Planned Parenthood Assn. v. Dept. of Human Res.*, 297 Or 562, 574, 687 P2d 785 (1984), this court examined the "exceeds statutory authority" language of ORS 183.400(4)(b) and agreed with the following statement:

> "To resolve whatever the challenged rule is within the statutory authority of the agency, this court need only determine whether the rule is within the range of discretion allowed by the more general policy of the *** statutes. See *Springfield Education Assn. v. School Dist.*, 290 Or 217, 229, 621 P2d 547 (1980)."

PERB's adoption of a rule that provides for prospective changes to actuarial factors to avoid the potential loss of the plan's tax-qualified status and potential liability for impairing members' contract rights is "within the range of discretion allowed by the more general policy of the [statute]." *Id.*, 290 Or at 229. Not only did the trial court fail to consider the impact of these issues, it remarkably stated that they were of no concern.

> "Neither fear of litigation by employees, nor a concern for a potential challenge by the Internal Revenue Service is a sufficient basis for ignoring the board's own statutory obligations as established by the legislature." October 7, 2002 Opinion and Order, p. 14. ER-130.

The legislature delegated to PERB the power and duty to manage the system. ORS 238.630(2)(b). This includes broad authority to "establish rules for transacting its business and administering the system." ORS 238.650(1). Those rules become part of the written plan document for the purpose of the status of the system as a qualified plan under the Internal Revenue Code. ORS 238.650(2). The rule complies on its face with applicable statutory requirements. Hence, a correct analysis under the APA requires a determination whether "as applied" the rule exceeds statutory authority.

Here petitioners chose not to challenge the rule but the trial court nevertheless found that the rule was invalid. If the purpose of Section 4(b) of OAR 459-005-0055 was to protect the tax qualification of the plan and the members' contractual rights as declared by this court, the rule could not be declared invalid unless the court found that it somehow exceeded the statutory authority delegated by ORS 238.630(3)(h) and ORS 238.650(1). The court found that the rule violated ORS 238.300 by "failing to follow the legislative mandate to maintain 'actuarial equivalency' when determining retirement benefits." Conclusion of Law No. 4, April 23, 2003 Judgment. This conclusion lacks proper foundation. To reach it the court ignored the mandates of ORS 238.630(3)(h) and ORS 238.650(1) and ORS 238.650(2). At the very least this court should remand this case to the trial court to make proper findings and determinations as to the impact of these statutes on OAR 459-005-0055. However, as will be shown in the argument under the Third Assignment of Error, the rule did not exceed PERB's authority and, as a matter of law, was not invalid as applied.

IV. THIRD ASSIGNMENT OF ERROR

> **Third Assignment of Error:** The trial court erred in ruling that PERB applied an invalid administrative rule when it failed to update mortality tables to maintain "actuarial equivalency."

A. Preservation of Error

In Count Seven of the First Claim for Relief petitioners asserted that PERB was using "inaccurate" mortality tables to compute benefits. The trial court ruled in favor of petitioners on this issue.

The pertinent portions of the record are as follows:

> "4. During 1996 through 2000, the PERB directed PERS staff to calculate retirement benefits for PERS members by applying the actuarial equivalency factors rule set forth in

> OAR 459-005-0055. Application of that rule resulted in the use of outdated mortality factors which did not reflect then current life expectancies of PERS members, resulting in payment of retirement benefits in amounts greater than the 'actuarial equivalent of accumulated contributions by the member and the interest thereon credited at the time of retirement.' The PERB's payment of retirement benefits greater than permitted by ORS 238.300 caused the PERB to establish 1998 and 2000 employer contribution rates for Petitioners that were higher than those rates would have been if the PERB had calculated benefits using updated mortality factors reflecting then current member life expectancies which produced the "actuarial equivalent of accumulated contributions by the member and the interest thereon credited at the time of retirement" as required by ORS 238.300." Finding of Fact No. 4, January 16, 2003 Judgment.
>
> "4. ORS 238.300 requires that the PERB determine and provide to a member at the time of normal retirement a refund annuity which is the 'actuarial equivalent of accumulated contributions by the member and the interest thereon credited at the time of retirement.' The PERB violated ORS 238.300 by applying OAR 459-005-0055, which results in payment of refund annuities to members that are greater than the "actuarial equivalent of accumulated contributions by the member and the interest thereon credited at the time of retirement." OAR 459-005-0055 is invalid in that it does not comply with the requirements of ORS 238.300. The PERB violated the statutory requirements of ORS 238.300 in refusing to update its mortality tables and abused its discretion in failing to follow the legislative mandate to maintain "actuarial equivalency" when determining retirement benefits. The PERB has a duty to comply with the statutory mandate of ORS 238.300 immediately and fully." Conclusion of Law No. 4, January 16, 2003 Judgment

B. Standard of Review

The standard of review is only to determine if the agency's actions are within the range of discretion allowed by the general statutory policy. *Springfield Education Assn. v. School Dist.*, 290 Or 217, 229, 621 P2d 547 (1980).

C. Argument

1. Introduction

Recognizing the need to protect the tax-qualified status of the plan and employee contract rights and to comply with the *Henderson* injunctions, but also acknowledging the need to update actuarial factors on a more frequent basis, PERB adopted OAR 459-005-0055. This rule provides that whenever the board adopts new actuarial equivalency factors employee benefits will not be reduced.

This court recognizes the difference between "legislative" rules and "interpretive" rules. Interpretive rules announce an agency's interpretation of statutory provisions which operate of their own force without any rules. Legislative rules are made under a broad delegation of regulatory or managerial authority where the terms of the delegation have no direct regulatory impact on affected persons without such rules. *Realty Group v. Dept. of Rev.*, 299 Or 377, 382, fn. 3, 702 P2d 1075 (1985). In *Springfield*, *supra* at 229-230, this court stated:

> "Regulatory schemes may involve delegation of broader, almost plenary authority to make the policy decisions, legislative in nature, necessary to accomplish political objectives which the legislature expresses in general terms."

In *Springfield* this court gave examples of such legislative rulemaking. For example, in discussing the rulemaking powers of the Public Utility Commissioner, this court stated:

> "The legislature can, if it chooses, enact more specific statutes as to liquor licensing policy and it could set utility rates from time to time by statute, but it has not. Rather, the agencies are empowered to regulate and, in so doing, to make delegated policy choices of a legislative nature within the broadly-stated legislative policy." *Springfield*, *supra* at p. 230.

Here PERB has the power to set employer rates within a broad delegation from the Legislature. OAR 459-005-0055 is a legislative rule.

In 1996 PERB changed the rule to provide that for members joining the system in 1999 and later actuarial factors may be reduced in the future if necessary, but only for benefits earned after the effective date of the change. In computing the employer contribution rates for 1998 PERB continued to apply the rule to "grandfather" the existing factors as a "floor" on benefits. Ex. 107, pp. 9-12; Tr. Vol. IV, pp. 190-192. Similarly, PERB applied the "floor" on benefits when computing employer contribution rates for 2000.

The administrative rule has the force of law until a court declares the rule to be unconstitutional or otherwise invalid. Here the agency's order complied with the administrative rule and the court found that it was the application of the rule which resulted in the use of outdated mortality factors. Finding of Fact No. 4, January 16, 2003 Judgment.

2. The trial court mistakenly found that PERB was "refusing" to update its mortality tables

The premise for the trial court's ruling was its belief that PERB was computing benefits based upon 1978 mortality assumptions. This conclusion is inconsistent with the evidence. While over the years the actuarial equivalency factors may not have changed very much (or at all for certain members), this is not because PERB has been simply assuming the same mortality rates. To the contrary, PERB has evaluated and recognized changing mortality rates but has also determined that increasing earnings assumptions have offset the impact of longer life expectancy.

When the 1978 actuarial equivalency factors were determined the earnings assumption was only 7%. In 1979 the earnings assumption increased to 7.5%, and in 1989 to 8%. Tr. Vol. IV, p. 179. The PERS actuary and PERB concluded throughout the 1980s and early 1990s that the increase in benefits caused by higher earnings assumption offset the decrease in benefits expected from increased life expectancy. Therefore, in truth PERB did

"update" the mortality table when it did not increase benefits in the face of higher earnings assumptions. The actuary explained:

> "In my opinion, it's not properly labeling them to say it's 1978 mortality because in reality, they were judged to be rough equivalent to 8 percent interest and a later mortality table as opposed to 1978 mortality and 7 percent interest." Tr. Vol. IV, p. 180.

Most notably in 1992, when the earnings assumption increased, PERB did make changes to the actuarial equivalency factors when the factors based on updated mortality and current earnings assumptions produced a higher benefit. In 1993 the PERS board adopted OAR 459-005-0055 which provided for periodic review of actuarial factors but limited adoption of new factors to those which would not decrease benefits. In 1996 the board further amended OAR 459-005-0055 to provide for a new set of actuarial factors for those who joined the system after January 1, 1999 and a procedure for making further changes in those factors while protecting the rights of those members. PERS was studying new methods of calculating actuarial factors and was exploring options which would permit the use of updated mortality tables while protecting the contract rights of members and the qualified status of the plan. Ex. 37.

3. <u>The Legislature delegated to PERB the determination of the expression "actuarial equivalent"</u>

ORS 238.300 defines a PERS member's retirement benefit. It provides in part that the member is to receive

> "(1) A refund annuity which shall be the actuarial equivalent of accumulated contributions by the member and interest thereon credited at the time of retirement ***."

The determination of "actuarial equivalence" is left to the broad discretion of PERB. Indeed, ORS 238.630(3)(g) expressly delegates to PERB the authority to "establish from time to time

*** the necessary actuarial factors ***." Nothing in the statute specifies how "actuarial equivalence" is to be determined and nothing in the statute requires the application of any particular actuarial factors. Because actuarial equivalence requires an analysis of mortality, assumed earnings and other policy considerations and because ORS 238.255 requires PERB to determine an assumed interest rate each year, the Legislature unquestionably has delegated to PERB the calculation of the factors for determination of actuarial equivalence.

The framework for analysis is contained in *Springfield Education Association v. School Dist.*, 290 Or 217, 621 P2d 547 (1980). In reviewing PERB's interpretation and application of ORS 238.300(1) the trial court's task was to determine whether the phrase "actuarial equivalent" was an exact term, an inexact term, or a delegative term; the determination then establishes the appropriate standard of review.

In *Springfield* this court explained these three classes of statutory terms, each of which conveys a different responsibility for the agency in its initial application of the statute and for the court on review of that application. They are:

1. Terms of precise meaning, whether of common or technical parlance, requiring only fact finding by the agency and judicial review for substantial evidence;
2. Inexact terms which require agency interpretation and judicial review for consistency with legislative policy; and
3. Terms of delegation which require legislative policy determination by the agency and judicial review of whether that policy is within the delegation.

Clearly "actuarial equivalent" is not an exact term. The only question is whether it is an "inexact term" or a "delegative term." An example of a case finding an "inexact term" is *England v. Thunderbird*, 315 Or 633, 638, 848 P2d 100 (1993). The court classified the term

"earning capacity" under a provision of the Workers Compensation law as an "inexact term" because the Legislature expressed its meaning completely, but left it to the agency to spell out the meaning in the agency's rule or order.

To illustrate a "delegative term" this court in *Springfield* explained that in *McPherson v. Employment Division*, 285 Or 541, 591 P2d 1381 (1979), it dealt with a statutory term, "good cause," which calls for completing a value judgment that the Legislature itself has only indicated. In *McPherson*, 285 Or at 550, this court explained:

> "'Good cause' in its own terms calls for completing a value judgment that the legislature itself has only indicated: evaluating what are 'good' reasons for giving up one's employment and what are not. Judicial review of such evaluations, though a 'question of law,' requires a court to determine how much the legislature has itself decided and how much it has left to be resolved by the agency. For an agency decision is not 'unlawful in substance,' ORS 183.482(2), *Supra*, if the agency's elaboration of a standard like 'good cause' is within the range of its responsibility for effectuating a broadly stated statutory policy."

See also *Megdal v. Board of Dental Examiners*, 288 Or 293, 605 P2d 273 (1980) (the term "unprofessional conduct" expressed a general legislative policy and delegated to the licensing agency the authority and responsibility to complete the legislation by rule specifying what specific acts could be the basis for license revocation).

The controlling authority here, however, is *Salem Fire Fighters Local 314 v. PERB*, 300 Or 663, 717 P2d 126 (1986), which dealt with the requirement of ORS 237.620(4) for retirement benefits to fire fighters "equal to or better" than those offered through PERS. This court held:

> "We do not believe that the legislature meant PERB's determination of 'equal or better' benefits to follow one mathematically exact actuarial formula and to exclude any qualitative judgment by PERB. The statute could have stated such an actuarial formula, or it could have required 'identical or greater' benefits, which would have made any agency

> judgment largely superfluous. But the statute states that benefits are to be 'equal to or better than' those provided by PERS *as determined by PERB*. That phrase leaves to PERB some responsibility for comparing plans that do not have identical or directly comparable features, a responsibility that increases when differences in employee contributions must be taken into account, as we hold. *** **The statute places responsibility for determining the relevant retirement benefits provided by public employers to PERB, and we do not anticipate or prejudge what PERB may decide upon refining its comparative analysis**." *Id.* at 670 (emphasis in italics in original; emphasis in bold added).

The Legislature could have set the actuarial factors in ORS Chapter 238, including the adoption of a fixed and permanent mortality table, just as it could set utility rates by statute, as this court noted in *Springfield*, 290 Or at 230. Instead the Legislature delegated to PERB certain policy decisions, including "equivalence." As in *Salem Fire Fighters*, this involves a "qualitative judgment by PERB."

Stated in *Springfield* terms, "actuarial equivalent" expresses non-completed legislation which the Legislature has given authority to the board to complete.

> "*** The legislature may use general delegative terms because it cannot foresee all the situations to which the legislation is to be applied and deems it operationally preferable to give to an agency the authority, responsibility and discretion for refining and executing generally expressed legislative policy.***" *Springfield*, 290 Or at 228.

Under *Springfield* the trial court's review was limited to whether the rule adopted by the board was within the statutory delegation. As will be discussed below, PERB's actions are within the scope of statutory delegation and so petitioners' challenges must fail.

4. PERB determined that OAR 459-005-0055 was necessary to preserve the tax qualified status of the plan

PERS is a qualified plan within the meaning of Internal Revenue Code (IRC) § 411(a)(11)(B), as applied through IRC § 401(a) to governmental plans. Ex. 113. The loss of "qualified" status would be catastrophic. Employees would lose the tax shelter of their contributions. In those cases where employers have "picked up" the employee's share of contributions, those contributions would be taxable to the employee even though the money is placed into a fund inaccessible to the employee until retirement. It is no wonder why throughout the years PERB has carefully considered the tax status of the fund and why the Legislature in 1995 adopted 1995 Or. Laws, Ch. 296, §5 (now ORS 238.630(3)(h)) requiring PERB to take all actions necessary to maintain qualification of the system as a qualified governmental retirement plan and trust under the Internal Revenue Code.[18]

The Retirement Equity Act of 1984 added section 401(a)(25) to the IRC. That provision–which *does* apply to governmental plans–states that a qualified pension plan must include actuarial assumptions that "are specified in the plan in a way that precludes employer discretion." 26 USC § 401(a)(25). The legislative history of the 1984 Act makes it clear that this provision essentially affirms the position of the IRS in Revenue Rulings 79-90 and 82-12.[19]

Those Revenue Rulings hold that the actuarial factors for providing benefits that are "definite and determinable" as required by Treasury Reg. 1.401-1(b)(1)(i), cannot be

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[18]Between 1985 and 1995 former ORS 237.251(3)(h) required the board to establish limits on contributions and benefits equal to those fixed by federal law for retirement plans qualified under Section 401(a) of the Internal Revenue Code.

[19]See S. Rep. No. 98-575, 98th Cong., 2d Sess., *reprinted in* 1984 U.S.C.C.A.N. 2547, 2573 (citing Rev. Rul. 79-90 and 81-12), which was attached to respondents' Post-Trial Brief and is included in the Appendix.

changed to reduce a participant's accrued benefit. Revenue Ruling 79-90 states that the "definite and determinable" rule requires that the actuarial factors for determining benefits be stated in a defined benefit plan in order for the plan to be tax-qualified. Revenue Ruling 81-12 expanded on this rule by stating that although the regulations do not preclude a change in actuarial factors, the "definite and determinable" rule would not be satisfied unless the change to actuarial factors for determining benefits does not reduce a participant's accrued benefit. The ruling states that there are several acceptable methods that may be specified in a plan to prevent a decrease in accrued benefit, giving two examples.[20]

In reaction to the 1984 congressional enactment the Oregon Legislature passed 1985 Or. Laws, Ch. 823, § 7, now ORS 238.630(3)(g) and (h), which provide:

> "(3) The board:
>
> "* * *
>
> "(g) Shall determine the actuarial equivalency of optional forms of retirement allowances and establish from time to time for that purpose the necessary actuarial factors, which shall constitute part of the system; and
>
> "(h) Shall adopt rules and take all actions necessary to maintain qualification of the Public Employees Retirement System and the Public Employees Retirement Fund as a qualified governmental retirement plan and trust under the Internal Revenue Code and under regulations adopted pursuant to the Internal Revenue Code. Rules under this paragraph may impose limits on contributions to the system, limits on benefits payable from the system and other limitations or procedures required or imposed under federal law or regulation for the purpose of qualification of the Public Employees Retirement System and Public Employees Retirement Fund under the Internal Revenue Code as a governmental retirement plan and trust."

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[20]A 1986 IRS regulation, Treasury Reg. 1.411(d)-3, stated that section 401(a)(25) of the IRC "affirms" the provisions of Revenue Rulings 79-90 and 81-12 relating to the "definitely determinable benefit" requirement.

In June 1992 PERB reviewed the actuarial factors after the 1991 Actuarial Valuation. While PERB adopted some new actuarial factors it also "grandfathered" certain factors from the 1978 tables because they were more favorable to the members. Ex. 1, p. 4.

In 1993 PERB adopted OAR 459-005-0055. This rule contemplates frequent review of the mortality and interest assumptions used to fund PERS. PERB was correctly concerned about promulgating a rule which would violate federal tax law. To protect the plan from disqualification PERB built in protection to satisfy Revenue Ruling 81-12. By stating in section 5 that PERB would not change a factor if it would produce a lower benefit for members before January 1, 1999 PERB not only complied with Revenue Ruling 82-12 it protected the contract rights of the members recognized by this court. *Oregon State Police Officers' Assn. v. State of Oregon*, 323 Or 356, 918 P2d 765 (1996). PERB's decision to promulgate an administrative rule that adopted a method of changing actuarial factors that preserves member rights is not only within the range of discretion delegated by the Legislature to PERB, it is consistent with the legislative mandate to take all necessary steps to protect and preserve the plan's tax qualification.

5. PERB did not abuse its discretion in considering members' contract rights in setting actuarial equivalency factors

PERB has understandably and responsibly considered the contractual rights of members. It is now well settled that PERS creates a contract between the public employers and the public employees. *Hughes v. State of Oregon*, 314 Or 1, 18, 838 P2d 1018 (1992); *Taylor v. Multnomah Dep. Sher. Ret. Bd.,* 265 Or 445, 450, 510 P2d 339 (1973). See, also, *Sheffield v. Alaska Public Employees' Association, Inc.*, 732 P2d 1083 (Alaska 1987), (the adoption by Alaska PERS of a new table of actuarial factors based on then-current mortality and interest earnings data violated the contract rights of the members contrary to the Alaska

constitution). It was not an abuse of discretion for PERB to define actuarial equivalency factors in a manner that preserves the contract rights of PERS members. To do otherwise would run afoul of this court's decisions, resulting in the expenditure of PERS funds in the defense of class action lawsuits. See, generally, *Stovall v. State of Oregon*, 324 Or 92, 922 P2d 646 (1996). Members of PERB adopting such a course could be held to be in violation of their fiduciary duties.

The trial court apparently believed that the employer rates were too high. However, the Legislature delegated to PERB the responsibility for setting rates in the face of competing policies. To determine benefits PERB must consider mortality and income factors, but also must appreciate the impact of constraints imposed by the Internal Revenue Service and the courts. PERB could not ignore the decision of the United States District Court discussed below or the decisions of this court just so it could set a lower rate for employers. The trial court's cavalier brush-off of the serious impact of potential challenges by the Internal Revenue Service or employee lawsuits should not be sanctioned by this court.

6. PERB did not abuse its discretion by complying with a federal court injunction

In effect the trial court has ruled that PERB abused its discretion by complying with a federal court injunction.

In *Henderson v. State of Oregon et al.*, 405 F Supp 1271 (D. Or. 1975), Judge Solomon ruled that Title VII of the Civil Rights Act of 1964 prohibits the use of sex-segregated life expectancy tables in calculating refund annuity benefits for state employees. The defendants appealed, but during the pendency of the appeal to the Ninth Circuit the United States Supreme Court decided *City of Los Angeles Department of Water and Power v. Manhart*, 435 US 702, 98 S Ct 1370 (1978). On August 21, 1978 the Ninth Circuit

remanded the *Henderson* case to the trial court. The parties then stipulated to a judgment (Ex. 116; ER-7) which provides in part:

> "1. The judgment of this Court dated January 16, 1976 is set aside and this judgment is entered in lieu of it.
>
> "2. Title VII of the Civil Rights Act of 1964 prohibits the use of sex-segregated life expectancy tables in calculating 'refund annuity' retirement allowances of the employe members of the Oregon Public Employe Retirement System.
>
> "3. Defendant Public Employes Retirement System is permanently enjoined and restrained from the use of sex-segregated life expectancy tables in calculating 'refund annuity' retirement allowances prospectively only for members retiring effective July 1, 1978, and thereafter, shall provide a monthly 'refund annuity' retirement allowance to female members retiring after that date *which is identical to the 'refund annuity' retirement allowance males of the same age and amount of contributions received prior to that date*. Defendant shall have no obligation to recalculate 'refund annuity' retirement allowances to female members already retired or retiring before July 1, 1978." (emphasis added).

It is apparent from the terms of the judgment that PERB negotiated for absolution of its obligation to recalculate retirement allowances to female members already retired or retiring before July 1, 1978. In exchange PERB agreed to utilize tables identical to the retirement allowance males received prior to July 1, 1978. A quarter of a century later the trial judge in this case has decided that PERB should not be using actuarial equivalency factors based upon 1978 mortality tables. Because actuarial tables are applied at the time of retirement even PERS members who were in the system in 1978 will now be deprived of the benefit of the *Henderson* decree. In effect, the trial judge has placed PERB in contempt of the federal court's injunction, at least as to those PERS members who were entitled to the benefit of the *Henderson* case.

D. Conclusion

Consistent with its mandate PERB has set actuarial equivalency factors to protect the plan's tax-qualified status, as well as to comply with the *Henderson* injunction and to protect the contractual rights of members. The trial court's edict to PERB to use updated mortality tables swept away years of carefully considered policy. The result is an unpermitted intrusion by the judiciary upon the discretion delegated to PERB by the Legislature. What is more, if this court affirms the trial court the system may very well lose its tax-qualified status. This court should reverse the trial court and dismiss the petitioners' challenge to PERB's use of actuarial factors.

V. FOURTH ASSIGNMENT OF ERROR

> **Fourth Assignment of Error:** The trial court erred in denying intervenors' motion to compel production of legal opinions advising PERB on PERS administration relating to actuarial factors.

A. Preservation of Error

It was intervenors' position that the trial court should have had the benefit of the opinions of the Attorney General relating to the administration of PERS, as those opinions are relevant to the PERB's exercise of discretion in adopting actuarial factors. May 28, 2002 Transcript, p. 71. When the Attorney General's office refused to produce the opinions intervenors sought an order compelling production.

The pertinent portions of the record are as follows:

> "THE COURT: Okay, I looked at your memorandum, and basically I'm not persuaded either as to the correctness of the analysis or the applicability of the federal cases to this proceeding so I'm denying the motion to compel." Tr. Vol. IV, p. 3.

B. Standard of Review

The standard of review is abuse of discretion. *Doe v. Denny's, Inc.*, 146 Or App 59, 67, 931 P2d 816 (1997), *aff'd* 327 Or 354 (1998).

C. Argument

Intervenors moved to compel production from respondent PERB of the written opinions of the Attorney General's office and outside counsel relating to the administration of the system in the adoption of actuarial factors. Intervenors did not request any attorney-client communications with regard to the litigation.

The petitioners in this case alleged and the trial court found that PERB abused its discretion. However, it is apparent that PERB was not acting arbitrarily; rather, it was following the advice of its legal counsel, including the advice of outside tax counsel advising PERB on the intricacies of federal tax law. Respondents admitted as much in their Trial Memorandum.

> "The Board is required by statute–specifically, by ORS 238.630(3)(h)–to 'take all actions necessary' to maintain the system as a qualified governmental retirement plan for tax purposes. Again, the legislature has delegated broad discretion to the Board to decide what actions may be 'necessary' to retain the qualified status of the plan. This principle limits the Board's discretion in changing actuarial factors because the Board determined–after consulting with tax attorneys from the Department of Justice and retaining a tax law expert from Stoel Rives–that any change in actuarial factors that decreases the retirement benefits that are payable to current PERS members could jeopardize the 'qualified' status of the plan for purposes of the Internal Revenue Code. ***" June 5, 2002 Respondents/ Defendants Trial Memorandum, p. 18 (footnotes omitted).

The trial court should have had the benefit of the advice received by PERB to determine whether the policy choices made by PERB were arbitrary or were sound. If based on sound and conservative rationale those policies cannot be abuses of discretion.

Intervenors are beneficiaries of the PERS system trust fund. As such there is no attorney-client privilege which can be asserted against disclosure of the legal opinions. Where, as here, a trustee seeks legal counsel's advice regarding issues of plan administration, the trustee cannot prevent a plan beneficiary from receiving access to the same legal advice.

The courts have articulated two rationales for this exception. Under one rationale beneficiaries sit in the capacity as client and hold the attorney-client privilege to the same extent as the trustee. In *United States v. Evans*, 796 F2d 264, 266 (9th Cir. 1986), the Ninth Circuit found that "as a representative for the beneficiaries of the trust which he is administering, the trustee is not the real client in the sense that he is personally being served." At least as to advice regarding plan administration, "a trustee is not 'the real client' and thus never enjoyed the privilege in the first place." *United States v. Mett*, 178 F3d 1058, 1063 (9th Cir. 1999). Rather, the beneficiaries are the clients of the attorneys "as much as the trustees . . ., and perhaps more so." *Riggs Nat. Bank of Washington D.C. v. Zimmer*, 355 A2d 709 (Del. Ch.1976) *cited by United States v. Doe*, 162 F3d 554 (9th Cir. 1998).

Under the second rationale the need of the beneficiaries to have access to all the details of the plan's administration outweighs the needs of the trustees to keep their communications with attorneys private from their beneficiaries. *Id.* The federal courts in cases under ERISA have adopted this "fiduciary exception" to the attorney-client privilege. "An employer acting in the capacity of a ERISA fiduciary is disabled from asserting the attorney-client privilege against plan beneficiaries on matters of plan administration." *Betcher v. Long Island Lighting Company*, 129 F3d 268, 272 (2nd Cir. 1997), approved by *United States v. Mett*, *supra*. See also, *In Re Occidental Petroleum Corporation*, 217 F3d 293 (5th Cir. 2000).

The courts have recognized a limitation to this exception. If a trustee is obtaining legal counsel to defend it in litigation against the beneficiary, the attorney-client privilege prevents disclosure of that information. See, *United States v. Mett*, *supra* at 1063. However, the cases cited above hold that legal advice regarding plan administration is discoverable by plan beneficiaries, even if later litigation claims inappropriate plan administration by the trustee.

ORS 180.210 created the Department of Justice with the Attorney General at its head. ORS 180.060(2) provides:

> "The Attorney General shall give opinion in writing, when requested, upon any question of law in which the State of Oregon or any public subdivision thereof may have an interest, submitted to the Attorney General by the Governor, any officer, department, agency, board or commission of the state or any member of the legislature."

ORS 180.220 provides:

> "(1) The Department of Justice shall have:
>
> > "*** (b) Full charge and control of all the legal business of all departments, commissions and bureaus of the state, or of any office thereof, which requires the services of an attorney or counsel in order to protect the interests of the state."

In *Frohnmeyer v. SAIF*, 294 Or 570, 577-78, 660 P2d 1061 (1983), this court stated that:

> "All of the State's legal affairs, whether included within the term 'civil actions and legal proceedings' of ORS 180.220(1)(a) or within the term 'legal business' of ORS 180.220(1)(b), remain under the charge, control, and supervision of the Department of Justice."

Recently in *TVKO v. Howland*, 335 Or 527, 538, 73 P2d 905 (2003), this court stated:

> "As this court noted in *State ex rel v. Motts*, 163 Or 631, 640, 97 P2d 950 (1940):
>
> > " 'Officers acting in good faith have a right to rely on the opinion of the attorney general, as he is the officer

> designated by law to render such service for their guidance and protection.'
>
> "If the law were otherwise few administrators would care to assume responsibility for rendering hard decisions in matters like the one presented here ***."

If the Department of Justice advised PERB on the negative impact of contemplated actions on the legal rights of members, the restrictions imposed by the federal court's injunction in the *Henderson* case, and the possible disqualification of the plan by the IRS resulting from choices confronted by PERB, and if the Department of Justice directed PERB not to pursue such actions, the members of PERB were left with no discretion to ignore such direction. PERB was subject to the "charge, control and supervision" of the Department of Justice. It cannot be an abuse of discretion for PERB to follow the dictates of the Department of Justice.

D. Conclusion

Even though it was the petitioners' burden to prove that PERB abused its discretion this court should not affirm the trial court's ruling finding abuse of discretion in adopting actuarial factors until the State provides and the trial court considers the legal opinions and directives requested by intervenors.

VI. FIFTH ASSIGNMENT OF ERROR

> **Fifth Assignment of Error:** The trial court erred in granting summary judgment on the fourth claim for relief, ordering PERB to fund a contingency reserve.

A. Preservation of Error

In Count One of the First Claim for Relief and Count Two of the Fourth Claim for Relief petitioners asserted that PERB was required to fund and use a contingency fund to

prevent deficits in pension accounts. The trial court granted summary judgment in favor of petitioners on this issue.

The pertinent portions of the record are as follows:

> "***I find that PERB has abused its discretion in failing to fund, maintain and manage a contingency reserve as required by ORS 238.670(1)." July 31, 2001 Opinion and Order, p. 19.
>
> "Petitioners are therefore entitled to an order remanding the March 2000 Earnings Allocation Order to the Board with instructions to abide strictly with the statutory mandate to fund and maintain a Contingency Reserve in accordance with ORS 238.670(1).***" October 7, 2002 Opinion and Order, p. 17.

B. Standard of Review

The standard of review is error of law.

C. Argument

1. <u>The Legislature empowered PERB with absolute discretion to determine the amount of funding of the contingency reserve</u>

ORS 238.670(1) provides that each year PERB

> "Shall set aside, out of interest and other income received through investment of the Public Employees Retirement Fund during that calendar year, such part of the income *as the board may deem advisable*, not exceeding seven and one-half percent of the combined total of such income, which moneys so segregated shall remain in the fund and constitute therein a reserve account ***. Such reserve account shall be maintained and used by the board to prevent any deficit of moneys available for the payment of retirement allowances, due to interest fluctuations, changes in mortality rate or, *** other contingency***." (emphasis added)

A delegation to PERB to determine how much it deems advisable to place in the contingency reserve necessarily authorizes PERB to decide that no contributions to the reserve are necessary at all.

2. The trial court misunderstood the purpose of the contingency reserve

The contingency reserve is different from the gain/loss reserve. The purpose of the gain/loss reserve is to set aside some portion of the earnings in good years to cover the earnings guaranteed to Tier One members in case of bad years, that is, years when the earnings are less than the guaranteed amount. The purpose of the contingency reserve is different; its function is only to assure that there is enough cash on hand to pay benefits ("to prevent any deficit of monies available for the payment of retirement allowances").

It is apparent that the trial court viewed the contingency reserve as another form of gain/loss reserve. The court stated:

> "As employer/petitioners point out, PERB's practice of failing to fund the contingency account periodically forces the board to increase employer contributions as an alternative method of making up any and all unforeseen shortfalls in monies available for the payment of retirement allowances. That practice is inconsistent with both the statutory language and the apparent intended purpose of this statutory reserve fund."

There is no evidence of any prospects of shortfalls in monies available for the payment of retirement allowances. The trial court's conclusion that the failure to fund the contingency reserve results in an increase in employer contributions reflects the trial court's misunderstanding of the effect on employer rates of funding of the contingency reserve, as shown below.

3. There was a complete failure of proof that funding the contingency reserve would reduce employer rates or that the failure to fund the contingency reserve resulted in an increase in employer rates

The petitioning employers sought judicial review of the 1998 and 2000 rate orders. Under the APA the court only had jurisdiction if the petitioners were adversely affected or aggrieved by the orders. ORS 183.480(1). Under the statute, a person is "aggrieved" by an agency order and is entitled to judicial review if the person shows one or more of the following factors:

> (1) a person has suffered an injury to a substantial interest resulting directly from the challenged governmental action;
>
> (2) the person seeks to further an interest that the Legislature expressly wished to have considered; or
>
> (3) the person has such a personal stake in the outcome of the controversy as to assure concrete adverseness to the proceeding.

In the absence of a showing that they would suffer injury as a result of PERB's action or inaction in funding the contingency reserve petitioners have not met their threshold jurisdictional requirement. *People for Ethical Treatment v. Inst. Animal Care*, 312 Or 95, 101-102, 817 P2d 1299 (1991). In support of their motion for summary judgment petitioners supplied the court with no evidence that employer rates are affected by the failure to fund the contingency reserve. Consequently, petitioners failed to meet their jurisdictional threshold.

Actuary Mark Johnson explained that funding the contingency reserve would not reduce employer rates. Mr. Johnson first assumed that the contingency reserve would be funded from investment earnings off the top. Tr. Vol. V, p. 28. Because fewer dollars would have been credited to member accounts the benefits ultimately paid to those members may have been less. However, just as a lower amount of interest was available to credit the employees' accounts so was there less interest available to credit the employers' earnings on their assets. So this action alone would not have saved the employers anything. Tr. Vol. V,

p. 29. Because under this scenario earnings are taken out of the system and set aside there would have been less interest credited to the BIF, the benefits-in-force reserve used to pay retired members. The funding of the BIF is the responsibility of the employers. The effect of less money in the BIF is to put upward pressure on employer contributions. Tr. Vol. V, p. 30. Mr. Johnson's first conclusion is that the initial impact of funding the contingency reserve would be to *raise* employer rates. Tr. Vol. V, p. 31.

Mr. Johnson then went on to discuss what the ultimate effect of utilizing the contingency reserve would have been. Only if the contingency reserve were used at some future point to spread across all the employers (and not credited to employee accounts) would employer contribution rates be lower. Similarly, if one employer went bankrupt and the contingency fund was used to cover that employer's obligation the other employers' rates would not increase as much as they would otherwise. Tr. Vol. V, pp. 31-32.

Of course, the hypothetical use of the contingency reserve to pay for an employer's bankruptcy or to reduce employer rates is only wishful thinking on the part of the employers. There is no evidence that PERB would ever have used the contingency fund for such purposes.[21] If PERB had at its disposal a contingency reserve (and had the unfettered discretion to use it) the employees would have just as much right to petition PERB to use the fund to increase their benefits. After all, PERB has a fiduciary duty to the members, not to the employers. ORS 238.660(1) ("Nothing in this subsection shall be construed to impose a fiduciary duty on the board to consider the interests of public employers, and the board shall

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[21]In 2001 the Legislature adopted ORS 238.670(1)(a) to make clear that reserves to prevent a deficit in the fund by reason of the insolvency of a participating public employer may be funded only from the earnings on employer contributions. 2001 Or. Laws Ch. 945, § 5.

consider the interests of public employers only with respect to matters unrelated to the board's fiduciary duties as trustee of the fund.")

During the trial petitioners attempted to cure the jurisdictional problem. Counsel for petitioners asked actuary Mark Johnson to assume that the board could have used the contingency reserve to pay for all or part of the cost of House Bill 3349 (codified as ORS 238.375). Tr. Vol. III, p. 79. Mr. Johnson's response to this hypothetical question does not prove that employer rates would have been less. House Bill 3349 was a settlement of the class action resulting from the *Hughes* and *Stovall* decisions. In exchange for the dismissal of their suit for damages against public employers the public employees accepted the benefits codified by HB 3349.[22] It is ludicrous to assume that the public employees would have allowed the State to use a contingency reserve funded in part with the employees' own money to pay the additional benefits provided by HB 3349 (benefits representing compensation for the State's breach of contract by taxing retirement benefits), and yet this is the very premise of the hypothetical question.

In short, there was a complete failure of proof that the funding of a contingency reserve would in any way have reduced or prevented an increase in employer rates. Because the public employers were not adversely affected by the failure to fund the contingency reserve, the trial court lacked subject matter jurisdiction and erred in granting summary judgment in their favor.

4. <u>The trial court did not have jurisdiction to issue a declaratory opinion</u>

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[22]The law further provides that the public employees may re-open the class action for damages if the benefits provided by HB 3349 are ever reduced. ORS 238.375.

Without a showing of adverse impact all that petitioners requested and all that they were granted is a declaratory opinion to the effect that PERB was required to fund a contingency reserve. The trial court was not authorized to issue such a declaration. On several occasions the Oregon Court of Appeals has explained that ORS 183.480(2) and numerous decisions of that court make clear that judicial review of final agency orders shall be solely as provided in the APA. See, e.g., *Mendieta v. Division of State Lands*, 148 Or App 586, 599, 941 P2d 582 (1997); *Lake County v. State of Oregon*, 142 Or App 162, 165, 920 P2d 1115 (1996), and cases cited therein. Because the logic stated in these decisions is unassailable this court should agree that the trial court's granting of declaratory relief was beyond its authority.

D. Conclusion

PERB correctly exercised its discretion in not funding the contingency reserve but, in any event, the failure to fund this reserve did not adversely affect petitioners.

VII. SIXTH AND SEVENTH ASSIGNMENTS OF ERROR

> **Sixth Assignment of Error:** The trial court erred when it ruled that PERB abused its discretion in failing to allocate out of the 1999 earnings an amount sufficient to meet a 30-month funding goal for the gain/loss reserve account.
>
> **Seventh Assignment of Error:** The trial court erred in ruling that PERB abused its discretion by its allocation of 1999 earnings to employee accounts.

A. Preservation of Error

In Count Ten of the First Claim for Relief of the Third Amended Petition, petitioners asserted that PERB improperly credited earnings to Tier One accounts without first adequately funding the gain/loss reserve. The trial court ruled in favor of petitioners on this issue.

The pertinent portions of the record are as follows:

> "3. In 1999, the PERB's goal for the gain/loss reserve was to fund it with sufficient amounts to pay 8% to Tier One employee regular accounts for a period of 30 months during which there was no fund income available for distribution to those accounts. In distributing 1999 PERS fund earnings, the PERB allocated 20% to Tier One regular employee accounts, employer accounts and the benefits-in-force reserve account, with the remainder allocated to the gain/loss reserve account. After this earnings distribution, the gain/loss reserve account contained 72.4% of the 30-month goal that the PERB established." January 16, 2003 Judgment, Finding of Fact No. 3.

> "3. The PERB abused its discretion in allocating 1999 earnings of 20% to Tier One regular employee accounts. On remand, if the PERB does not allocate out of the 1999 earnings an amount that is sufficient to meet its previously-stated 30-month funding goal for the gain/loss reserve account, the PERB must explain this inconsistency so this court can adequately review the PERB's decision." January 16, 2003 Judgment, Conclusion of Law No. 3.

B. Standard of Review

The standard of review is only to determine if the agency's actions are within the range of discretion allowed by the general statutory policy. *Springfield Education Assn. v. School Dist.*, 290 Or 217, 229, 621 P2d 547 (1980).

C. Argument on Sixth and Seventh Assignments of Error

In considering the actions of PERB the trial court should have followed the Administrative Procedures Act and the decisions of this court explaining the proper role of the courts in reviewing agency discretion. Certainly the court should properly have deferred to the special expertise of the agency in the administration of its complex pension system.

The decisions relating to the funding of the gain/loss reserve are left to the sound discretion of PERB. ORS 238.670(3) provides that the board "*may* set aside" funds for the reserve. A higher balance in the gain/loss reserve will decrease the potential for a deficit in

that reserve. However, it also lowers the amounts credited to member accounts and hence causes a reduction in benefits. Petitioners' Exhibit 41; Tr. Vol. III, p. 150.

In the trial court's view once PERB announced an objective to fund the gain/loss reserve at a 30-month level it had to reach that goal as quickly as possible and at the earliest opportunity. As noted, however, PERB must strike a balance between conflicting interests and policies. Funding the gain/loss reserve reduces the amount of employee benefits.

In February 2000 PERB increased the funding goal for the gain/loss reserve from 18 months to 30 months. Exhibit 106 C, p. 2. PERB then had to decide how fast to achieve its newly-adopted funding goal. PERB was presented with a matrix of 30 different options. Exhibit 108 B, p. 13; Exhibit 20, p. 5. At one extreme the entire amount of 1999 earnings available for distribution could be allocated pro-rata to member accounts, employer accounts, and the benefits-in-force reserve. This would have left the gain/loss reserve funded at 50.7% of the 30-month goal. At the other extreme only the minimum earnings allocation of 8% could be made to employee accounts, employer accounts, and the benefits-in-force reserve, with the remainder allocated to the gain/loss reserve. This would have left the gain/loss reserve funded at 133.9% of the goal.

PERB chose an earnings allocation option between these two extremes. At its meeting on March 27, 2000 it selected an earnings allocation of 20% to member accounts, employer accounts and the benefits-in-force reserve, leaving the remaining available earnings to be allocated to the gain/loss reserve. Exhibit 20. This left the gain/loss reserve funded at 72.4% of the total funding goal.[23]

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[23]PERB's decision to take additional time to achieve its financial goal is reminiscent of the situation faced by the Legislature when by 1995 it had still not achieved a funding equity goal established in 1991 legislation. In *Withers v. State of Oregon*, 133 Or App 377, 891 P2d 675 (1995), and in *Withers v. State of Oregon*, 163 Or App 298, 987 P2d 1247

(continued...)

Petitioners failed to produce any evidence that PERB should have projected or even anticipated 30 months of earnings at less than the assumed rate (8%). For that matter there was not even any evidence that PERB was faced with a possibility of such event given the strong investment climate when it made its decision for distribution of the 1999 earnings.

While it is in the employers' interests to see the gain/loss reserve funded as high as possible with employee money, it cannot be an abuse of discretion for PERB to refuse to fund the reserve at whatever levels the employers wish. PERB also has to consider the impact on the members of the system.

As explained, the decision PERB faced is reflected in the March 27, 2000 Orr memorandum, Ex. 20, p. 5, a copy of which is included in the Appendix. Option 23 would have distributed 14.28% to the accounts and the balance would have fully funded the 30-month goal for the gain/loss reserve. If PERB has chosen Option 23 a member's account (and corresponding retirement benefit) would be 8.5% less than if all earnings went to the accounts.[24] This would have been particularly harsh for the those members ready to retire under *money match*. They would have seen their retirement benefits reduced by 8.5% to

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[23](...continued)
(1999), the Court of Appeals explained that the pace at which the Legislature achieved the goal was a policy matter.

> "The question becomes whether it is better policy to implement incrementally funding equalization to avoid harming students in some districts than to require immediate funding equalization to benefit students in other districts. That is precisely the sort of public policy choice the legislature is constitutionally empowered to make and which we are in no position to second-guess." 163 Or App at 309.

[24]To illustrate, assume an employee's account is $100,000. If PERB selected Option 1 the employee would have then had $124,890 in the account. By the selection of Option 23 the employee would have received earnings bringing the account to $114,280. The difference of $10,610 represents an 8.5% reduction in the value of the account under Option 1. The selection of Option 11 still represents a 4% reduction.

fund a reserve from which they receive no benefit. By choosing Option 11, allocating 20% to the accounts and 4.89% to the gain/loss reserve, PERB lessened the impact on the retiring members while still funding 72.4% of the 30-month goal.

The trial court's efforts to micro-manage the Public Employees Retirement System should not be sanctioned by this court. PERB made a decision which left the gain/loss reserve funded at 72.4% of the 30-month goal. This still left the fund with a reserve to cover the Tier One guarantee for more than 21 consecutive months. PERB expected that the earnings in future years would permit the funding which would satisfy the 30-month goal. PERB cannot be judged by 20/20 hindsight.[25] The fact that the years 2000 and 2001 were poor ones for investments cannot be used to now second guess the decision PERB made regarding the 1999 earnings.

> "When the application of statutory policy to fact is entrusted to an agency, and the agency has correctly interpreted the law, then the function of the court on review is not to substitute its judgment, but to uphold any reasoned application of that interpretation to the facts." *Springfield*, 290 Or at 235.

D. Conclusion

PERB's decision to fund the gain/loss reserve at 72.4% of the 30-month goal, rather than to severely reduce employee benefits by achieving 100% of the goal from 1999 earnings alone, was a proper exercise of its discretion. This court should reverse the decision of the trial court.

VIII. EIGHTH ASSIGNMENT OF ERROR

Eighth Assignment of Error: The trial court erred in admitting evidence of conditions which occurred after the 1998 and 2000 rate orders.

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[25]This should be particularly true when even at a lower reserve level there had not been a deficit in the gain/loss reserve for over 20 years. Ex. 117.

A. Preservation of Error

It was intervenors' position that evidence of later conditions should not be relevant to the review of PERB's actions in setting the 1998 and 2000 rate orders.

The pertinent portions of the record are as follows:

> "MR. HARTMAN: ***And I would submit to you that I don't think it's proper for the court to consider any evidence of things which took place after the decision was made. And let me refer to the 1993 order, the order which adopted a particular process insofar as the actuarial assumptions are concerned.
>
> "I would suggest to you that for the court to consider what had happened in 2001, what happened in 2002, or the year 2000, when you're deciding whether PERS was acting within their discretion when they adopted that order would be entirely inappropriate." Opening Statement of Intervenors, Tr. Vol. I, pp. 38-39.
>
> "MR. GARY: Those exhibits that we are not offering are 12, 15, 16, 17, 18, 19, 22, and 23. With those exceptions, I offer all of the exhibits contained in the binder that we've given you, Exhibits 1 through 38." Tr. Vol. I, p. 41.
>
> "MR. HARTMAN: *** [T]o the extent any of these documents are offered to prove the petitioners'–to carry the petitioners' burden to show that a certain decision made by the board was beyond their authority or whatever standard they indicated is the appropriate standard, to the extent that those documents are subsequent to that decision, we object to them." Tr. Vol. I, p. 42.
>
> "THE COURT: *** I'll overrule that objection. If that's the only objection, they'll be received." Tr. Vol. I, p. 42.
>
> "MR. HARTMAN: Your Honor, I would look to renew my objection that I made previously on the issue of the receipt of information post-decision-making in order to carry the petitioners' burden in regard to showing you that the decision was wrongly made in either 1993 or 1978.
>
> "You've already ruled on that, but may I have a continuing objection on that issue so that I can –

> "THE COURT: Sure, umm-hmm.
>
> "MR. HARTMAN: – preserve the record?
>
> "THE COURT: And my – my ruling will continue to be that it goes to the weight, not the admissibility, and I'll allow it.
>
> "MR. HARTMAN: I understand. And I assume I have a continuing objection?
>
> "THE COURT: Yes." Tr. Vol. I, p. 61.

B. Standard of Review

The standard of review is error of law. *State v. Titus*, 328 Or 475, 481, 982 P2d 1133 (1999).

C. Argument

The issue before the court was whether PERB abused its discretion in failing to fully fund the 30-month gain/loss reserve goal when it had an opportunity to do so. In ruling that PERB did abuse its discretion the court was clearly influenced by and relied upon the subsequent downturn in investment performance which occurred after the board made its decision. It was intervenors' consistent position that the PERB's exercise of discretion cannot be judged with 20/20 hindsight. After all, if history were different and the years 2000 and 2001 also had had good earnings which PERB used to bring the gain/loss reserve to 100% of the 30-month level, would anyone now contend that the board abused its discretion by failing to fully fund the reserve with 1999 earnings?

It was error for the court to consider exhibits such as petitioners' Exhibit 5, a memorandum to the members of the PERS board dated March 14, 2002, discussing the impact of negative 2001 earnings. Similarly, Exhibits 6, 7, 8, 11, 14, 24, 25, 26, 27, 28, 29, 30, 37 and 38 introduce post-decision history which should not have been considered by the court in rendering its decision. These exhibits were not relevant to prove whether PERB

properly exercised discretion in 2000. While the court did not expressly refer to the low earnings in subsequent years, it is clear that the court was influenced by this evidence.

> "The inevitable effect of that aggressive crediting decision was to substantially increase the burden on the gain/loss reserve for covering future earnings shortfalls as required to meet the guaranteed rate of return to those accounts. At the same time, this aggressive earnings allocation has substantially raised the future potential needs of the gain/loss reserve account, particularly if it is ever to be funded at a level that meets the board's 30-month funding goal." October 7, 2002 Opinion and Order, p. 18. ER-134.

PERS is a trust fund. PERB is declared to be the trustee of the fund. ORS 238.660(1). Trustees have an obligation to exercise their best judgment, but are not guarantors of success. In *Marshall v. Frazier*, 159 Or 491, 528-29, 80 P2d 42, 81 P2d 132 (1938), this court explained:

> "In determining whether a trustee has used sound discretion in the investment of funds entrusted to him, it is necessary for the court to place itself in the position in which the trustee was at the time of making the investment." Citing *United States National Bank & Trust Co. v. Sullivan*, 69 F2d 412 (7th Cir. 1934).

D. Conclusion

PERB should not be judged on the basis of hindsight. It was error for the court to admit evidence of later events or conditions.

IX. NINTH, TENTH, AND ELEVENTH ASSIGNMENTS OF ERROR

> **Ninth Assignment of Error:** The trial court erred in granting petitioners leave to file a third amended petition.

A. Preservation of Error

The pertinent portions of the record are as follows:

At the conclusion of the trial the following colloquy occurred.

> "MR. GARY: We have no further witnesses on rebuttal, Your Honor. I would move, pursuant to ORCP 23 D, for permission to conform our pleadings to the evidence. And what I would propose to do is to submit an amended pleading. It's not going to be significantly different than what we filed already, and I want to tie up any loose ends. And we'll submit that with our post-trial brief." Tr. Vol. V, p. 160.
>
> "MR. HARTMAN: Excuse me, Your Honor. We, too, would object ***." Tr. Vol. V, p. 163.
>
> "Petitioners' motion for leave to file Third Amended Petition is allowed." September 9, 2002 Order.

B. Standard of Review

The standard of review is abuse of discretion.

Tenth Assignment of Error: The trial court erred in refusing to allow additional evidence in response to the third amended petition.

C. Preservation of Error

The pertinent portions of the record are as follows:

> "It is therefore ORDERED that Petitioners/Plaintiffs' objections to the Affidavit of Dale S. Orr, Affidavit of Mark O. Johnson and Affidavit of Charles F. Howitt are sustained.***" October 10, 2002 Order.

D. Standard of Review

The standard of review is abuse of discretion.

Eleventh Assignment of Error: The trial court erred in denying intervenors' motion for new trial.

E. Preservation of Error

The pertinent portions of the record are as follows:

> "Pursuant to ORCP 64 B(1) and 64 C, intervenors move for a new trial on count 7 of petitioners' fourth claim for relief (allocation of 1999 earnings to Tier One employee accounts) because the trial court proceedings prevented a fair trial on that claim ***." January 8, 2003 Intervenors' Motion for New Trial.

> "[I]t is hereby ordered that intervenors' motion for new trial or for reconsideration is denied." April 23, 2003 Order.

F. Standard of Review

The standard of review is abuse of discretion.

G. Argument on Ninth, Tenth, and Eleventh Assignments of Error

After trial the court permitted petitioners to file a third amended petition over the objection of respondents and intervenors.

In the proposed third amended petition, petitioners added, *inter alia*, Count Seven to the Fourth Claim for Relief. By their August 19, 2002 Response intervenors objected to the proposed amendment and in their August 22, 2002 Memorandum relied upon the arguments presented by respondents in their August 15, 2002 memorandum in opposition to the motion for leave to amend pleadings, including the addition of Count Seven of the Fourth Claim.

Thereafter, respondents submitted the September 5, 2002 affidavit of Dale S. Orr describing the process for distribution of earnings in general and the specific process used in connection with the distribution of the 1999 earnings. By order dated October 10, 2002 the court ruled that the affidavit of Dale S. Orr would not be considered part of the trial record in the case.

A motion to amend to conform to the evidence is addressed to the sound discretion of the trial court. Nevertheless, the motion should not be granted when it results in prejudice to the other parties. See, *Quirk v. Ross*, 257 Or 80, 83, 476 P2d 559 (1970). Here the trial court abused its discretion by permitting petitioners to assert a new theory after trial. Respondents and intervenors were clearly prejudiced by the introduction of the new theory, as they had presented little or no evidence relating to the procedures utilized by PERB in making its decision for the distribution of the 1999 earnings.

ORCP 23 B permits amendments to conform to the evidence but also states that the court may grant a continuance to enable the objecting party to meet such evidence. Therefore, even if it was not an abuse of discretion to permit the amendment it was certainly an abuse of discretion not to permit respondents and intervenors to meet the new pleading with evidence. For the same reason it was an abuse of discretion for the trial court to deny intervenors' motion for new trial.

X. CONCLUSION

PERB has a very daunting task. Not only must it forecast the future in order to set present employer rates, it must also protect the rights of the members deriving from paramount law. In considering the actions of PERB the trial court should have followed the Administrative Procedures Act and the decisions of this court explaining the proper role of the courts in reviewing agency discretion. Certainly the court should properly have deferred to the special expertise of the agency in the administration of its complex pension system.

The trial court recognized that the PERS statutes have sections that are poorly drafted. However, in its zeal to find ways to reduce employer rates the trial court has thrown the entire system into turmoil.

The trial court erroneously required PERB to change the method of computation of the employer portion of *money match*. The trial court erroneously required PERB to use updated mortality tables without regard to the broader legal consequences. The trial court erroneously ordered PERB to fund a contingency reserve. The trial court erroneously ruled how PERB should have distributed 1999 earnings. The trial court also erroneously refused intervenors access to important discovery and refused to allow intervenors to address issues raised by petitioners after trial.

For all of these reasons this court should reverse the trial court and enter judgment in favor of intervenors.

Dated this ___ day of January, 2004.

Bennett, Hartman, Morris & Kaplan, LLP

_____

Gregory A. Hartman, OSB# 74128
Michael J. Morris, OSB 77283
Of Attorneys for Intervenors-Appellants

APPENDIX

CERTIFICATE OF SERVICE

I hereby certify that I filed the original and 15 copies of the APPELLANTS' OPENING BRIEF by regular first class mail on the following:

State Court Administrator
Records Section
Supreme Court Building
1163 State Street
Salem OR 97310

I further certify that I served two copies of the foregoing document upon each:

Jeffery J. Matthews
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by mailing in a sealed, first-class postage prepaid envelope, addressed to said persons' addresses as shown above and deposited in the U.S. Mail at Portland, Oregon on the date set forth below.

DATED this _____ day of January, 2004.

BENNETT, HARTMAN, MORRIS & KAPLAN, LLP

Gregory A. Hartman, OSB# 74128
of Attorneys for Intervenors-Appellants, Cross-Respondents