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November 19, 2003

FACSIMILE AND FIRST CLASS MAIL

James Baker
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Old Federal Reserve Bank Building
400 Sansome Street
San Francisco, CA 94111-3143

Re: *City of Eugene, et al. v. State of Oregon, et al.*
Marion County Circuit Court Consolidated Case No. 99C12794
Baker County Library District, et al. v. State of Oregon, et al.;
Marion County Circuit Court Case No. 03C13182
Adrian School District, et al. v. State of Oregon, et al.;
Marion County Circuit Court Case No. 03C13183
City of Albany, Oregon, et al. v. State of Oregon, et al.;
Marion County Circuit Court Case No. 03C13184
Baker County Oregon, et al. v. State of Oregon, et al.;
Marion County Circuit Court Case No. 03C13185
League of Oregon Cities, et al v. State of Oregon, et al
Marion County Circuit Court Case No. 03C13186
Canby Utility Board, et al. v. State by and through PERB;
Marion County Circuit Court Case No. 03C17944

Dear Jim:

I enjoyed meeting you last week and I appreciate the opportunity we had to discuss the above cases. I was gratified to learn that the Public Employees Retirement Board (PERB) will join with the state and local government defendants in their effort to uphold the 2003 PERS reform legislation against the pending court challenges. I look forward to working with you to that end.

As we discussed, the *Lipscomb* decision is an important predicate to the reforms enacted by the Legislative Assembly. Although we do not completely agree with his position, Greg Hartman will argue that the validity of the reform legislation is dependent upon the validity of the legal conclusions that underlie the *Lipscomb* judgment. If the PERB pursues its appeal of the *Lipscomb* judgment and argues, as it did below, that the circuit court's legal conclusions are erroneous, Mr. Hartman

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undoubtedly will exploit the apparent inconsistency between the PERB's positions in *Lipscomb* and in the PERS reform litigation.

The eight local government petitioners in *Lipscomb* commenced the litigation in order to correct mistakes made over a long period of time by the former PERB. Those mistakes, coupled with unintended consequences of certain legislative actions over the years, combined to set PERS on a dangerous, non-sustainable course. Unless corrected, that course threatened the future financial stability, not only of PERS, but of all Oregon government institutions. The petitioners believe that the *Lipscomb* judgment, together with the reform legislation and the administrative changes at PERS that the new PERB has begun to implement, offer hope that we can achieve the secure, fair and affordable pension system that public employees and Oregon taxpayers deserve. The petitioners look forward to the time, hopefully soon, when public employers and employees work cooperatively with the PERB to achieve that common goal. Accordingly, petitioners propose to settle all of the remaining litigation against PERB on the following terms:

I. The *Lipscomb* Case.

A. PERB will agree that, effective immediately, the PERS staff will calculate the employer cost associated with money match retirement benefits for members who have a variable account balance according to the statutory interpretation adopted by Judge Lipscomb, unless and until that interpretation is modified by legislation or by a subsequent final and enforceable judgment directing PERB to do otherwise.

B. As soon as practicable, PERB will reallocate 1999 earnings credited to Tier One regular accounts from the previous allocation of 20% to 11.3%. This is consistent with the preliminary decision of the former PERB and with the PERS staff recommendation. Petitioners will not challenge the reallocation.

C. As soon as practicable, PERB will reallocate 1999 earnings credited to member variable accounts and corresponding accounts to comply with Judge Lipscomb's ruling on intervenors' challenge to the "employer in variable" rule. Petitioners will not challenge the reallocation.

D. PERB will comply with the legislature's directions concerning reserving practices and mortality tables as interpreted by Judge Lipscomb and as modified in HB 2003, HB 2004 and HB 2020 unless and until those directions are modified by legislation or by a subsequent final and enforceable judgment directing PERB to do otherwise.

E. PERB will direct its actuary to recalculate the employer contribution rates for the City of Eugene (including EWEB) and Lane County for 1998 and 2000, and for the Cities of Portland,

Roseburg and Huntington, Multnomah County, Canby Utility Board and Rogue River Valley Irrigation District for 2000. PERB will instruct the actuary to determine what the employer contribution rates would have been in those years if PERS practices with respect to the variable match, mortality tables, and employer in variable had been consistent with the law as interpreted by Judge Lipscomb and if the PERB had originally allocated earnings of 11.3% to Tier One regular accounts for 1999. PERB will issue revised rate orders for 1998 and 2000 pursuant to the actuary's recalculations.

The difference between the employer contributions paid by petitioners pursuant to the original contribution rate orders and the lesser amounts that should have been paid under the revised contribution rate orders will be deemed by PERB to be excess employer contributions. At the option of each petitioner, the excess employer contributions may be applied to reduce any unfunded actuarial liability attributed to that petitioner or may be applied to reduce the petitioner's future employer contribution rate, commencing with the 2004 employer contribution rate order described below and over a commercially reasonable amortization period selected by PERB.

F. PERB will pay petitioners their reasonable costs and attorney fees. To date, these fees and costs are approximately \$1,390,000. This sum represents the actual amount paid by the petitioners in costs and attorney fees during the four years that this litigation has been pending. It includes fees incurred in connection with the 2003 rate order challenges. Petitioners have paid attorney fees pursuant to discounted rates. At standard hourly rates, petitioners' reasonable attorney fees exceed \$1,580,000.

G. PERB will dismiss its appeal of the *Lipscomb* judgment. It is unclear whether this settlement will render the intervenors' appeal of the *Lipscomb* judgment moot. If the intervenors' appeal is not dismissed, petitioners will defend the appeal at their own expense.

H. Upon execution and implementation of this settlement agreement, petitioner will execute and file a satisfaction of judgment.

II. The 2003 Rate Order Litigation,

A. By no later than July 1, 2004, PERB will issue new employer rate orders. Every PERS participating employers' contribution rate will be calculated in a manner that takes into account PERB's implementation of the Lipscomb decision as described herein.

B. Petitioners will dismiss the 2003 rate order challenges.

Hartman Affidavit
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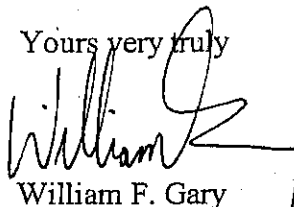
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Petitioners believe that the foregoing proposal provides a mechanism for resolving the pending litigation in a fair and workable manner. I look forward to PERB's response. If you have questions concerning any of the foregoing, do not hesitate to call.

Yours very truly



William F. Gary

WFG:jan

c: Clients
Jeffrey M. Batchelor

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