Comment

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Moro v. Oregon: Overturning Legislative Changes to the Public Employee Retirement System (PERS) Leaves Limited Options for a Cash Strapped State

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INTRODUCTION

Like changes to Social Security at the federal level, changes to the Oregon Public Employee Retirement System (PERS) have been the untouchable "third rail" of state politics. With more than $68 billion in assets[1] and providing retirement benefits to more than three hundred thousand state employees,[2] PERS has been a far-reaching and politically charged topic for decades. Unfortunately, because employee benefits have outgrown contributions in recent years, PERS's total unfunded liability has grown to more than $21 billion[3] and made it the most pressing issue facing Oregon's legislators as they work to set the state budget.

Because both local and state agencies contribute to PERS, it has a far-reaching fiscal impact in Oregon. Presently, government agencies (state and local) will be responsible for contributing an additional $885 million to the PERS system during the 2017–2019 biennium, *a forty-four percent increase* from the 2015–2017 biennium![4] This makes PERS one of the larger cost drivers contributing to Oregon's budget deficit[5] and, like Social Security, this problem will only grow as more baby boomers retire.

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1 *2015 PERS Fund Earnings Fall Short of Assumed Rate*, PERSPECTIVES FOR OPSRP MEMBERS, (Or. Pub. Emp. Ret. Sys., Tigard Or.), Apr. 2016, at 1, https://www.oregon.gov/pers/MEM/OPSRP/Documents/Perspectives/opsrp_perspectives_4-1-16.pdf.

2 OR. PUB. EMPS. RET. SYS., PERS: BY THE NUMBERS 2 (2017), http://www.oregon.gov/PERS/Documents/General-Information/PERS-by-the-Numbers.pdf.

3 Editorial, *Oregon Swallowed by PERS Costs*, REG. GUARD, Aug. 27, 2017, at G2.

4 Ted Sickinger, *PERS: Oregon's Public Pension Costs Will Go Up $885M Next Year*, OREGONIAN (July 30, 2016, 3:21 PM), https://www.oregonlive.com/politics/index.ssf/2016/07/pers_oregons_public_pension_co.html.

5 Mike Rogoway, *Oregon's Economy Soars yet State Budget Gap Grows: Here's Why*, OREGONIAN (Apr. 9, 2017, 5:13 PM), https://www.oregonlive.com/business/index.ssf/2017/04/oregons_economy_soars_yet_stat.html.

Many argue that changes to PERS are necessary to maintain the financial solvency of Oregon. However, changes to PERS face huge political opposition from public employee unions, as well as challenges in the courts. As Governor Kate Brown said in a 2016 gubernatorial debate, "When I hear [PERS reform proposals], I hear lawsuit, lawsuit, lawsuit . . . ."[6]

This Comment helps to frame the history and public policy issues surrounding PERS in Oregon. To be explicit, this is not a political or advocacy piece focused on any specific future changes. Instead, this piece aims to identify how Oregon reached this point with PERS and analyze the Oregon Supreme Court's rationale in deciding the most recent PERS case: *Moro v. State*.[7] Part I discusses the history and background of PERS, including prior reforms to the program and subsequent legal challenges that preceded *Moro v. State*. Part II examines the changes to PERS passed by the Oregon legislature in 2013, which led to the challenges in *Moro. v. State*. Part III analyzes the Oregon Supreme Court's decision in *Moro v. State*, particularly in relation to the expansion of the protections of the U.S. and Oregon Constitutions's contract clauses. Lastly, without advocating for any particular changes, Part IV highlights the political realities and limited options that remain for the Oregon legislature to bend the rising cost curve of PERS.

I
BACKGROUND LAW

A. Development of PERS

The Oregon Public Employee Retirement System (PERS) has been around for more than sixty years.[8] Prior to the establishment of PERS, several different sectors of public employees, including firemen, police officers, and teachers, had their own separate pension systems.[9] The Oregon legislature established a pension program for all

[6] Paris Achen, *Brown, Pierce and Independent Thomason Spar on Taxes, Affordable Housing, Economy*, PORTLAND TRIB. (Oct. 6, 2016), https://portlandtribune.com/pt/9-news/326387-206075-independent-joins-brown-pierce-in-gubernatorial-debate.

[7] Moro v. State, 357 Or. 167, 351 P.3d 1 (2015).

[8] OR. PUB. EMPS. RET. SYS., THE OREGON PUBLIC EMPLOYEES RETIREMENT SYSTEM HISTORY THE FIRST 60 YEARS 7 (2010), https://www.nasra.org/files/State-Specific/Oregon/History_1-11-2011.pdf [hereinafter PERS HISTORY].

[9] *Id.* at 4.

Oregonians over age seventy in 1933, and at the federal level, Social Security was signed in to law in 1935.[10] Both of these events, combined with discontent with existing pension systems, provided momentum for a unified pension system for public employees.[11]

The original PERS program was created during the 1945 legislative session and became effective on July 1, 1946.[12] PERS functioned for nearly a decade before it became evident that the existing program was not meeting the needs of retirees.[13] From 1939 to 1952, the average cost of living doubled,[14] while PERS benefits stayed flat, primarily because the state only matched pension payments on the first $3000 of an employee's salary.[15] The combination of a rising cost of living with flat PERS benefits further exacerbated the problem for retirees. Because of this discrepancy, changes to PERS were needed for retirees to maintain their purchasing power.

Surprisingly, the federal government inadvertently helped provide the solution to this problem.[16] In 1953, President Eisenhower announced an expansion of the Social Security System, namely the Old Age and Survivors Insurance (OASI) program.[17] While some public employee union leaders advocated for abolishing PERS in favor of solely participating in OASI, this option likely would have only led to a marginal increase in benefits with the added risk of being subject to centralized decision making in Washington, D.C., rather than Salem.[18] To address this, Governor McKay appointed a special committee to examine integrating OASI with PERS.[19] The special committee found that integrating OASI with PERS would lead to the best outcome for state employees.[20] OASI, however, was only available to state employees not covered under existing plans.[21] So

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10 *Id.*

11 *Id.* at 4–6.

12 *Id.* at 7.

13 *Id.* at 9.

14 *Id.* at 8.

15 *Id.*

16 *Id.*

17 *Id.* OASI is a separate program and trust fund under Social Security, though the two have largely merged in present day practical implementation. *Old-Age & Survivors Insurance Trust Fund*, SOC. SECURITY, https://www.ssa.gov/oact/progdata/describeoasi.html (last visited Sept. 20, 2017).

18 PERS HISTORY, *supra* note 8, at 8–9.

19 *Id.* at 8.

20 *Id.* at 9.

21 *Id.*

the legislature hatched a plan to repeal PERS as it existed under the Public Employee Retirement Act of 1945, enroll state employees under OASI, and reinstate PERS, substantially in the same form, under the Public Employee Retirement Act of 1953.[22] This essentially allowed employees to benefit from both OASI and the new PERS program.

PERS continued to undergo routine periodic adjustments over the next few decades. In 1967, a bill packaging several PERS changes was signed into law; the two most notable changes shifted PERS benefits to a "guaranteed pension" and allowed for a portion of PERS proceeds to be invested in stocks with oversight by the Oregon Investment Council (OIC).[23] As a result of being able to invest in high risk, high reward stocks, the OIC sought to increase returns and chose to invest ten percent of PERS funds in common stock.[24] Further, the guaranteed pension reforms led to the tripling of many retirees' checks.[25] However, economic fluctuations changed the needs of employees as time went on. Because of stagnant wages, the Oregon legislature passed a 1967 bill package that allowed unions to negotiate with employers for employers to "pick up" the six percent pension contribution for which the employees were responsible.[26]

Throughout the 1970s, public employee unions continued to advocate for increases in pension benefits and structural changes to PERS.[27] A few key changes included: (1) changes to the pension formula increasing the average pension benefit; (2) addition of an annual cost of living adjustment, initially capped at 1.5% and later increased to 2%; (3) an allowance for employees to retire with full benefits at earlier ages depending upon the number of years of service; and (4) a 25% increase in pension benefits for retirees prior to 1968.[28]

The most notable change to PERS came in 1975. The stock market slump of 1973 and 1974 led to concern about continuing to invest

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[22] *Id.*

[23] *Id.* at 12.

[24] *Id.* at 13.

[25] *Id.* at 14.

[26] *Id.* at 36. Since passage of this bill, local unions have been very successful in negotiating for employers to provide the "6% pick up." Seventy-two percent of employees in PERS now have their contribution covered by their employer. OR. PUB. EMP. RET. SYS., *supra* note 2, at 14.

[27] PERS HISTORY, *supra* note 8, at 14.

[28] *Id.* at 15.

PERS proceeds in the stock market.[29] Though the market eventually turned north again in 1975, the legislature was under pressure to act to protect promised PERS benefits.[30] Accordingly, the legislature passed a bill that guaranteed PERS beneficiaries at least a 5.5% annual return on their PERS accounts.[31] This is largely where the present day problems began; the addition of this guaranteed return added significantly to the budget deficits that now exist.

B. Significant Structural Changes to PERS in the 1990s

During the 1990s, as a larger number of PERS employees began to retire, the required contributions from public agencies increased.[32] As costs increased, PERS reforms were put forward in legislation, ballot initiatives, and various public task forces.[33] One of the most substantial reform efforts was under Ballot Measure 8 in 1994. Ballot Measure 8 would have made three changes to PERS as it existed at the time: (1) prevented employers from paying for part or all of an employee's required six percent contribution, (2) prevented employees from using accumulated sick leave to retire early, and (3) removed the guaranteed rate of return on PERS investments.[34] Measure 8 narrowly passed on the November 1994 ballot.[35] However, Measure 8 was immediately challenged as unconstitutional for violating the contracts clause of the United States Constitution. All three provisions of Measure 8 were eventually struck down by the Oregon Supreme Court in *Oregon State Police Officers' Association v. State* as unconstitutional because they eliminated contractual rights that were already earned.[36] This ruling established key precedent for future challenges to PERS reforms regarding contractual rights.

PERS also faced court mandated changes. Under Oregon statute, PERS benefits were tax-exempt.[37] A similar state statute in Michigan was challenged, and the U.S. Supreme Court held in *Davis v. Michigan Department of Treasury* that treating state and federal

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29 *See id.*

30 *Id.*

31 *Id.*

32 *Id.* at 21.

33 *Id.* at 19.

34 *Id.* at 20.

35 *Id.*

36 Or. State Police Officers' Ass'n v. State, 323 Or. 356, 380–81, 918 P.2d 765, 779 (1996).

37 PERS HISTORY, *supra* note 8, at 20.

pensions different under state tax laws violated the intergovernmental tax immunity doctrine.[38] Essentially, to be valid, the two types of benefits must be treated the same.[39] Because Oregon taxed federal pension benefits but exempted PERS benefits,[40] Oregon was required to either start taxing PERS benefits or exempt from taxes federal pension benefits.

In response to the *Davis* ruling, the Oregon legislature eliminated the tax-exempt status for PERS benefits in 1991.[41] Affected public employees immediately sued in *Hughes v. State* challenging the removal of tax-exempt status for PERS benefits, alleging that the changes violated the contract clause of the Oregon Constitution.[42] *Hughes* established two important precedential principles. Specific to taxation, *Hughes* held that the state either had to exempt PERS benefits from taxation or could provide additional financial benefits to offset the newly imposed taxes on PERS benefits.[43] The Oregon legislature would eventually opt for the latter option.[44] The legislature enacted tax offsets first in 1991, and later in 1995, which applied to retirees in Oregon and those who retired out of state.[45] More broadly relevant to future PERS reforms, *Hughes* established that the Oregon legislature could make prospective changes to PERS benefits not yet earned by public employees but could not make retrospective changes to PERS benefits that were already earned.[46] In combination, *Oregon State Police Officers Association* determined that retrospective changes violated the contracts clause of the U.S. Constitution,[47] and *Hughes* added that retrospective changes violated the contracts clause of the Oregon Constitution.[48]

38 Davis v. Mich. Dep't of Treasury, 489 U.S. 803, 817 (1989).
39 *Id.*
40 PERS HISTORY, *supra* note 8, at 20.
41 Moro v. State, 357 Or. 167, 185–86, 351 P.3d 1, 15 (2015).
42 Hughes v. State, 314 Or. 1, 5–7, 838 P.2d 1018, 1020–21 (1992).
43 *Id.* at 30–31, 838 P.2d at 1035.
44 *Moro*, 357 Or. at 188, 351 P.3d at 16.
45 *Id.*
46 *Id.* at 187–88, 351 P.3d at 16.
47 Or. State Police Officers' Ass'n v. State, 323 Or. 356, 361, 918 P.2d 765, 768 (1996).
48 *Hughes*, 314 Or. at 30–31, 838 P.2d at 1035.

C. The Current Three Tier PERS System

While ballot measures and court rulings dealt with specific portions of PERS, the legislature also took periodic action to make structural changes to PERS. The first structural reforms were passed in 1995, beginning for new employees starting January 1, 1996.[49] Employees entering service after that date are said to be in Tier 2, whereas employees who entered service prior to that date are said to be in Tier 1.[50] The legislature passed further reforms in 2003, creating a third tier of retirees.[51] The 2003 legislation created a new retirement program called the Oregon Public Service Retirement Plan, or OPSRP, which applies to employees hired after August 28, 2003.[52] Although OPSRP is technically a new retirement program, OPSRP, in practice, is just a new tier of PERS employees.

The differences in the three tiers are best analyzed by looking at the two components of PERS, a defined benefit pension and a defined contribution annuity. Each tier of PERS member has some aspect of both a defined benefit pension and a defined contribution annuity.[53] Generally speaking, the defined contribution annuity is funded by the employee's six percent contribution, which may actually be paid by the employer, and supplemented by employer contributions.[54] This annuity is called a defined contribution plan because the employee's contribution to the account is a fixed amount.[55] The defined contribution annuity functions similarly to an individual retirement account (IRA) or 401(k) retirement plan.[56] The six percent contribution is put into an individual account, which is invested to create additional returns.[57] Some of the PERS tiers create a guaranteed percentage of return on investment, generally set at six

49 Gretchen Stangier, *Oregon PERS Part 3: A Historical Look into a Troubled Past*, STANGIER WEALTH MGMT. (May 6, 2013), https://www.stangierwealthmanagement.com/blog/oregon-pers-part-3-a-historical-look-into-a-troubled-past.html.

50 *Id.*

51 *Moro*, 357 Or. at 182, 351 P.3d at 12.

52 *Id.* at 178, 182, 351 P.3d at 10, 12.

53 *See id.*

54 Carol Samuels, Senior Vice President, Seattle-Northwest Sec. Corp. & Lance Colley, Chief Operations Officer, Roseburg Pub. Sch., Everything You Wanted to Know About PERS . . . but Were Too Afraid to Ask, Presentation at the Oregon Summer Board Conference 18 (July 14, 2012), https://www.osba.org/-/media/Files/Event-Materials/SBC/2012/Materials/PERS-pdf.pdf?la=en.

55 *Moro*, 357 Or. at 176, 351 P.3d at 9.

56 *See* Samuels & Colley, *supra* note 54, at 3.

57 *Moro*, 357 Or. at 177, 351 P.3d at 12.

percent, rather than the actual market return on investment.[58] Upon retirement, the total amount in the individual account is divided into annual payments that the employee receives for life.[59] If the actual market return on investment is less than the guaranteed return, that shortfall is supplemented by the employer.[60] Some tiers also add an annual cost of living adjustment (COLA) to the annuity,[61] discussed in more detail below.

In addition to the defined contribution annuity, some PERS retirees also receive a defined benefit pension.[62] The pension is called "defined benefit" because the benefit is defined for when an employee retires but the employee's contributions do not change. Rather the employer's contributions are adjusted over time to properly pay for the defined benefit.[63] The pension system is funded by government-employer's contribution and investment income on those contributions.[64] When investment returns do not match expectations by the PERS board, the board can either reduce or increase an employer's contribution rates.[65] This Board-mandated adjustment can lead to spikes in employer contribution rates during economic downturns or market crashes, like in 2008.[66]

The PERS defined benefit pension is calculated using one of three formulas: Full Formula, Money Match, or Pension Plus Annuity.[67] These formulas involve complex calculations but generally include as factors, among other things, the number of years of service and final average salary of the employee.[68] In addition to these formulas, the pension amount can be influenced by a COLA and, as discussed above, an income tax offset.[69]

Tier 1 retirees enjoy of number of superior benefits. First, Tier 1 retirees enjoy a guaranteed rate of return on their defined contribution

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58 *See id.* at 176–81, 351 P.3d at 10–12.

59 *See id.*

60 *Id.* at 177, 351 P.3d at 10.

61 *Id.* at 179, 351 P.3d at 11.

62 *Id.* at 176, 351 P.3d at 9.

63 *Id.* at 176, 351 P.3d at 10.

64 *Id.* at 175–78, 351 P.3d at 9–10.

65 *Id.*

66 *Id.* at 82–83, 351 P.3d at 13.

67 *Id.* at 179, 351 P.3d at 11.

68 *Id.*

69 *Id.*

annuity, which has historically been eight percent.[70] This benefit is particularly fruitful because it compounds year after year, with virtually no risk of decrease. Second, Tier 1 retirees can choose the highest net formula of the three formulas offered.[71] Although the legislature intended the Full Formula to be the standard and most used, the Money Match formula proved to be the highest returning formula in recent years.[72] Indeed, for some retirees, this lucrative formula has even led to some retirees receiving an annual income that is larger than their salary when they were working.[73] Third, Tier 1 retirees enjoy a high multiplier factor of 1.67% in calculating their Full Formula.[74] Fourth, Tier 1 retirees enjoy being paid up to a 9.89% premium on their retirement benefits to cover state income taxes on their benefits.[75] Fifth, Tier 1 retirees enjoy the lowest possible retirement age of all PERS retirees, with retirement eligibility at age fifty-eight.[76] These perks make Tier 1 retirement benefits particularly generous when compared to the other PERS plans.

The legislative changes enacted in 1995 to create PERS Tier 2 retirees made a substantial impact to the unfunded liability that existed at the time. First, Tier 2 retirees do not have any guaranteed rate of return on their annuity contributions.[77] Instead, they receive only true market investment rates.[78] This change is particularly impactful because of the compounding effect mentioned above. Second, Tier 2 retirees are only allowed to choose the highest among two formulas in calculating their pension: Full Formula or Money Match.[79] Removing the availability of the Pension Plus Annuity formula made a minimal impact because it was rarely the highest pension formula for a retiree. Third, as a specific result of the *Hughes* decision, the legislature removed the additional premium paid on

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70 *Id.* at 178, 351 P.3d at 10. The rate was reduced to 7.75% in 2013. *Id.* at 178 n.6, 351 P.3d at 10 n.6.

71 Samuels & Colley, *supra* note 54, at 3.

72 *Moro*, 357 Or. at 180, 351 P.3d at 11.

73 John Tyler, *We'll Continue to Pay for PERS' Long Con*, REG. GUARD, Sept. 18, 2016, at H1 (showing over twenty percent of current retirees receive more in retirement than their last working salary); *see Oregon Swallowed by PERS Costs*, *supra* note 3.

74 Comparison of Pension Programs, Presentation at the Oregon State University Faculty Senate (Mar. 2009), https://www.oregonstate.edu/senate/agen/2009/0903_Options.pdf.

75 OR. PUB. EMPS. RET. SYS., *supra* note 2, at 3.

76 Comparison of Pension Programs, *supra* note 74.

77 Samuels & Colley, *supra* note 54, at 4.

78 *See id.*

79 *See id.*

PERS benefits to offset income taxes. Lastly, the retirement eligibility age was increased to age sixty for Tier 2 retirees.[80]

Though the 1995 PERS reforms helped curb the growing costs of the retirement program, the dotcom bubble burst in the early 2000s and led to rising contribution rates from employers because of the losses in the stock market.[81] As a result of these costs increases, the Oregon legislature passed the 2003 PERS reforms, creating the new Tier 3 of PERS employees, OPSRP.[82] The OPSRP changes are significant because, in addition to creating a new class of retirees, those hired after August 28, 2003, OPSRP also stopped Tier 1 and Tier 2 employees from continuing to earn benefits under those programs.[83] That is to say, current employees in 2003 kept any accrued benefits under Tier 1 and Tier 2, and those contributions already paid in to the system continued to accrue benefits according under those programs, but all retirement contributions after 2003 were now paid in to OPSRP, for all employees.[84] This is certainly an accounting nightmare: someone who worked for the state from 2000 to 2010 would have separate earned benefits under Tier 2 from 2000 to 2003 and earned benefits under OPSRP from 2004 to 2010.[85] However, this change, with those discussed below, helped move PERS from being only sixty-five percent funded in 2003 to ninety-eight percent funded in 2007.[86]

In addition to moving all existing employees into the new OPSRP system, OPSRP reformed the defined contribution annuity into a new program called the Individual Account Program (IAP).[87] Like the annuity program that preceded it, the IAP is similar to an individual retirement account because it is funded by the six percent employee contribution.[88] However, unlike its predecessor, the IAP is not paid for life and is not subject to a COLA.[89] Rather, the IAP annuity is

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80 OR. PUB. EMPS. RET. SYS., *supra* note 2, at 3.

81 PERS HISTORY, *supra* note 8, at 23–24.

82 *See id.* at 24–25.

83 Moro v. State, 357 Or. 167, 179, 351 P.3d 1, 10–11 (2015).

84 *See id.*

85 *See id.* at 181, 351 P.3d at 12 (discussing how employees earn benefits in different tiers).

86 *Id.* at 182–83, 351 P.3d at 13.

87 *What is the IAP*, OREGON.GOV, https://www.oregon.gov/pers/MEM/Pages/What-is-the-IAP.aspx (last visited Sept. 27, 2017).

88 *Id.*

89 *Moro*, 357 Or. at 181, 351 P.3d at 12.

solely based on the six percent employee contribution plus any investment income or losses.[90] Because the annuity is only based on the funds deposited in the account, there is never a need for employers to supplement it.[91]

OPSRP also made prospective changes to the defined benefit pension. Compared to Tier 2 retirees, OPSRP only offered one pension formula, the Full Formula.[92] In addition to only offering this formula, OPSRP lowered the multiplier factor to 1.5% in calculating the Full Formula, down from 1.67% enjoyed by Tier 1 and Tier 2 retirees.[93] Lastly, OPSRP increased the full retirement age to either sixty-five years or age fifty-eight with thirty years of service.[94]

The 2003 PERS reforms helped put PERS on a more sustainable path towards full funding. By 2007, PERS was ninety-eight percent funded.[95] Indeed, in early 2007 (prior to the beginning of the recession), PERS was even recognized by *PLANSPONSOR Magazine*, a journal focused on public retirement systems, as the best funded public employee retirement system in the country.[96] However, the recession was on the horizon.

In 2008, PERS's investments lost more than a quarter of their value.[97] Just a year after determining that PERS was ninety-eight percent funded, the PERS board determined that PERS was only seventy-eight percent funded and had developed a $16.1 billion shortfall.[98] To adjust for this shortfall, the PERS board had to raise contribution rates from employers.[99] However, the PERS board only adjusts actuarial rates for employers once every two years,[100] and the PERS board had just established contribution rates for the 2009–2011 biennium immediately before the recession hit.[101] This meant that the soonest that employer rates could be adjusted would have been in

90 *Id.*

91 *See id.*

92 *See id.*

93 Samuels & Colley, *supra* note 54, at 3.

94 Comparison of Pension Programs, *supra* note 74.

95 *Moro*, 357 Or. at 183, 351 P.3d at 13.

96 Judy Ward, *Public Plan Sponsor of the Year: The Oregon Trail*, PLANSPONSOR (Feb. 2007), https://www.plansponsor.com/magazine/public-plan-sponsor-of-the-year-the-oregon-trail/.

97 *Moro*, 357 Or. at 183, 351 P.3d at 13.

98 *Id.*

99 *Id.*

100 *Id.* at 177, 351 P.3d at 10.

101 *Id.* at 183, 351 P.3d at 13.

2010 for the 2011–2013 biennium.[102] This lag time in adjusted employer contributions meant that PERS fell even farther behind during the recession than other similarly impacted retirement plans.

Further exacerbating the problem is the fact that there is a cap, called a "rate collar," on how much employer contribution rates can be raised for any biennium.[103] This cap was established to help prevent employers from seeing excessive spikes in contribution rates from year to year.[104] From 1975 to 2005, employer contribution rates averaged between 9.15% and 11.4%.[105] However, with the recession causing the PERS fund to lose twenty-seven percent of its value and with rate increases being delayed until 2010, a large rate increase was necessary to compensate for the losses that the fund suffered as a result of the stock market crash. As a result of the 2011–2013 rate increases, the system-wide contribution rate rose to the maximum allowable by the rate collar: 16.3%.[106] However, even the 16.3% rate did not fully meet the actuarial needs of PERS.[107] Thus, the employer contribution rates continued to increase in later years, despite more prosperous financial conditions. For the 2013–2015 biennium, the PERS board set the rate at 21.4%;[108] however, this rate relied on the cost savings from the 2013 legislative changes. As discussed further below, with the legislative changes being struck down in *Moro v. State*, the unfunded liabilities of PERS continued to rise. Contribution rates for the 2017–2019 biennium are 20.85%, again lagging behind what is necessary to achieve full funding because they are limited by the rate collar.[109] Contribution rates are expected to continue to rise in to the future.[110]

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102 *Id.*

103 *Id.*

104 *Id.*

105 *Id.* at 183 n.11, 351 P.3d at 13 n.11. Current rates are difficult to precisely compare with historical rates because of a difference in accounting method that was implemented in 2013.

106 *Id.* at 183, 351 P.3d at 13.

107 *Id.*

108 *Id.*

109 Steven Patrick Rodeman, PERS Overview 13 (Mar. 6, 2017), https://olis.leg.state.or.us/liz/2017R1/Downloads/CommitteeMeetingDocument/103800.

110 *Id.* at 16.

II
CASE FACTS OF *MORO V. STATE*

Realizing that changes to the program were necessary to both provide long-term sustainability and provide financial relief to public agency budgets, the Oregon legislature acted in 2013 by making substantive changes to PERS.

Changes first came in the form of Senate Bill 822 (SB822). SB822 made changes to the PERS COLA statute and tax offset statute. Prior to SB822, the COLA was added each year using the Portland Consumer Price Index (CPI), and it compounded from year to year.[111] The annual COLA is capped at 2%, and any CPI increase above 2% is banked, or reserved, for future years when the CPI is below 2%.[112] PERS members built up a fairly substantial COLA bank because, since 1972, the CPI has only been below 2% in seven years.[113] SB822 reduced the COLA cap from 2% to 1.5% and imposed a graduated cap, decreasing as total benefits increased, for retirement benefits in excess of $20,000, but the COLA was still based on the Portland CPI and could be banked.[114]

Regarding the tax offset statute, SB822 removed the 1991 and 1995 tax offset provisions from PERS members who were not subject to Oregon income taxes, which were primarily out-of-state retirees.[115] This change would have affected more than 16,000 retirees, which is about 14% of benefit recipients.[116] In total, SB822 was predicted to reduce employer contribution rates from 21.1% to 18.6%, with 88% of those savings attributed to the COLA modifications.[117]

However, concern remained that these reforms were not enough to save government agencies from having to make staffing cuts. To address these concerns, the legislature passed Senate Bill 861 (SB861). SB861 was passed before the reforms in SB822 went into effect and further reformed the COLA modifications.[118] Rather than changing how the cap functioned with a variable COLA tied to a CPI, SB861 changed the COLA to a graduated fixed rate. Under SB861,

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111 *Moro*, 357 Or. at 185, 351 P.3d at 14.

112 *Id.*

113 *Id.* at 186, 351 P.3d at 15.

114 *Id.* The cap decreased as retirement benefits increased, with the minimum COLA of 0.25% applying to benefits above $60,000. *Id.*

115 *See id.* at 190, 351 P.3d at 17.

116 *Id.*

117 *Id.*

118 *Id.*

the first $60,000 in retirement benefits would receive a 1.25% annual COLA, and benefits above $60,000 would receive only a 0.15% annual COLA, which would dramatically reduce the growth of benefits for amounts over $60,000.[119] Further, the transition from a variable COLA to a fixed COLA provided more certainty to the PERS Board and employer contributors in planning contribution rates for the future.

To help soften the impact of the COLA reduction on low-income retirees, SB861 established two small supplemental payments, one mandatory and one discretionary.[120] The first supplemental payment, which was mandatory, provided an additional 0.25% retirement benefit, up to $50, for those members who receive less than $20,000 annually.[121] The second supplemental payment, which was discretionary, allowed the PERS board to provide an additional 0.25% supplemental payment, not to exceed $150.[122] This second supplemental payment was meant to be used during years of very high inflation. These supplemental payments were to be taken from contingency reserves, not from employer or employee contributions.[123]

The additional changes under SB861 to the COLA, combined with those under SB822, roughly doubled the anticipated savings from the 2013 reforms.[124] Between SB822 and SB861, employer contribution rates were anticipated to be reduced by a total of 4.5%.[125] Through 2029, these changes would have represented system-wide savings of $5.3 billion dollars,[126] a very significant amount.

These bills were the result of months of negotiations spearheaded by then-Governor John Kitzhaber.[127] Because of the amount of political capital invested in them and the significant impact they would have on bending the PERS cost curve, these bills were referred

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119 *Id.* at 186, 351 P.3d at 15.

120 *Id.*

121 *Id.*

122 *Id.*

123 *Id.*

124 *Id.* at 190, 351 P.3d at 17.

125 *Id.* This projected reduction did not incorporate the cost of the supplemental payments that were ultimately included in SB861.

126 *Id.* at 191, 351 P.3d at 17.

127 Lauren Drake, *"Grand Bargain" Session Ends: Kitzhaber Proclaims Success in Reforming PERS, Funding Schools*, BULLETIN (Oct. 3, 2013, 5:00 AM), https://www.bendbulletin.com/slideshows/1292327-151/grand-bargain-session-ends.

to as the "grand bargain" of the 2013 legislative session.[128] At the time, the PERS unfunded liability stood at around $14 billion, and these changes were expected to reduce that liability by up to one-third.[129] Because the changes in SB822 and SB861 applied to both benefits already earned and benefits that would be earned in the future, the changes were both retrospective and prospective.[130]

SB822 and SB861 faced very strong opposition from current retirees, future retirees, and public employee unions.[131] A group of plaintiffs representing long-time retirees, recent retirees, and future retirees, both in state and out of state, brought suit in state court challenging SB822 and SB861 as unconstitutional under the Oregon and United States Constitutions.[132] The plaintiffs primarily argued that the changes to PERS violated the contract clauses,[133] which prohibit "laws impairing the obligations of contracts."[134] In the alternative, the plaintiffs argued that the two bills were a breach of contract of their promised retirement benefits and were a takings without compensation under the Fifth Amendment.[135] In passing these reforms, the Oregon legislature specifically granted the Oregon Supreme Court with original jurisdiction, so the case went directly to the Supreme Court and was argued on October 14, 2014.[136]

III
MORO V. STATE

The plaintiffs sought to challenge SB822 and SB861 with four main arguments: (1) that the changes impaired their employment contracts and violated the contract clause of both the Oregon and U.S. Constitutions; (2) that the changes amounted to a breach of retirement benefits contracts and were an unconstitutional taking under both the Oregon and U.S. Constitutions; (3) that the changes violated the equal privileges and immunities clauses of the Oregon and U.S.

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128 *Id.*

129 *Id.*

130 *See Moro*, 357 Or. at 232, 351 P.3d at 39–40.

131 *See* Tyler Leeds, *PERS Legal Battle Heats up: Oregon School Boards Association Works to Uphold Reform Bill in Legal Fight*, BULLETIN (Aug. 16, 2013, 5:00 AM), https://www.bendbulletin.com/news/1343374-151/pers-legal-battle-heats-up.

132 *Id.*

133 *Moro*, 357 Or. at 192, 351 P.3d at 18.

134 OR. CONST. art. I, § 21.

135 *Moro*, 357 Or. at 192, 351 P.3d at 18.

136 *Id.* at 167, 351 P.3d at 8.

Constitutions; and (4) that the changes violated federal statute, 4 U.S.C. § 114, regarding taxation of pension income.[137] While several alternate arguments were presented, both parties focused on the contract clause claim, which is how the court ultimately decided the case.[138] In response to the contract clause claim, the defendants made two arguments: (1) that "the COLA and income tax offset are not contractual" and thus not subject to the contract clause; and (2) if the COLA and income tax offset are contractual, "that the amendments do not substantially impair the contract and are justified by a sufficient public purpose."[139]

The Oregon Constitution's contract clause states that "no . . . law impairing the obligation of contracts shall ever be passed . . . ."[140] This language largely matches the contract clause in the U.S. Constitution.[141] Because the language closely mirrors the U.S. Constitution, Oregon precedent has followed the U.S. Supreme Court's interpretation of the federal contract clause.[142] Considering Supreme Court precedent, Oregon courts previously held that the protections of the contract clause are limited to retrospective, not prospective, impacts; that is, only contracts that are agreed to prior to the enactment of a limiting statute are protected by the contract clause.[143] Thus, as it relates to SB822 and SB861, the court only considered "the potential impairment of contractual obligations arising only from contracts *entered into before* the effective date of the law being challenged."[144] As the court would later explain, the converse also holds true: changes to PERS affecting future employment contracts are not within the shelter of the contract clause.

In considering violations of the contract clause, the court employed a four-step analysis that was used in prior Oregon cases: (1) is there a contract?; (2) if a contract exists, what are the exact terms of the contract?; (3) considering the terms of the contract, what obligations do those terms require on behalf of each party?; and (4) have actions of the state impaired the contract obligations of the parties?[145] In

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137 *Id.* at 191–92, 351 P.3d at 18.

138 *See id.* at 235–36, 351 P.3d at 41–42.

139 *Id.* at 192, 351 P.3d at 18.

140 OR. CONST. art. I, § 21.

141 U.S. CONST. art. I, § 10, cl. 1.

142 *See Moro*, 357 Or. at 192, 351 P.3d at 18.

143 *See id.* at 231, 351 P.3d at 39.

144 *Id.* at 194, 351 P.3d at 19 (emphasis added).

145 *See id.*

deciding contract clause cases, rulings are generally made utilizing "general rules of contract law."[146] Particular to this case, because the State of Oregon was the allegedly violating party, the court also considered "the state's role serving the public."[147]

The court must balance competing interests: in order to do business, parties have to know that the state will make good on its promises; however, state promises with unintended consequences, like PERS, can hinder current and new policy goals.[148] Further, the Oregon Supreme Court has established a high bar that "disfavors interpreting statutes as contractual promises."[149] Statutes are generally only considered contractual promises "if the legislature has 'clearly and unmistakably' expressed its intent to create a contract."[150] This interpretation is guided by the principle that a current legislature generally does not act in attempt to prevent a future legislature from changing existing policy.

A. Do PERS Benefits Constitute a Contract?

To determine if PERS represents a contract, and when precisely the contract was formed and in effect, the court applied prior Oregon precedent in combination with contract common law. Two prior cases, *Strunk v. Public Employees Retirement Board*[151] and *Hughes v. State*,[152] held PERS benefits to be contractually earned. Both parties in *Moro v. State* agreed that PERS benefits represented a contract, so this point was relatively undisputed.

The court discussed common law contracts as applied to employment law. Employment contracts are generally unilateral contracts, with employers promising to compensate employees at a later date for services that are presently performed.[153] Unilateral contracts are accepted via performance, which is not necessarily when an employee begins work for an agency.[154] This compensation takes a

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146 *Id.*

147 *Id.*

148 *See id.*

149 *Id.* at 195, 351 P.3d at 19; *see* Strunk v. Pub. Emps. Ret. Bd., 338 Or. 145, 171, 108 P.3d 1058, 1075 (2005).

150 *Moro*, 357 Or. at 195, 351 P.3d at 20 (quoting Campbell v. Aldrich, 159 Or. 208, 214, 79 P.2d 257, 259 (1938)).

151 *Strunk*, 338 Or. 145, 108 P.3d 1058.

152 Hughes v. State, 314 Or. 1, 838 P.2d 1018 (1992).

153 *Moro*, 357 Or. at 198–99, 351 P.3d at 21–22.

154 *See id.*

variety of forms, including salaries, health insurance, vacation and retirement benefits, among other options.[155] For example, PERS benefits are not delivered until an employee is in retirement, but they are earned when the employee renders his or her services.[156] Because this case involved legislative changes to the PERS program, the court clarified that "the PERS statutes are themselves not an offer that employees can accept."[157] That is, changes to the PERS program are not de facto changes to the employee's compensation contract.

Because the PERS program is legislatively established and included as an offer by government employers, the contract is not formed when legislation is passed, but rather when an employee accepts an employer's offer of employment for compensation.[158] Therefore, just like a paycheck, retirement benefits are being continuously offered along with employment by employers, and employees are continuously accepting that offer by rendering services.[159] Because PERS benefits are considered compensation in a unilateral contract, the PERS contract likewise is formed when the employee's services are rendered, and not when PERS legislation is passed or when they initially begin work for an employer.[160]

B. What Are the Terms of the Contract?

After establishing that PERS benefits are part of the employment contract, the court next considered the second step of the four-step analysis: defining the terms of the contract. In particular, the parties raised three contested issues relating to the terms of the contract: (1) what standard should a court use in identifying terms of the contract?; (2) were the 1991 and 1995 tax offset provisions terms of the contract?; and (3) were the COLA provisions terms of the contract?[161]

In analyzing whether or not statutes create contractual promises, Oregon courts utilize the "unmistakability doctrine," which "requires courts to interpret statutes as noncontractual unless the legislature's

155 *See, e.g.*, *id.* at 198, 351 P.3d at 20.
156 *Id.*
157 *Id.* at 197, 351 P.3d at 21.
158 *Id.*
159 *See id.* at 198–99, 351 P.3d at 21–22.
160 *Id.*
161 *Id.* at 201–13, 351 P.3d at 23–29.

intent to bind the state is unmistakable."[162] Interestingly, the plaintiffs argued that the unmistakability doctrine only applies to the first step in the analysis—whether there is a contract—but does not apply to subsequent steps.[163] The respondents argued that the unmistakability doctrine applies to both the first and second steps and went a step further arguing that only explicit language describing a statute as a contract can meet the unmistakability doctrine.[164] Here, the court ruled that neither party properly interpreted precedent, particularly *Hughes v. State*, which refined the unmistakability doctrine.[165]

Following *Hughes v. State,* the unmistakability doctrine clearly applies throughout the four-step contractual analysis; however, explicit language stating a statute creates a contractual right is not necessary to overcome the unmistakability doctrine.[166] Rather, the unmistakability doctrine can be overcome with either explicit language or by looking at the broader implicit context of a particular provision of PERS.[167] In applying the unmistakability doctrine, the court also considered two principles relevant to *Moro v. State*. First, because the PERS offer by definition includes "remunerative provisions," or financial benefits, the offer can also "include provisions that define the eligibility for benefits or the scope of benefits."[168] Put another way, statutory provisions defining eligibility and calculation of retirement benefits can be part of the PERS contract because they determine the financial compensation in the contract. The court noted that the converse is also true: solely administrative aspects of implementation of PERS generally cannot be part of the PERS contract.[169] Second, remunerative provisions are not by definition part of the PERS contract.[170] Rather, remunerative provisions will be part of the PERS contract "only if it is mandatory, rather than optional or discretionary."[171] In considering the terms of the PERS contract, the court applied these two principles to the 1991 and 1995 tax offset measures and COLA provisions.

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162 *Id.* at 202, 351 P.3d at 23.

163 *Id.*

164 *Id.*

165 *Id.* at 203–05, 351 P.3d at 24–25.

166 *Id.* at 202, 351 P.3d at 24.

167 *Id.* at 203, 351 P.3d at 24.

168 *Id* at 204, 351 P.3d at 25.

169 *Id.*

170 *Id.* at 205, 351 P.3d at 25.

171 *Id.*

While both the 1991 and 1995 tax offset provisions accomplished roughly the same purpose, the 1995 bill contains a unique provision. This provision explicitly states that "[n]o member of the system or beneficiary of a member of the system shall acquire a right, contractual or otherwise, to increased benefits."[172] Because of this provision, the 1995 tax offset clearly does not grant a contractual right, regardless of the high bar of the unmistakability provision.[173] The 1991 tax offset, however, contains no similar provision and is thus subject to the unmistakability doctrine.

Under the unmistakability doctrine, the court found the 1991 tax offset to not be part of the PERS contract. The 1991 tax offset does contain mandatory wording for the calculation of benefits, making it eligible to be considered under the second principle of the unmistakability doctrine.[174] However, the court reasoned that the 1991 offset was not passed with the purpose of being an offer intended to *increase* the benefits for employees in exchange for services rendered.[175] Rather, the 1991 offset was passed with the intent of serving as preemptive mitigation for a possible breach of contract case when the state began to tax state employee retirement benefits.[176] Further evidence of this intent were the facts that the offset did not go in to effect until PERS benefits became taxable and that legislators sought advice from the Attorney General about whether it would suffice to mitigate damages from making PERS benefits taxable.[177]

The plaintiffs further argued that even if the 1991 and 1995 offsets were not contractual terms of the PERS contract, the offset provisions were contractual terms of a 1997 settlement agreement that resolved a class action lawsuit, and the 2013 amendments should still be overturned.[178] The court found that this argument failed for two reasons. First, the settlement agreement itself "contemplates future legislative action decreasing the benefits available under the tax offsets."[179] Second, and more importantly, the remedy for violation of

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172 OR. REV. STAT. ANN. § 238.362(3) (West 2017).
173 *Moro*, 357 Or. at 205, 351 P.3d at 25.
174 *Id.* at 207, 351 P.3d at 26.
175 *Id.*
176 *Id.*
177 *Id.*
178 *Id.* at 208, 351 P.3d at 27.
179 *Id.*

the settlement agreement is allowing for the reopening of the litigation, not overturning state statutes.[180] For these reasons, the 1991 tax offset did not meet the high threshold of the unmistakability doctrine and was held to not be a contractual provision of PERS.[181]

The court also applied the unmistakability doctrine to the pre-amendment COLA provisions to determine if they were a term of the PERS contract. The plaintiffs argued that changing the COLA to a flat rate and decreasing it as benefits increased was directly analogous to the COLA changes that were struck down by the Oregon Supreme Court in the 2005 *Strunk v. Public Employees Retirement Board* case.[182] Because this case was very similar to *Strunk*, the respondents made three arguments to differentiate this case from *Strunk*: (1) that *Strunk* only held that requiring a COLA was a contractual term, and the court was free to independently analyze the COLA cap and COLA bank;[183] (2) in the alternative, the court should overturn *Strunk* because it was inadequately considered and wrong at the time it was decided;[184] and (3) that even if *Strunk* applies, it only protects the COLA provisions for Tier 1 and Tier 2 PERS members, not OPSRP members.[185]

The court first discussed the scope of the legal challenge in *Strunk*. *Strunk* focused on a legislative amendment that prevented the PERS board from making COLA adjustments for certain retirees and changed the same pre-amendment COLA provisions at issue in this case.[186] In *Strunk*, the court focused on the second principle of applying the unmistakability doctrine, that a provision must be mandatory in order for it to possibly be part of the terms of the PERS contract. In particular, the *Strunk* court emphasized the use of the word "shall"[187] in mandating the PERS board to first determine the COLA, apply it to the retiree's benefits, and cap and bank any amount

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180 *Id.* at 209, 351 P.3d at 27.

181 *Id.*

182 *Id.* at 210, 351 P.3d at 28.

183 *Id.*

184 *Id.* at 213, 351 P.3d at 29.

185 *Id.* at 217, 351 P.3d at 32.

186 *Id.* at 210–11, 351 P.3d at 28.

187 Strunk v. Pub. Emps. Ret. Bd., 338 Or. 145, 219, 108 P.3d 1058, 1101 (2005). ("As soon as practicable after January 1 each year, [the board] *shall* determine the percentage increase or decrease in the cost of living . . . [T]he allowance . . . *shall* be multiplied by the percentage figure determined . . . [but] such increase or decrease *shall* not exceed two percent . . . .") (emphasis added) (quoting OR. REV. STAT. § 238.360 (2011)).

above two percent.[188] Because of the mandatory nature of the text and a review of the legislative record, the *Strunk* court found that the legislature unmistakably evidenced its intent for the CPI-based COLA to be part of the PERS contract.[189]

The respondents first argued for a narrow reading of *Strunk* as only finding that the underlying COLA tied to the CPI to be a term of the PERS contract and leaving this court free to independently analyze whether the COLA cap and bank were terms of the PERS contract.[190] In support of this argument, the respondents contended the COLA cap and bank were intended to provide more stability for employees, in contrast to the intent of the CPI-based COLA to compensate employees.[191] Following this argument, because the COLA cap and bank were for the benefit of the employers, the legislature did not intend for them to be a term of the PERS contract, so the removal of them by SB822 and SB861 was allowable.[192] However, because the COLA cap and bank intertwined function with the CPI-based COLA, the court quickly dismissed this argument.[193] Because the three COLA provisions function together and *Strunk* found the CPI-based COLA to be a term of the PERS contract, the court found the COLA cap and bank to also be terms of the PERS contract.[194]

In the alternative, the respondents argued for the court to overturn *Strunk*. In order for the court to do so, the respondents had to argue that *Strunk* "was inadequately considered or wrong when it was decided."[195] While the court acknowledged that "the analysis in *Strunk* is brief," the court found it to be adequate, primarily because it relied on prior precedent in *Hughes*, which contained lengthy analysis.[196] The court further reinforced the analysis in *Strunk*, holding the pre-amendment COLA to be a part of the PERS contract because it "set[s] out financial benefits, and . . . use[s] mandatory

188 *Moro*, 357 Or. at 210–11, 351 P.3d at 28.
189 *Strunk*, 338 Or. at 220, 108 P.3d at 1102.
190 *Moro*, 357 Or. at 210–11, 351 P.3d at 28.
191 *See id.* at 211–12, 351 P.3d at 28–29.
192 *Id.*
193 *Id.* ("[T]he COLA cap clearly determines the scope of the COLA requirement, and the COLA requirement was intended to benefit employees.").
194 *Id.*
195 *Id.* at 213, 351 P.3d at 29 (quoting Farmers Ins. Co. of Or. v. Mowry, 350 Or. 686, 693, 261 P.3d 1, 5 (2011)).
196 *Id.* at 213, 351 P.3d at 29–30 ("The court's heavy reliance on *Hughes* in *Strunk* does not mean that the court failed to adequately consider the issue.").

wording."[197] Thus, the court found that *Strunk* adequately considered the question of whether the COLA is a term of the PERS contract.[198]

The respondents also argued that *Strunk* was wrong at the time that it was decided. In support of this argument, the respondents pointed to the fact that when PERS was originally established in 1945, there was no COLA or other automatic adjustment for inflation, but the legislature did authorize a "dividend payment system" in 1963 to help account for inflation reducing purchasing power.[199] These dividend payments were discretionary by the PERS board and were issued for only seven years, until the COLA was enacted in 1971.[200] The respondents argued that because the dividend payments were discretionary and gratuitous, they were not part of the PERS contract, and that because the COLA just replaced the dividend payments, it was also not part of the PERS contract.[201] This is similar to the arguments made by the State of Oregon in *Strunk*, and just as it failed in 2005, it failed in 2015. The court was not persuaded because (1) the COLA was mandatory whereas the dividend payments were discretionary, (2) the legislature wrote the COLA to apply to current and future PERS retirees whereas the dividend payments only applied to current retirees, and (3) the COLA was funded by current employer contributions whereas the dividend payments came from investment returns in excess of the assumed interest rate for a particular year.[202] Thus, the court refused to overturn *Strunk* on the grounds that it was either inadequately considered or wrongly decided that the COLA provisions were part of the PERS contract.[203]

Lastly, the respondents argued that *Strunk* only determines that the COLA is a term of the PERS contract for Tier 1 and Tier 2 members, but not for OPSRP members because the OPSRP statute included a "reservation of rights" clause allowing the legislature to only prospectively change the OPSRP benefits that are "attributable to service performance and salary earned" and make both retrospective and prospective changes to benefits that are not attributable to service.[204] The respondents contended that the COLA is not

197 *Id.* at 213, 351 P.3d at 30.

198 *Id.*

199 *Id.* at 214, 351 P.3d at 30.

200 *Id.*

201 *Id.* at 215, 351 P.3d at 30–31.

202 *Id.* at 215–16, 351 P.3d at 31.

203 *Id.* at 217, 351 P.3d at 32.

204 *Id.* at 218, 351 P.3d at 32.

attributable to service performance because it is attributable to the Portland CPI.[205] The court rejected this argument for several reasons, primarily because the employee earns the right to PERS and the subsequent COLA benefits as a result of employment.[206] Having found *Strunk* to be controlling precedent and rejected all of the respondents' arguments, the court found the pre-amendment COLA provisions to be a term of the PERS contract.[207]

C. Since the COLA Provisions Are a Term of the PERS Contract, What Obligations Does the PERS Contract Require?

Having determined that the COLA provisions are terms of the PERS contract, the court next turned to what obligations those provisions impose. Because the tax offset provisions were determined to not be a term of the PERS contract, the court did not discuss them further.

Regarding the COLA provisions, once the court determined that they are a term of the contract, the court also found that those benefits cannot be touched after they are earned.[208] And because PERS benefits were deemed to be a unilateral contract, the benefits are earned when the employee performs the services, and those benefits are accrued on a regular basis.[209] However, it was contemplated that because employers offered a set of benefits when an employee started working for a government entity, the employer was obligated to continue to offer the same set of benefits as long as the employee continued to work for the employer.[210]

To answer this question, the court had to differentiate seemingly conflicting precedent. In *Strunk*, the court held that benefits not yet earned could be amended or revoked, so long as irrevocability was not an express term of the offer.[211] Because PERS contained no such language regarding irrevocability, prospective changes, but not retrospective changes, were upheld.[212] However, just prior to *Strunk*, the court held in *Oregon State Police Officers' Association v. State*

205 *See id.*
206 *Id.* at 219, 351 P.3d at 33.
207 *Id.*
208 *Id.*
209 *See id.*
210 *See id.* at 221, 351 P.3d at 33–34.
211 *See* Strunk v. Pub. Emps. Ret. Bd., 338 Or. 145, 193, 108 P.3d 1058, 1087 (2005).
212 *See id.*

(*OSPOA*)[213] that irrevocability need not be explicit, but rather could be an implicit term of an offer.[214] In *OSPOA*, the court held that an employee's right to retirement benefits, including PERS, vest when work is performed "but also [for] work that has not yet begun."[215] And this vesting was held to encompass an implicit right to continue earning that same benefit so long as the employee remained under the employment of the same government agency.[216] The court in *Strunk* distanced itself from the *OSPOA* holding, limiting it to only the specific statute in question in that case, but the court in *Moro* completely disavowed the *OSPOA* reasoning and instead applied the "explicit irrevocability test" from *Strunk*.[217] Applying this test, the court found no language in PERS, or specific to the COLA provisions, that expressly made irrevocability a component of the offer or contract.[218] Thus, the obligations under the COLA provisions of the PERS contract require employers to pay the employee for PERS benefits earned for work to date, but allow the employer to make prospective changes for future benefits not yet earned.[219]

D. Has the State Impaired Any Required Obligations of the PERS Contract?

Having established that the COLA provisions are terms of the PERS contract and those terms prevent the retroactive change to PERS benefits, the court found that SB822 and SB861 impaired the obligations of the PERS contract because they made retroactive changes.[220] As a final effort, the respondents made three arguments that allow for impairment of contracts: (1) that the COLA changes may not necessarily result in reduced benefits for all PERS members; (2) that even if the COLA change does impair the PERS contract, they are not "substantial" impairments; and (3) that the COLA changes are "justified as reasonable and necessary for an important public purpose."[221]

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213 Or. State Police Officers' Ass'n v. State, 323 Or. 356, 918 P.2d 765 (1996).

214 *See id.* at 371, 918 P.2d at 773.

215 *See id.*

216 *See id.*

217 Moro v. State, 357 Or. 167, 224–27, 351 P.3d 1, 36–37 (2015).

218 *Id.*

219 *See id.*

220 *Id.* at 227–28, 351 P.3d at 37.

221 *Id.* at 228, 351 P.3d at 37–38.

Because of the uniqueness of the litigation, the court appointed a special master to serve as factfinder prior to briefing on the legal arguments.[222] Respondents argued that under certain economic conditions, the fixed COLA at 1.25% could exceed the Portland CPI that the pre-amendment COLA is linked to and lead to a net benefit for employees.[223] However, the court quickly rejected this because of the economic assumption of normal economic growth included in the record prepared by the special master.[224]

Next, the court considered how "substantial" of an impairment the COLA changes would create.[225] Pointing to the power of compound interest, the court considered that "[w]ith annual compounding, by the tenth year of retirement, the COLA can make up about 20% of the retirement benefit . . . [a]nd by the fourteenth year of retirement, under the same conditions, the COLA can make up about 30% of the retirement."[226] The fact that the COLA grows to become such a large portion of the annual retirement benefit led the court to conclude that these changes would meet a substantial impairment threshold.[227]

Lastly, the respondents sought to import the federal "public purpose defense" into the application of the state contract clause.[228] Under the public purpose defense, impairment is allowed when (1) a contract "would require the state to 'surrender[ ] an essential attribute of its sovereignty,'" or (2) "impairment is 'reasonable and necessary to serve an important public purpose.'"[229] The court quickly dismissed the first argument because fulfilling a financial obligation to public employees is a commonplace contract that does not implicate state sovereignty.[230] The court further considered whether or not the COLA amendments were necessary for an important public purpose, but found the respondents' arguments still failed.[231] Following federal precedent, this is a balancing test with the "scales

222 *Id.* at 174, 351 P.3d at 8.
223 *Id.* at 226–27, 351 P.3d at 37.
224 *Id.*
225 *Id.* at 228, 351 P.3d at 37–38.
226 *Id.* at 228, 351 P.3d at 38.
227 *Id.*
228 *Id.*
229 *Id.* at 229, 351 P.3d at 38 (alteration in original) (quoting U.S. Tr. Co. of N.Y. v. New Jersey, 431 U.S. 1, 23, 25 (1977)).
230 *Id.*
231 *Id.*

weighed against allowing the state to impair its own contractual obligations," with consideration of alternatives being a large factor.[232]

Here, importantly, the court found that the state failed to consider alternatives of reducing other parts of the budget in order to increase funding for public safety and education, the stated goal of making PERS reforms.[233] That is, the state would have to show that "current level[s] of funding [are] so inadequate as to justify allowing the state to avoid its own financial obligations."[234] The court found that the state failed to meet that threshold.[235] While the state did argue that it has a limited ability to raise tax revenue while still remaining economically competitive with other states, the court did not find this persuasive because Oregon was below the national average in several tax indicators.[236]

Having concluded that the COLA provisions are part of the PERS contract and that SB822 and SB861 would interfere with that contract, the court struck down those provisions, while upholding the changes to the tax offset provisions.[237]

IV
AFTER *MORO*, IS REFORM POSSIBLE?

Three main barriers stand in the way of meaningful reforms.[238] First, after the ruling in *Moro v. State*, there are limited options that the Oregon legislature can enact that would pass constitutional muster and make a meaningful difference to bend the cost curve. To prevent substantial increases in employer contributions over the coming years, changes need to be made not only for existing employees, but also for all new hires, putting them potentially into their own new system, a fourth tier.

Second, while there are still some limited reform possibilities left for current employees, Oregon politicians will likely choose to fill budget shortfalls through other means, as changes to PERS would continue to face fervent opposition from public employee labor

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232 *Id.*

233 *Id.* at 230–31, 351 P.3d at 39.

234 *Id.* at 230, 351 P.3d at 39.

235 *Id.*

236 *Id.*

237 *Id.* at 234–35, 351 P.3d at 41.

238 To again be explicit, this piece does not aim to advocate for any particular changes to PERS. Rather, this piece explores what reforms remain legally possible following the ruling in *Moro v. State.*

unions. Rather than addressing PERS as a spending problem, pursuing tax increases is much more politically palatable in Oregon.

Third, with limited legislative options and political will lacking, only a shift in the law would allow changes like SB822 and SB861 to be upheld. With judges being elected in Oregon and labor unions being so politically active, however, this seems unlikely to happen. Because of this, PERS is likely here to stay, and it will continue to become a larger and larger share of Oregon's biannual budget.

A. Limited Options Moving Forward

In striking down SB822 and SB861, the Oregon Supreme Court has once again reiterated that PERS reforms not only face a political uphill battle in the legislature, but also an uphill judicial battle. While *Moro v. State* struck down the COLA amendments, which promised to provide the majority of the financial savings for the state, the court did provide some budgetary relief for the state by upholding the amendments to the tax offset provisions.

Few options remain for the state legislature to realize cost savings from the PERS program. First, PERS changes that are prospective are clearly constitutional. However, those changes would not address Tier 1 and Tier 2 employees, who are the primary cost drivers of PERS. Second, although the court did not specifically endorse the "substantial impairment" requirement for violating the contract clause, changes to PERS that did not "substantially impair" the PERS contract could potentially be upheld. Third, while the court found that SB822 and SB861 did not meet the "public purpose test" for violating contractual obligations, if funding for public programs were dramatically in peril, future changes to PERS could potentially be upheld under the "public purpose test." Lastly, looking forward, if the legislature does seek to make any changes to PERS in the future, the legislature must be explicit that they do not intend to create a contractual right for employees, if that is in fact not their intent.

After *Moro v. State*, the only set of PERS reforms that will clearly not run afoul of the contract clause are prospective changes. Because PERS has been deemed a unilateral contract, employees do not accept the contract until performing the services. Because the benefits are not earned until an employee performs the services, the legislature is still free to make changes to future benefits that will be earned by current and future employees. These changes would likely be upheld for both current and new employees. Just as PERS has seen structural changes to the benefits it offers resulting in Tier 1, Tier 2, and OPSRP members, the legislature could choose to create a new tier of PERS members with benefits further trimmed from the existing OPSRP plan. However, because of the guaranteed rate of return, Tier 1 employees, whose previously earned benefits are untouchable by prospective changes, continue to be the biggest cost drivers in the broader PERS system[239] and their benefits earned to date are off limits.

If the State did attempt to make retrospective changes to the benefits already earned by these members, there is a possibility that small changes would not exceed the "substantial" impairment threshold in the fourth step of analyzing contract clause cases. Although the court declined in both *Strunk* and *Moro* to specifically announce that contract impairments must be substantial in order to violate the contract clause, the court discussed the substantial threshold in both cases. However, it remains an open question whether or not the court would apply the threshold in the future, and if it did, what an unsubstantial impairment would look like. The court spent little time defining "substantial," and focused its analysis on how much of a financial impact SB822 and SB861 would have on PERS retirees. However, any PERS reforms that would provide sought-after cost savings would likely be substantial, whereas unsubstantial changes would likely not meet the goal of providing cost savings.

In the 2017 Legislative Session, Oregon faced a $1.8 billion dollar shortfall, but Oregonians continue to show a reluctance to raise taxes, evidenced by the failure of Measure 97 in November 2016. Because of this, Oregonians are likely to see a reduction in state services over the coming years. While the court rejected that the SB822 and SB861 were "'reasonable and necessary to serve an important public purpose,'"[240] the legislature could argue that future PERS reforms meet this threshold. However, this would seem to be very difficult to meet. As the court described, meeting the public purpose test would require for the "current level of funding [to be] so inadequate as to justify allowing the state to avoid its own financial obligations."[241]

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[239] ECONORTHWEST, *PUBLIC EMPLOYEE RETIREMENT IN OREGON: WHERE DOES THE SYSTEM STAND AND WHERE COULD OREGON GO FROM HERE?* 4–3 (Aug. 31, 2007), https://chalkboardproject.org/sites/default/files/public-employee-retirement-in-oregon.pdf.

[240] *Moro*, 357 Or. at 229, 351 P.3d at 38 (quoting U.S. Tr. Co. of N.Y. v. New Jersey, 431 U.S. 1, 25 (1977)).

[241] *Id.* at 230, 351 P.3d at 39.

This implies that the state budget would have to be in extremely dire straits. Further, the public purpose test requires that a government consider and eliminate other alternatives of achieving the same goal. If the state's budget were to reach this extreme level of inadequacy, the public would likely be more willing to increase tax revenues, particularly on corporations, than voters currently are. Thus, like the "substantial impairment" threshold, it seems unlikely that the "public purpose test" is a viable option for upholding future PERS reforms.

While few options remain for tackling the real cost drivers in the PERS program, one takeaway from *Moro v. State* is how to avoid contract clause implications in the future. While the court seemed to focus on the word "shall" as evidence of legislative intent for a provision to be part of the PERS contract, thus meeting the unmistakability doctrine, the legislature can make their intent clear in the future by including a section regarding contractual rights. For example, the court was able to quickly decide that the 1995 tax offset was not part of the PERS contract because of Section 2 stating "[n]o member of the system or beneficiary of a member of the system shall acquire a right, contractual or otherwise, to the increased benefits provided" by those provisions.[242] Thus, as the legislature considers making any prospective changes to PERS, creating a near tier of PERS, or reforming any other benefits, the legislature should be clear about their intent to create, or not to create, a contractual right.

B. Politics Hampers Few Remaining Reform Options

Assuming the Oregon legislature did choose to pursue one or several of the possible remaining reforms, political will is likely lacking both from the Governor's office and the legislature to see changes through to completion.

When the "Grand Bargain" was passed in 2013, Governor Kitzhaber was the driving force behind development of the legislative package and its eventual passage. Fast-forward to 2017, where Governor Brown has made numerous statements that she only hears "lawsuits" when PERS reform is discussed,[243] and the issue is noticeably lacking when Governor Brown discusses her priorities for the 2017 Legislative Session and beyond. Given her political base, Governor Brown seems unlikely to change her mind on PERS reform.

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242 OR. REV. STAT. ANN. § 238.362(3) (West 2017).

243 Achen, *supra* note 6.

Without strong leadership from the Governor's office on PERS reform, the leadership is left to come from the Oregon legislature. While legislative leaders in the senate have formed a bipartisan workgroup that has put forth reform ideas in discussion drafts, these drafts have yet to receive much support. Oregon as a state has historically favored the Democratic Party and will continue to do so without major political shifts. Without support from the Democratic Party, reforms to PERS are unlikely to succeed. A large constituency of the Democratic Party is public employee unions, who often oppose PERS reforms. Democratic legislators have little incentive to push for PERS reforms because of opposition from their political base. Thus, the political incentives remain stacked against PERS reform.

C. Without Shift in the Law, PERS Reforms Are Unlikely

One last avenue that could open additional options for PERS reforms could be a shift in the legal analysis currently employed for analyzing the constitutionality of changes to PERS, like that employed in *Moro v. State*. Pressing economic crises have shifted legal analyses in the past. For example, private economic rights were dramatically weakened during the early part of the twentieth century.[244] This occurred for several reasons. First, the Great Depression served as a dramatic incentive for Congress to increase the involvement of the federal government in economic matters. Second, legislative programs, like that in the New Deal, that were earlier thought to have clearly violated the commerce clause, were passed and helped the country recover from the Great Depression. Third, President Roosevelt appointed several new Supreme Court justices and threatened to appoint more who would be more open to this kind of government growth.[245] These events led to a dramatic shift in Supreme Court analysis of economic rights and a growth of the commerce clause.

One could argue that Oregon has its own perfect storm of factors that could lead to a shift in the legal analysis of PERS reforms. First, Oregon voters have refused to pass sales tax measures or other revenue increases, most recently including Measure 97 in November

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244 *See* Thomas B. Colby & Peter J. Smith, *The Return of Lochner*, 100 CORNELL L. REV. 527, 535–36 (2015) (claiming that the Supreme Court "would no longer protect unenumerated economic rights").

245 *Id.* at 539.

2016.[246] Second, despite various initiatives and increases in funding for education over the last decade, Oregon continues to rank in the bottom five states in the country in numerous educational metrics, including high school graduation rate.[247] Third, in terms of future composition, the composition of justices on the Oregon Supreme Court will likely shift to newer justices who are less likely to be PERS Tier 1 beneficiaries.

While these circumstances exist, a shift in the legal analysis for PERS seems unlikely to occur, at least in the near term. First, while judges are generally regarded as impartial administrators of justice, Oregon judges are elected to their terms, rather than serving for life as federal judges do.[248] Oregon judges that appear likely to uphold PERS reforms would likely face the wrath of public employee unions in future elections. Second, while voters have repeatedly rejected new revenue proposals, the Oregon Supreme Court is likely to continue to view an increase in taxes as a release valve to solve budgetary woes before they get more involved by utilizing the "substantial impairment" or "public purpose test" discussed in *Moro v. State*. Third, while the composition of judges of the Supreme Court may change and not be PERS Tier 1 employees, this factor is unlikely to lead to new judges being willing to move so blatantly afar from *stare decisis* and prior precedent. For these reasons, a shift in the analytical structure for future PERS reforms seems unlikely.

CONCLUSION

PERS will continue to be a hotly debated topic in Oregon because of the budget implications and politics surrounding public employee compensation. While many had hoped that SB822 and SB861 would help to control cost growths and leave more of the state budget for public services like education, *Moro v. State* struck down the PERS COLA amendments, one of the biggest cost savers, while upholding the removal of tax offset provisions, which is providing little

246 Hillary Borrud, *Oregon Corporate Tax Measure 97 Defeated: Election 2016 Results*, OREGONIAN (Nov. 8, 2016, 10:00 PM), https://www.oregonlive.com/politics/index.ssf/2016/11/oregon_corporate_tax_measure_9.html.

247 Betsy Hammond, *Oregon's Graduation Rate, Among Worst in Nation, Inches up 1 Percent*, OREGONIAN (Jan. 26, 2017, 7:57 AM), https://www.oregonlive.com/education/index.ssf/2017/01/oregons_graduation_rate_among.html.

248 *Judicial Selection in the States: Oregon*, NATIONAL CENTER FOR STATE COURTS, https://www.judicialselection.us/judicial_selection/index.cfm?state=OR (last visited Sept. 28, 2017).

budgetary relief. More broadly, this case means that the legislature's hands are largely tied for benefits already earned by employees, particularly Tier 1 employees, whose benefits are the largest cost drivers in PERS. This leaves only prospective changes as viable options for PERS reforms, which are unlikely to be passed. Thus, PERS reforms are unlikely, but the discussion about how we cover the budgetary shortfalls caused by PERS will surely continue as PERS continues to swallow a growing share of the state budget.