

# BENNETT, HARTMAN, MORRIS & KAPLAN, LLP

GREGORY A. HARTMAN  
MICHAEL J. MORRIS  
HENRY J. KAPLAN§  
NELSON R. HALL  
THOMAS K. DOYLE♦  
ARUNA A. MASIH♦  
HEIDI K. BROWN  
SHARON MAYNARD

ATTORNEYS AT LAW  
SUITE 500  
210 S.W. MORRISON STREET  
PORTLAND, OREGON 97204-3149  
(503) 227-4600  
FAX (503) 248-6800  
[www.bennetthartman.com](http://www.bennetthartman.com)

ROBERT A. BENNETT (RETIRED)  
LINDA J. LARKIN\*  
MARGARET S. OLNEY\*♦  
\* OF COUNSEL  
♦ ALSO MEMBER  
WASHINGTON BAR  
§ ALSO MEMBER  
NEW YORK BAR

## LEGAL ANALYSIS FOR OUT-OF-STATE TAXATION PROPOSAL

The courts will apply the customary two-step analysis to determine whether any legislative proposal changing benefits for out-of-state retirees breaches or impairs PERS members' contract rights.

### Is there a Contract?

An analysis of the rights of out-of-state retirees to benefits must start by recognizing that there are two separate enactments which operated together to increase benefits. The first is Senate Bill 656, enacted by the 1991 legislature. The second is House Bill 3349, enacted by the 1995 legislature. Each of those will be examined in turn.

- *Hughes v. State of Oregon*, 314 Or 1 (1992). The court held that the imposition of state income tax on PERS retirees was a breach of their contract rights, at least insofar as benefits which were earned prior to the date of enactment in 1991.
- Senate Bill 656 (1991). At the same time that the court imposed income tax on PERS retirees in 1991 it passed Senate Bill 656 which provided for additional benefits for PERS retirees ranging from 1% to 4% based on their years of service at the time of retirement.
- *Ragsdale v. Dept. of Revenue*, 321 Or 216 (1995). The court rejected the argument made by federal retirees that Senate Bill 656 was an impermissible partial tax rebate to PERS retirees. The court ultimately held that the Senate Bill 656 was permissible compensation not related to the amount of taxation paid by PERS retirees. The court emphasized the fact that the benefits were paid to all, even those out-of-state retirees who paid no Oregon income tax.
- House Bill 3349 (1995). The 1995 legislature provided for a second increase in PERS benefits due to taxation which in conjunction with the earlier-enacted SB 656 would provide a benefit sufficient to fully compensate for the damages identified in the *Hughes* case. Importantly, consistently with the *Hughes* analysis, HB 3349 only provided benefits for work performed prior to 1991 and significantly, provided specifically that members acquired no contract rights in these additional benefits.
- *Vogel v. Dept. of Revenue*, 327 Or 193 (1998). In *Vogel* the court addressed once again a challenge by federal retirees that HB 3349 was an impermissible tax rebate. In holding in

favor of the federal retirees, the court distinguished its prior findings in *Ragsdale* by emphasizing the following points:

- HB 3349 was specifically structured to compensate for Oregon's existing tax rates.
- HB 3349 was clearly a response to the decision in the *Hughes* case.
- HB 3349 gave benefits only for service prior to 1991.
- HB 3349 had a provision providing that no contract rights accrued in these new benefits.

In contrast SB 656 was additional compensation, which would ordinarily carry with it an expectation that employees obtain a vested right in those benefits.

- **Conclusions**

- HB 3349 does not create a contract because the 1995 legislature expressly provided that it did not create a contract
- SB 656 is contractual as it is part of the PERS contract, is specifically promissory and unlike HB 3349 contains no limitation on a statutory promise. It also does not contain any express provisions limiting the scope of the promise to only those paying Oregon taxes.

**Is there an Impairment of the Obligation?**

- What is the scope of the contractual obligation?
  - SB 656 promises a benefit based on years of service at retirement to all retirees.
- Is the obligation impaired or breached?
  - By denying certain retirees the benefits provided by SB 656, the legislature impairs their contract rights.

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## LEGAL ANALYSIS FOR COLA PROPOSALS

The courts will apply the following two-step analysis to determine whether any legislative proposal changing the COLA provision of PERS (i.e., ORS 238.360) breaches or impairs PERS members' contract rights.

### Is there a Contract?

- The Oregon Supreme Court will not look at ORS 238.360 in isolation but rather, will look at the context in which it was enacted and all related statutory provisions in the context of their collective operations. *See Hughes v. State of Oregon*, 314 Or 1, 22-24, 838 P2d 1018 (1992); *see also Strunk v. PERB*, 338 Or 145, 183, n. 34, 108 P3d 1058 (2005).
- In the *Strunk* case, the Oregon Supreme Court has already recognized that the general promise embodied in section 1 of ORS 238.360 evinces a legislative intent to provide retired members with annual COLAs on their service retirement allowances; whenever the CPI warrants such COLAs.
- The legislative history from the 1971 Session, when the COLA was enacted, shows further that:
  - The legislature knew that COLAs were becoming the “accepted standard for retirement systems in either the public or the private sector” and wanted to provide a set amount instead of distributing “excess earnings” to retirees, which might vary from year to year.
  - To achieve that set amount, the legislature included 3 components which were intended to operate collectively:
    - Provided the CPI (Portland area – all items) as the index for the COLA;
    - Set One and a Half percent as the maximum; and
    - Allowed accumulation of amounts in excess of the maximum for use in future years.
  - The legislature understood that providing the set COLA would result in increased PERS costs for state and local employers in the long-term based on information provided by the PERS Actuary and the Executive Department Budget Division.
- In 1973, the legislature increased the maximum for the COLA to 2 percent.
  - The legislature was again aware that the “post-retirement cost-of-living escalator” would result in increased costs to employers based on information provided by the Budget Division.

- The increase was enacted after the Oregon Supreme Court issued its ruling in *Taylor v. Multnomah County Deputy Sheriff's Retirement Board*, 265 Or 445, 450-51, 510 P2d 339 (1973), holding that contract rights in retirement benefits can vest before retirement.
- The COLA provision has remained unchanged in substantive part since that time.

### **Is there an Impairment/Breach of the Contract?**

#### *What is the Scope of the Contractual Obligation?*

- In *Strunk*, the Oregon Supreme Court has already recognized that included within the scope of the obligation of ORS 238.360(1) is that PERB annually apply a COLA to each member's properly calculated service retirement allowance in years in which the CPI warrants such an allowance.
- The legislative history from 1971 and 1973 further makes clear that included within the scope of the same obligation are also the following 3 components:
  - The CPI (Portland area – all items) index;
  - The two percent maximum; and
  - The banking of amounts in excess of the maximum for use in future years.

#### *Is the Obligation Impaired or Breached?*

- If the legislative proposal eliminates the legal duty (i.e., CPI, two percent maximum or banking of amounts in excess of maximum), there is an impairment of contract. In contrast, if the legal duty to provide these continues to exist but the legislative proposal mandates non-performance (i.e., something less or different for a period), there is a breach.
- In either case, PERS members are entitled to a remedy for the non-performance of the contractual obligation.
- In *Strunk*, because ORS 238.360(1) remained a part of the PERS statutory scheme but the 2003 PERS Legislation required that no COLA be applied to the fixed service retirement allowance for a period, the Oregon Supreme Court concluded it amounted to a “directive from the legislature to PERB to breach the promise set out in ORS 238.360(1). Rather than send the breach back to the legislature for a remedy, the Oregon Supreme Court simply voided the language mandating the breach.