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January 13, 2004

Via Facsimile - (503) 371-2471
and Regular Mail

Bill Linden
Association of Oregon Faculties
867 Liberty Northeast
P.O. Box 12945
Salem, Oregon 97309

Re: Optional Retirement Plan
Our File No.: 10086-00

Dear Bill:

I. Introduction

You recently asked our office to review proposed changes to Oregon University System ("OUS") contributions to Optional Retirement Plan ("ORP") members' retirement accounts. OUS notified ORP members that it is reducing their employer contribution amounts by as much as 7.44 percent. You requested that we review this proposed change, provide an analysis as to whether this change is lawful and propose the most effective means of challenging this rate reduction The following is our analysis.

II. ORP Contributions

The Optional Retirement Plan was created under ORS 243.800 for certain academic and administrative higher education employees.[1] Under that provision, the Board of Higher Education may create an Optional Retirement Plan as an alternative to membership in the Public Employees Retirement System ("PERS"). PERS members are allowed to make an irrevocable election to participate in the plan. Under ORS 243.800(9), OUS is required to contribute monthly to the Optional Retirement Plan, "a percentage of salary of each employee participating in the plan equal to the percentage of salary that would otherwise have been contributed as an *employer contribution*, on behalf of the employee to the Public Employees Retirement System if the employee had not elected to participate in the Optional Retirement Plan." (Emphasis added). Thus, contributions under the Optional Retirement

[1]This language has been left relatively unchanged since this provision was enacted in 1995 in HB 3395.

Plan are dictated by the employer contribution that would have been made if the employee remained a member of PERS. The Optional Retirement Plan in effect functions as a defined contribution plan, whereby that contribution is dictated by the employer contribution required as if the employee were a member of PERS.

III. Lump Sum Unfunded Actuarial Liability ("UAL") Payments

Under OAR 459-009-0084, PERS has established procedures to allow for employers to make lump sum payments to cover unfunded actuarial liabilities ("UALs"). A UAL is the excess of the actuarial liabilities for future retirees over the fair market actuarial value of employer contributed assets. Employers, including the State, are allowed to make payments on those liabilities before they are due through a "side account" mechanism. In effect, this allows an employer to refinance this debt obligation through its bonding powers. Under OAR 459-009-0084, any payment which is not regularly scheduled, that is not paid as a percentage of salary, and that is made for the express purpose of reducing the UAL, is considered a lump sum UAL payment. That side account is held by PERS for the benefit of the employer and enjoys a preferential status in that it receives earnings of the fund in general, but is only subjected to reductions for administrative expenses and for reserve account payments. Payments are then made out of this lump-sum account to the employer contribution account for that employer once a year. The amount of these payments is determined by the PERS actuary on an annual basis. Under these rules, these payments are treated as pre-funded contributions for the payment of obligations of the employer under ORS Chapter 238. Thus, in effect, these payments from the side account are treated as employer contributions. The only difference between these payments and ordinary contributions is that they come from the employer's lump sum side account as opposed to the employer's general fund. The rule specifically provides that these payments are not to be treated as a reduction of the employer's contribution obligations but rather as a contribution to satisfy that obligation.

IV. Ballot Measure 29

In November 2003, the State of Oregon decided to take advantage of the lump-sum UAL payments option. The legislature referred and the voters passed Measure 29. That measure allowed the State of Oregon to borrow two billion dollars to fund the State's unfunded actuarial liabilities. That two billion dollars was borrowed by the State of Oregon and placed into a side account as a lump-sum payment to prepay unfunded actuarial liabilities pursuant to OAR 459-009-0084. As a result of this lump-sum payment, the additional funds required from the State to satisfy its required contribution have been reduced. As a result, the employer contribution rate has been reduced in an amount corresponding to the amount that has been prepaid from this side account. According to the OUS, it was notified by PERS that its employer contribution, which had been 11.31 percent for Tier One members, will be dropped to 3.71 percent. Similarly, Tier Two members whose rate had been 11.71 percent of their salary would be 4.27 percent. According to OUS, because of this prepayment contribution, and because the rate has dropped as a result of this prepayment, it is only obligated to pay the rate required by PERS. In effect, OUS has taken

the position that the pre-payment amount is not to be considered an "employer contribution" for purposes of ORS 243.800.

V. "Employer Contribution"

OUS is under the impression that the 2 billion dollar pre-payment by the State of Oregon to PERS is not considered an "employer contribution" under ORS 243.800. Therefore, according to OUS, it is only obligated to pay the employer contribution rate as set by PERS, regardless of any prepayments. However, this position is contrary to OAR 459-009-0084(10), which states that the UAL lump-sum payment "shall offset any pooled, unfunded actuarial liabilities and shall be treated as pre-funded contributions and additional assets for the payment of obligations of the employer under ORS Chapter 238, rather than as a reduction of those obligations." Thus, under this regulation, the 2 billion dollar contribution on behalf of state employees must be treated as a pre-funded "employer contribution." The State of Oregon, in effect, has made a pre-payment on its obligations to its employees. In no way has that pre-payment changed the amount due for the benefits of its employees, as expressed as a total percentage of the employer's payroll. The source of the monies which fund the employer contribution, ie. the side account versus the general fund, is irrelevant to the determination of the amount of the employer contribution.

Under ORS 243.800, the ORP plan requires that the Board contribute the percentage of salary of each employee participating in the plan, equal to the percent of salary that would otherwise have been contributed as an employer contribution on behalf of the employees to PERS. There can be no doubt that the OUS is required to make the same proportional "employer contribution" to ORP members as it has for PERS members.

The amount of the employer contribution is either the two billion dollar payment made into the side account or is the amount paid out of the side account to the employer contribution account as a pre-payment of that year's actuarial liabilities. In no case can OUS wholly exclude pre-payments it is making on behalf of PERS members from the ORP contribution calculation.

If the two billion dollar payment is considered as "employer contribution" for PERS members, then OUS is obligated to make a comparable contribution, expressed as a percentage of salary, to ORP members. Therefore, OUS is obligated to pay the same percentage as the ratio of the 2 billion dollars to the total employer contribution for all state employees in 2003. We have no doubt that this amount approaches or exceeds 100% of the State employees' annual salary. Under this reading of ORS 243.800 and OAR 459-0089-0084, the OUS would be required to contribute this same rate for ORP members.

As a second, and perhaps more palatable alternative, it may be that the "employer contributions" are only those funds which are deposited in the employer contribution account, not the side-account. If this is our position, then the total contribution, in terms of

percentage of salary, should be nearly unchanged as a result of the two billion dollar payment. In effect, the State of Oregon simply has placed two billion dollars into an account and is paying its UAL as it becomes due from this account. The combination of these payments and the regular employer contributions should equal the employer contribution, before the side account was established.

In no case can we see a legitimate argument that the OUS is not obligated to make a similar contribution to ORP members as it has to PERS members, simply by virtue of the fact that it has decided to make a prepayment of its obligation from a side-account managed by PERS. Such an accounting sleight of hand would place the State in a position whereby it can eliminate any obligation it has under this retirement plan, simply by creating separate accounting. This can not be the case.

VI. Remedy

It is our understanding that the OUS has begun to withhold payments to ORP members, effective November 2003. We regard this as a very serious violation of ORS 243.800; therefore, we suggest that an aggressive challenge to this change is an appropriate means of addressing this issue.

It is our opinion that the Oregon wage statutes are the best means of seeking redress. It is widely accepted that pension payments by an employer on behalf of an employee are considered wages for purposes of the Oregon wage statute (ORS 652.120 *et seq).*[2] OUS's failure to pay these wages by the designated monthly pay day constitutes a violation of this statute.[3] We suggest that this office make a demand upon the OUS to correct its failure to pay these wages immediately. A demand should be made also that back wages be paid and any earnings that would have accrued on those wages also be credited to individuals' accounts. Failure of the OUS to comply with this demand within 14 days will subject the state to penalty wages equal to full salary for all ORP members for 30 days from the date the payment is not made. Arguably, since payments are to be made on a monthly basis, each failure to contribute the appropriate funds by each payday will begin a new penalty period.

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[2]It is also possible that we could bring a suit against the trustees of the ORP directly. Those trustees may be in breach of their fiduciary duty to the members by failing to make appropriate contributions to their member accounts. We may also bring a breach of contract claim against the OUS for its failure to comply with the ORP contract, through this accounting slight of hand. We would explore these alternative theories as part of any litigation we undertake.

[3]We will also note that the employer rates as established under HB 2003 and HB 2004 are lower than pre-HB 2003 and 2004 rates. As an aside, we may want to consider a challenge to HB 2003 and 2004, based upon the effect of HB 2003 and HB 2004 on the ORP plan. This would be a separate piece of litigation from that discussed above. Such litigation has not been fully explored yet by this office.

As a result, penalty wages will continue indefinitely until the OUS reverses its decision to reduce ORP member contributions. Clearly, this could be a significant liability on the OUS. OUS could also be liable for attorney fees accrued by plaintiffs in this litigation if we are successful. Please remember that the award of attorney fees is not assured in this type of litigation and should not be counted on in determining the costs of the litigation to AOF. However, we would make every effort to recover from the State the full cost of this litigation at our regular rates, which would go to reimburse AOF for fees it has paid.

VII. Conclusion

In conclusion, based upon a reasonable interpretation of the applicable statutes and regulations, the OUS is violating Oregon statutes by failing to pay the full employer contribution rate for ORP members. We propose that this office challenge OUS first through an informal demand letter and then through litigation. We hope this analysis is of assistance. Please do not hesitate to contact this office once AOF has had a chance to review this letter. We would also be pleased to meet with any AOF representatives to discuss this matter in more detail.

Sincerely,

BENNETT, HARTMAN, MORRIS & KAPLAN, LLP

Thomas K. Doyle

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