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MEMORANDUM

To: PERS Coalition
From: Aruna Masih
Subject: Public Employees Retirement Board-Breach of Fiduciary Duty
Our File No. 5415-247
Date: February 17, 2004

I. INTRODUCTION.

As you are aware, the legal position taken by the Public Employees Retirement Board in the pending Supreme Court action challenging HB 2003 and HB 2004 has raised some serious concerns regarding the fiduciary duty owed by the Board to its employee members.

Specifically of concern is the fact that, although only named as a necessary¹ party, the Board has pursued an aggressive litigation strategy against PERS members' claims and in defense of the Legislature and Governor's actions reducing members' vested benefits. The Board's strategy has included granting the Governor as well as state and local employers free access to the PERS actuary and staff, while denying PERS members, the sole recognized beneficiaries of the PERS trust fund,² equal access to such information.

In light of these Board actions, we have undertaken a review of the statutory and common law rules governing the Board's fiduciary obligation and have reached the conclusion that the Board's actions constitute a breach of its duty to PERS members. Therefore, PERS members may maintain a tort action to challenge this breach of fiduciary duty. Our analysis of the law on the subject follows.

II. NATURE OF THE DUTY OWED.

As trustees of the PERS Fund (PERF), Board members owe a number of common law and statutory duties to PERS members.

Recently, there was a codification of the duties recognized under the common law of trusts by the National Conference of Commissioners on Uniform State laws, which approved and recommended for enactment the Uniform Management of Public Employee Retirement Systems Act of 1997. The Act has yet to be adopted in

¹The law requires that where complete relief cannot be accorded in the absence of a specific person, the person has to be joined as a party to the lawsuit, and if that person should join as a plaintiff but refuses to do so, the person has to be made a defendant in the lawsuit. See ORCP 29A; See also *Stanley Adm v. Mueller*, 211 Or 198, 202, 315 P2d 125 (1957)(unless all persons who have an interest which would be affected by the declaration are parties to the proceeding, there is no jurisdiction for the court to enter a declaratory judgment).

²See 49 Or Op Atty Gen 1 (1997).

Oregon but is nonetheless instructive as it incorporates well-established doctrines of trust law which have long been recognized by Oregon courts as well as federal the Internal Revenue Code fiduciary requirements expressly made applicable to PERS as a qualified governmental plan. Section 7 of the Act, describes the duties owed as follows:

SECTION 7. GENERAL FIDUCIARY DUTIES. A trustee or other fiduciary shall discharge duties with respect to a retirement system:

- (1) solely in the interest of the participants and beneficiaries;
- (2) for the exclusive purpose of providing benefits to participants and beneficiaries and paying reasonable expenses of administering the system;
- (3) with the care, skill, and caution under the circumstances then prevailing which a prudent person acting in a like capacity and familiar with those matters would use in the conduct of an activity of like character and purpose;
- (4) impartially, taking into account any differing interests of participants and beneficiaries;
- (5) incurring only costs that are appropriate and reasonable; and
- (6) in accordance with a good-faith interpretation of the law governing the retirement program and system.

A. Duty of Loyalty.

The duty described above in section (1), that the trustee act solely in the interest of the beneficiaries, is also known as the duty of loyalty.¹

The United States Supreme Court has explained this duty as limiting a trustee from acting in any way which could divide its loyalties between employer participants and employee beneficiaries and result in possible injury to the beneficiaries.²

In accordance with this rule, therefore, any actions taken by the PERS Board which favor the interests of participating employers over the interests of participating employees would constitute a breach of the Board's fiduciary duty. In defending the actions of the Legislature and Governor benefitting employers to the detriment of PERS members,

¹See Restatement (Second) of Trusts §170 (1959).

²See *NLRB v. Amax Coal Company*, 453 US 322, 101 S Ct 2789 (1981)(explaining that a trustee must act solely in the interest of participants and beneficiaries and set aside the interests of a party responsible for appointing the trustee, such as an employer).

B. The Exclusive Benefit Rule.

The duty described above in section (2) is also known as the “exclusive benefit” rule and is expressly made applicable to the Board through ORS 238.660 and Internal Revenue Code Section 401(a).

Treasury Regulation 26 CFR §1.401-2(a)(3) provides that the phrase “purposes other than for the exclusive benefit of [...] employees or their beneficiaries” includes all objects or aims not solely designed for the purpose of satisfaction of all liabilities to employees or their beneficiaries covered by the trust.

Any action by the PERS Board, therefore, which can not be classified as solely designed for the purpose or satisfaction of all liabilities to employees or their beneficiaries would not only jeopardize the PERF’s qualified status under the Internal Revenue Code Section 401(a), but also constitute a violation of ORS 238.630(h), which expressly requires the Board to take all actions necessary to maintain the tax qualified status of PERS and the PERF. A failure of the Board to adhere to this obligation would also constitute a breach.

C. The Duty of Impartiality.

The duty described above in section (4) is also known as the duty of impartiality and requires the trustee to consider the interests of all beneficiaries when it takes any action. *See* Restatement (Second) of Trusts §183 (1959). Where there are conflicts among such interests, the fiduciary may determine which course best serves the purpose of the plan in providing benefits to the participants and beneficiaries as a whole.¹ However, the duty of

loyalty discussed above does prevent the trustee from weighing the interests of the employers over those of the employee beneficiaries when determining what best serves the purpose of the plan.

Consequently, to the extent the Board’s actions are even arguably based upon the interests raised by participating employers, such as those presented to the Legislature at the time of passage of HB 2003 and HB 2004, the Board breaches its duty to the PERS beneficiaries.

D. Good Faith Interpretation of the Law.

Furthermore, under section (6) above, a trustee is required to base its actions upon a good faith understanding of the law governing the system. With regard to understanding the law, retirement Boards have been permitted to rely in good faith upon the legal opinions of the attorneys general of the state.

¹*See generally Morse v. Stanley*, 732 F2d 1139 (2nd Cir 1990) and *Mahoney v. Board of Trustees*, 973 F 2d 968 (1st Cir 1992)(discussing the rule in the context of private sector pension plans governed by ERISA).

In this case, however, both the Attorney General and Legislative Counsel have issued opinions questioning the constitutionality of HB 2003 and HB 2004.¹ Those opinions have been a matter of public record and have discussed the long-standing, appellate, case law in this state protecting vested benefit rights of employees.²

Consequently, the Board's defense of a position which is not only contrary to these well-established principles but also to the opinions of the Attorney General and Legislative Counsel of the state is not entitled to any "good faith" protection and constitutes a breach of their duty to PERS members.

E. Incurring only Reasonable and Appropriate Costs.

¹See Chaimov Opinion Letter (March 11, 2003); Meyers Opinion Letter (July 3, 2003).

²See *Oregon State Police Ass'n v. State*, 323 Or 356, 918 P2d 765 (1996); *Hughes v. State*, 314 Or 1, 838 P2d 1018 (1992); *Bryson v. PERB*, 45 Or App 27, 607 P2d 768, *rev den'd* 289 Or 107 (1980); *Gantenbein v. PERB*, 33 Or App 309, 576 P2d 1257, *rev den'd* 282 Or 538 (1978); *Rose City Transit v. City of Portland*, 271 Or 588, 533 P2d 339 (1975); *Mchorse v. Portland General Electric*, 268 Or 323, 521 P2d 315 (1974); *Taylor v. Mult. Dep. Sher. Ret. Bd.*, 265 Or 445, 510 P2d 339 (1973); *Crawford v. Teachers Retirement Fund Ass'n*, 164 Or 77, 99 P2d 729 (1940).

Finally, as outlined above in section (5), a trustee is only permitted to incur those expenses which are reasonable and appropriate. Reasonable and appropriate costs can include expenses incurred in maintaining or defending an action.¹ However, trustees are only under a duty to defend actions which might result in a loss to the trust.²

In this case, however, the action the Board is incurring expenses to defend against, if successful, would result in an increase, not loss, to the trust. Therefore, any expenses the Board is incurring in defending an action which actually benefits the trust, are unreasonable and inappropriate.

III. REMEDIES AVAILABLE TO BENEFICIARIES.

For all the reasons explained above, it is apparent that the Board's current litigation position: (1) breaches the Board's duty of loyalty and impartiality; (2) is not intended for the exclusive benefit of PERS members; (3) jeopardizes the PERB's tax exempt status; (4) is not supported by a good faith interpretation of the law; and (5) involves the incurrence of expenses which are neither reasonable nor appropriate.

Consequently, PERS members may pursue an action for breach of fiduciary duty directly against the individual members of the Board to recover any losses incurred by the trust as result of the Board's breach and to enjoin the Board from committing any further breaches.³ In such an action, PERS members would be entitled to recover reasonable attorneys fees and costs incurred in successfully enforcing their rights.⁴ In order to pursue such an action, however, PERS members are required to provide a tort claims notice under the Oregon Tort Claims Act.⁵

To protect the interests of PERS members, it is recommended that a Tort Claims Notice be immediately served upon the PERS Board.

¹See Restatement (Second) of Trusts §188, comment (b) (1959).

²See Restatement (Second) of Trusts §178 (1959).

³See Restatement (Second) of Trusts §§199, 205, 206 (1959).

⁴See *e.g. Windishar v. Windishar*, 83 Or App 162, 731 P2d 445 (1986).

⁵See *Hanggi v. Hartford Ins. Co.*, 132 Or App 601, 889 P2d 365 (1995)(explaining that an action against the PERS Board for breach of fiduciary duty constitutes a "tort" for purposes of the Oregon Tort Claims Act (OTCA) and therefore, to pursue a claim for breach of that duty, beneficiaries must plead and provide notice of claim as required by ORS 30.275).