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Re: Opinion Request OP-2010-3

This opinion addresses the factors that the Oregon Investment Council (OIC) and the Oregon State Treasurer (Treasurer) may consider when establishing and implementing investment policies for the Oregon Public Employees Retirement Fund (OPERF). The principal focus of the opinion is the extent to which the OIC and the Treasurer may constitutionally accommodate so-called "social factor" instructions from the Legislative Assembly.

FIRST QUESTION PRESENTED

May the OIC or Treasurer consider statutory investment factors other than those directed by their fiduciary obligations, particularly as set forth in ORS 293.721 and 293.726, when establishing and implementing investment policy for OPERF?

SHORT ANSWER

Yes, provided the OIC and the Treasurer do not subordinate the interests of Public Employees Retirement System (PERS) members and their beneficiaries in their retirement income to unrelated objectives, such as social investing. The OIC and the Treasurer may consider statutory social factors in making an investment decision, but the OIC and Treasurer may select or reject an investment based on such factors only if the investment is equal to or superior to alternative investments when judged solely on the basis of its potential economic value.

SECOND QUESTION PRESENTED

May the Legislative Assembly require the OIC or Treasurer to deviate from their fiduciary duties when establishing and implementing investment policy for OPERF?

SHORT ANSWER

Yes, but only with significant consequences.

ORS 238.660(2) establishes a statutory contractual obligation to use OPERF for the exclusive benefit of PERS members and their beneficiaries. If the legislature changes that obligation as to prior employer or employee contributions and the earnings thereon, then this action would impair an obligation of contract in violation of Article I, section 21, of the Oregon Constitution.

The legislature may unequivocally direct the OIC or Treasurer to ignore the exclusive benefit obligation in ORS 238.660(2) in making OPERF investment decisions, but that action would breach the statutory PERS contract and provide a basis for a breach of contract action by PERS members and their beneficiaries. The action also would imperil the tax-exempt status of OPERF.

As to future employer and employee contributions to OPERF and earnings on those contributions, the Legislative Assembly may alter the exclusive benefit obligation in ORS 238.660(2) or require the OIC and the Treasurer to act inconsistently with their duty to manage OPERF for the exclusive benefit of PERS members. But this action would also imperil the tax-exempt status of OPERF.

DISCUSSION

I. Statutory Framework for OPERF Investments

OPERF is a trust fund. ORS 238.660(1). It is for the "uses and purposes set forth" in [ORS chapters 238] and 238A and ORS 237.950 to 237.980 and for "no other use or purpose * * *." *Id.* Neither the state nor any other contributing public employer has any "proprietary interest" in OPERF or in the contributions made by them to OPERF. ORS 238.660(3).

The Legislative Assembly expressly intends PERS to be "qualified and maintained under sections 401(a), 414(d) and 414(k) of the Internal Revenue Code as a tax-qualified defined benefit government plan." ORS 238.600(1).

OPERF "may not be diverted or otherwise put to any use that is not for the exclusive benefit of members and their beneficiaries" until all liabilities to PERS and their beneficiaries are satisfied. ORS 238.660(2). This restriction satisfies one of the requirements for a tax qualified plan under Internal Revenue Code (IRC) section 401(a)(2): It must be "impossible" under "the trust instrument," at any time "for any part of the corpus or income to be (within the taxable year or thereafter) used for, or diverted to, purposes other than for the exclusive benefit of [an employer's] employees or their beneficiaries * * *." 26 USC § 401(a).

The Public Employees Retirement Board (PERB) is the trustee of OPERF. ORS 238.660(1). But PERB neither establishes OPERF investment policy nor invests OPERF. Instead, the OIC is responsible for formulating OPERF's investment polices. ORS 293.731 (policies for "investment funds"); ORS 293.701(2)(a) (defining OPERF as "investment funds"). In developing these investment policies, the OIC is subject to its obligations under ORS 293.721 to "make moneys as productive as possible" and to the duties imposed by ORS 293.726(1)-(4) to act as a prudent investor, invest in accordance with the laws governing OPERF, employ an overall investment strategy, diversify investments, conform to the fundamental fiduciary duties of loyalty and impartiality, make prudent delegations, and incur only reasonable and appropriate expenses.

The Treasurer is the investment officer for the OIC. ORS 293.716(1). For the sake of brevity, this opinion refers simply to the Treasurer below when discussing investment duties related to OPERF, but those duties also apply equally to the OIC and to those performing investment duties for the OIC pursuant to a contract in accord with ORS 293.736(2).

In addition to the directions provided to the Treasurer in ORS 293.721 and ORS 293.726(1)-(4) mentioned above, the Legislative Assembly has enacted several additional investing instructions applicable to OPERF investments, which include:

- "[N]ot more than 50 percent of the moneys contributed to the [OPERF] may be invested in common stock * * *." ORS 293.726(6).[1/]

- "[N]otwithstanding any other general or specific law, moneys in the [Variable Annuity Account] shall be invested primarily in equities, including common stock, securities convertible into common stock, real property and other recognized forms of equities, whether or not subject to indebtedness." ORS 238.260(6).

- In making venture capital investment decisions, "look first at Oregon opportunities for diversification unless, under the circumstances, it is not prudent to do so." ORS 293.733(1).

- "[A]ct reasonably and in a manner consistent with ORS 293.721 and 293.726 to try to ensure that subject investment funds are not invested in any company the council knows is doing business in Sudan * * *," but divest and reinvest without "monetary loss to the fund[]." ORS 293.814(1), (2).

The latter two instructions involve in part what are commonly referred to as "social factors," i.e., factors considered to achieve a social as well as an investment objective.

II. Oregon Legislative Power and Impairment of Statutory Contracts

The lawmaking authority of the Oregon legislature is plenary, subject only to limitations in the state constitution or from federal law. *See*, *e.g.*, *Kellas v. Dept. of Corrections*, 341 Or 471, 478, 145 P3d 139 (2006) (so stating). One such limitation is the Contracts Clause of the

Oregon Constitution, Article I, section 21, which provides in pertinent part that "[n]o * * * law impairing the obligation of contracts shall ever be passed * * *." This provision applies to contracts made by the state as well as to contracts between private parties. *Eckles v. State of Oregon*, 306 Or 380, 390, 760 P2d 846 (1988) ("This court * * * has interpreted Oregon's provision to apply to contracts of the state and its subdivisions"), *appeal dismissed* 490 US 1032, 109 S Ct 1928, 104 L Ed2d 400 (1989).

There are two principal steps to analyzing an impairment of contract claim under Article I, section 21:

(1) Does "a contract exist[] to which the person asserting an impairment is a party?" and,
(2) Has "a law of this state * * * impaired an obligation of that contract"?

Hughes v. State, 314 Or 14, 17, 838 P2d 1018 (1992). In the case of an alleged impairment of a statutory contract, the first step may be broken into three subcomponent inquiries:

(1) [I]s there a state contract?;
(2) [I]f so, what are its terms?; and
(3) [W]hat obligations do the terms provide?

Strunk v. Public Employees Retirement Bd., 338 Or 145, 170, 108 P3d 1058, 1075 (2005) *Hughes,* 314 Or at 17-29.

In the case of PERS, the Oregon Supreme Court already has answered the first subcomponent inquiry in the affirmative: PERS is a statutory contract. *See Hughes,* 314 Or at 20, 25 (holding that "the legislature intended and understood that PERS generally constituted an offer, by the state to its employees, for a unilateral contract"). But in order to complete an Article I, section 21, impairment of contract analysis in the context of OPERF's investments, it remains necessary to determine the relevant terms of the PERS contract, the obligations imposed by those terms, and whether any current statutes or prospective statutes contemplated by your questions would impair or breach those obligations.

III. PERS' Exclusive Benefit Provision

As explained below, we conclude that the exclusive benefit provision in ORS 238.660(2) is an essential term of the PERS contract and that it limits the legislature's ability to require consideration of social factors in OPERF investment decisions. This provision is the functional equivalent of a trustee's common law fiduciary duty of loyalty. *See* ORS 293.726(4)(a) ("the [OIC and Treasurer] must * * * [c]onform to the fundamental fiduciary dut[y] of loyalty * * *."); *see also* RESTATEMENT (THIRD) OF THE LAW OF TRUSTS (2007), § 90(c) ("General Standard of Prudent Investment": "the trustee must * * * conform to the fundamental fiduciary dut[y] of loyalty"). While the exclusive benefit provision does not preclude consideration of social factors, it relegates such factors to a tie-breaker status. Investments supported by a consideration of social factors are permitted only insofar as they are equal to or superior to alternative investments, when judged solely on the basis of their economic value.

A. History of ORS 238.660(2) and 238.600(1)

The OPERF "exclusive benefit" provision in ORS 238.660(2) was enacted in 1999. Or Laws 1999, ch 317, § 8(2). But the OPERF "trust fund" language now found in ORS 238.660(1) originally was enacted in 1953. Or Laws 1953, ch 200, § 10 (1). The 1953 legislation declared OPERF to be "a trust fund" to be used for purposes set out in Oregon Laws 1953 chapters 180 and 200 and "for no other use or purpose, except that this provision shall not be deemed to amend or impair the force or effect of any law of this state specifically authorizing the loan of moneys from [OPERF] for the construction of state office buildings." *Id.* That provision also declared PERB to be the "trustee of said fund" "[f]or all purposes." *Id.*

Before 1999, we had interpreted the trust fund language in ORS 238.660(1)[2/] to satisfy "the requirement stated in Treas. Reg. § 1.401-2(a)(1)" that OPERF be used for the exclusive benefit of employee members and their beneficiaries. 46 Op Atty Gen 180, 203 (1989).[3/] Subsection (2) of ORS 238.660 thus makes explicit what had been implicit from subsection (1)'s declaration that OPERF was a trust that could be used only for PERS purposes and that the state may use assets of the fund only to benefit PERS members and their beneficiaries, not to further its own ends.

In 2005, the legislature expressly declared its intent that PERS comply with the tax-exemption requirements for qualified government plans and trusts under relevant sections of the IRC.[4/] Or Laws 2005, ch 808, §§ 1, 9; ORS 238.600(1) ("It is the intent of the Legislative Assembly that the system be qualified and maintained under sections 401(a), 414(d) and 414(k) of the Internal Revenue Code as a tax-qualified defined benefit governmental plan").

B. ORS 238.660(2) as Term of Statutory PERS Contract

ORS 238.660(2) expressly requires OPERF assets to be used exclusively for the benefit of PERS members and their beneficiaries: OPERF "may not be diverted or otherwise put to any use that is not for the exclusive benefit of members and their beneficiaries" until "all liabilities to members and their beneficiaries are satisfied." ORS 238.660(2). That requirement is not conditioned on the legislature's ability to authorize or mandate specific investments. The language is unambiguously promissory and, on its face, binds subsequent legislatures as it endures until all PERS liabilities are satisfied.

Moreover, complying with the exclusive benefit requirement is essential to avoiding taxation of both of employer and employee contributions to OPERF and the interest earned on them. The following consequences potentially could flow from the loss of tax-qualified status: (1) employer contributions could become currently taxable to employees as income; (2) the earnings on the fund could become taxable, probably as capital gains; (3) the state might be required to pay income tax withholding, FICA, and FUTA taxes on that income; and (4) the tax liabilities might be assessed retroactively to the date on which it was determined that OPERF no longer qualified for tax exemption. Letter dated August 16, 1994, to Hon. Jim Hill, State Treasurer, from Robert W. Muir, Assistant Attorney General, at 1-2.

If the legislature were to retreat from the exclusive benefit requirement, that change would take away the tax exemption that employees have always received, which would have a direct financial impact on them. For that reason, the fact that the provision was enacted to ensure the tax exempt status of the fund also weighs in favor of finding that the provision creates a contractual obligation.

Accordingly, we conclude that the exclusive benefit provision in ORS 238.660(2) establishes a contractual obligation because of: (1) the unambiguously promissory language; (2) the long duration of the requirement; (3) its appearance in the PERS statutes (in determining whether a provision is a term of the PERS contract, the Oregon Supreme Court consistently has given weight to whether the provision was enacted as part of the PERS statutes, *Hughes,* 314 Or at 22); (4) the context of OPERF's trust status and the state's declaration that it has no proprietary interest in the fund;[5/] and (5) the longstanding interpretation of ORS 238.660(1) to implicitly contain this requirement to make the fund tax-exempt qualified under federal law.

C. Obligations Imposed by "Exclusive Benefit" Provision

1. Method for Interpreting ORS 238.660(2)

In order to discern the specific obligations imposed by the exclusive benefit provision, we must construe that statute and related statutes. In interpreting statutes, we first examine the text in context. *PGE v. Bureau of Labor and Industries,* 317 Or 606, 610-611, 859 P2d 1143 (1993). In doing so, we apply statutory and judicial rules for reading text and context, such as giving terms of common usage their plain meanings. *Id.* Statutory context includes other provisions of the same statute, related statutes, the Oregon Supreme Court's interpretations of those statutes, and the existing common law. *Id.*; *Fresk v. Kraemer,* 337 Or 513, 520-21, 99 P3d 282 (2004). Courts also examine legislative history when it is useful to the analysis. *State v. Gaines,* 346 Or 160, 171-172, 206 P3d 1042 (2009).

Because the Oregon exclusive benefit requirement was patterned on and intended to ensure compliance with the federal statute, interpretations of the federal statute existing at the time that the state statute was enacted are relevant context for interpreting ORS 238.660(2). *See Stevens v. Czerniak*, 336 Or 392, 401, 84 P3d 140 (2004) (Federal Rules of Civil Procedure may serve as context for construing Oregon counterparts); *State of Oregon DCS v. Anderson*, 189 Or App 162, 171-172, 74 P3d 1149 (2003), *rev den* 336 Or 92, 79 P3d 313 (2003) (federal child support legislation is context for state law); *Harris v. Pameco Corp.*, 170 Or App 164, 176, 12 P3d 524 (2000) (federal civil rights law is "instructive" in interpreting state law).

2. Text

We begin by examining in greater detail the statutory phrase that assets of the fund "may not be diverted or otherwise put to any use that is not for the exclusive benefit of members and their beneficiaries." First, "may not" is an expression of "absolute prohibition." ORS 174.100(4). The pertinent plain meaning of "divert" is "to turn from one course, direction, objective or use to another." WEBSTER'S THIRD INTERNATIONAL (UNABRIDGED) DICTIONARY (2002) at 663. "Use" means "the act or practice of using something * * * the privilege or benefit of using something." *Id.* at 2523. "Exclusive" means "excluding or having power to exclude * * * limiting or limited to possession, control, or use * * * SINGLE, SOLE * * * UNDIVIDED, WHOLE." *Id.* at 793. The purpose of the OPERF trust is to provide benefits to members and their beneficiaries and to pay the associated administrative costs. Putting it all together, the provision prohibits using fund assets for any purpose other than funding the liabilities to PERS members and their beneficiaries. Hence, the provision would appear to prohibit investing OPERF to achieve objectives other than funding those PERS liabilities.

3. Internal Revenue Service Interpretations

We next consider the statute's context to determine whether it suggests that the plain meaning was the one intended or suggests a different interpretation. The impetus for the exclusive benefit provision was compliance with federal requirements to receive tax advantages for the trust. The IRC of 1986 (and its predecessors) provides substantial tax benefits to qualified government pension plans. As a precondition for obtaining those tax advantages, Congress required the plans to conform to certain limitations and safeguards analogous to those provided under the common law of trusts. As noted above, to qualify for the exemption the trust instrument must make it:

> [I]mpossible, at any time prior to the satisfaction of all liabilities with respect to employees and their beneficiaries under the trust, for any part of the corpus or income to be (within the taxable year or thereafter) used for, or diverted to, purposes other than for the exclusive benefit of his employees or their beneficiaries.

26 USC § 401(a)(2) (also referred to as IRC § 401(a)(2)). That provision was intended to ensure that exempt pension plans were in fact operated for the exclusive benefit of employee members. *See, e.g.,* JERRY S. ROSENBLOOM, THE HANDBOOK OF EMPLOYEE BENEFITS, DESIGN, FUNDING, AND ADMINISTRATION 1051-52 (6th ed 2005). Many commentators equate the "exclusive purpose" rule with the common law fiduciary duty of loyalty, which requires a fiduciary to administer a trust solely in the best interests of the beneficiaries. *Id.*

The pertinent Treasury Regulation, 26 CFR § 1.401-2(1)(3), provides that:

> As used in section 401(a)(2), the phrase "purposes other than for the exclusive benefit of his employees or their beneficiaries" includes all objects or aims not solely designed for the proper satisfaction of all liabilities to employees or their beneficiaries covered by the trust.

But, according to the Internal Revenue Service (IRS), the "exclusive benefit" requirement does not preclude investment in the employer (which obviously does not "exclusively benefit" the employee member but benefits the employer as well and would likely conflict with the duty of loyalty in some cases) as long as the following safeguards are met:

> (1) the cost must not exceed fair market value at the time of purchase;
>
> (2) a fair return commensurate with the prevailing rate must be provided;
>
> (3) sufficient liquidity must be maintained to permit distributions in accordance with the terms of the plan; and
>
> (4) the safeguards and diversity that a prudent investor would adhere to must be present.

Rev Rul 69-494, 1969-2 CB 88. While that ruling directly concerned investments in the employer, Rev Proc 72-6, 1972-1 CB 710 subsequently confirmed that it applied to any pension fund investments.

In other words, the IRS has not interpreted the federal requirement literally to require that investments "exclusively benefit" pension members to the exclusion of all others. That requirement would be impractical as all investments benefit the entity invested in as well as the investor. Instead, the federal requirement has been interpreted to permit an investment that would achieve benefits for the employer or other benefits, provided that "adequate safeguards that a prudent investor would adhere to" are present. Thus, the federal interpretation would appear to permit consideration of social factors if a socially-motivated investment option is at least as prudent, taking into account the balance between risk and likely investment return, as other available investments.

D. United States Department of Labor's Interpretations

Our view of the IRS interpretation of the exclusive benefit rule is consistent with the United States Department of Labor's (USDOL) more detailed interpretations of the exclusive benefit rule found in the federal Employee Retirement Income Security Act of 1974, as amended ("ERISA"). 29 USC §§ 1002-1461. ERISA is a comprehensive system of regulation of private pension and welfare plans. ERISA imposes uniform fiduciary duties upon all private pension plan trustees. ERISA, in relevant part, also includes an exclusive purpose or benefit rule:

> [A] fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and –
>
> (A) for the exclusive purpose of:
>
> (i) providing benefits to participants and their beneficiaries; and
>
> (ii) defraying reasonable expenses of administering the plan;

29 USC § 1104(a)(1).

Although ERISA, and specifically the fiduciary provisions of ERISA, do not directly apply to state government retirement plans,[6/] the ERISA fiduciary duties provisions are based on existing common law trust principles. HR REP NO. 93-533, 93d Cong, 1st Sess, at 11-12 (1974). Because of this etiology, the ERISA fiduciary duties, and the USDOL's interpretations of them, help inform interpretations of IRC section 401(a) and are instructive in interpreting similar obligations imposed by state statutes like ORS 236.660(2) and the common law. *See, e.g.*, RESTATEMENT (THIRD) OF THE LAW OF TRUSTS § 78 cmt. f (citing USDOL Interpretive Bulletin, 29 CFR § 2509.94-1 (updated by Interpretive Bulletin, 29 CFR § 2509.08-01 discussed below)).

USDOL issues advisory opinions about ERISA pursuant to ERISA Procedure 76-1 (41 Fed Reg 36281 (Aug. 27, 1976)). In a 1998 advisory opinion discussing "social investing," USDOL, Employee Benefits Security Administration (formerly Pension and Welfare Benefits Administration) states:

> The Department has expressed the view that the fiduciary standards of sections 403 and 404 do not preclude consideration of collateral benefits, such as those offered by a "socially-responsible" fund, in a fiduciary's evaluation of a particular investment opportunity. However, the existence of such collateral benefits may be decisive only if the fiduciary determines that the investment offering the collateral benefits is expected to provide an investment return commensurate to alternative investments having similar risks.
>
> * * * * *
>
> Your letter requests guidance concerning the application of the above standards to a plan fiduciary's selection of a "socially-responsible" mutual fund as a plan investment or as a designated investment alternative for an ERISA section 404(c) plan.
>
> With regard to your request, it is the view of the Department that the same standards set forth in sections 403 and 404 of ERISA governing a fiduciary's investment decisions, discussed above, apply to a fiduciary's selection of a "socially-responsible" mutual fund as a plan investment or, in the case of an ERISA section 404(c) plan, a designated investment alternative under the plan. Accordingly, if the above requirements are met, the selection of a "socially-responsible" mutual fund as either a plan investment or a designated investment alternative for an ERISA section 404(c) plan would not, in itself, be inconsistent with the fiduciary standards set forth in sections 403(c) and 404(a)(1) of ERISA.

ERISA Sec. 404(c), 98 Op. USDOL Off. Regulations and Interpretations, 04A (1998), *available at* http://www.dol.gov/ebsa/programs/ori/advisory98/98-04a.htm.

And in a 2008 Interpretive Bulletin, "Supplemental guidance relating to fiduciary responsibility in considering economically targeted investments" (ETIs), the USDOL advises that ERISA fiduciaries may make such investments if they conclude that an ETI is "truly equal" to alternative investments, *i.e.*, commensurate rates of return and degrees of risk. 29 CFR § 2509.08-01 (2008), *updating* 29 CFR § 2509.94-1 (1994). ETIs are "investments selected for the economic benefits they create apart from their investment return to the employee benefit plan." *Id.* at 1. The USDOL guidance explains:

> ERISA's plain text does not permit fiduciaries to make investment decisions on the basis of any factor other than the economic interest of the plan. Situations may arise, however, in which two or more investment alternatives are of equal economic value to a plan. The Department has recognized in past guidance that under these limited circumstances, fiduciaries can choose between the investment alternatives on the basis of a factor other than the economic interest of the plan. The Department has interpreted the statute to permit this selection because (1) ERISA requires fiduciaries to invest plan assets and to make choices between investment alternatives, (2) ERISA does not itself specifically provide a basis for making the investment choice in this circumstance, and (3) the economic interests of the plan are fully protected by the fact that the available investment alternatives are, from the plan's perspective, economically indistinguishable.

Id. The Interpretive Bulletin provides several examples, including one involving investment in "green companies":

> A plan sponsor adopts an investment policy that favors plan investment in companies meeting certain environmental criteria (so-called "green" companies). In carrying out the policy, the plan's fiduciaries may not simply consider investments only in green companies. They must consider all investments that meet the plan's prudent financial criteria. The fiduciaries may apply the investment policy to eliminate a company from consideration only if they appropriately determine that other available investments provide equal or better returns at the same or lower risks, and would play the same role in the plan's portfolio.

Id. In sum, even the USDOL's highly rigorous approach to the exclusive benefit rule does not rule out all considerations of social factors.

E. Treasurer's Fiduciary Duty of Loyalty

As noted above, many legal commentators view the exclusive benefit rule as being identical to a trustee's fiduciary duty of loyalty. ORS 293.726 expressly requires the Treasurer to "[c]onform to the fundamental fiduciary dut[y] of loyalty" in making OPERF investment decisions, along with other standards:

> (1) The investment funds shall be invested and the investments of those funds managed as a prudent investor would do, under the circumstances then prevailing and *in light of the* purposes, terms, distribution requirements and *laws governing each investment fund*.

> * * * * *
>
> (3) In making and implementing investment decisions, the Oregon Investment Council and the investment officer have a duty to diversify the investments of the investment funds unless, under the circumstances, it is not prudent to do so.
>
> (4) In addition to the duties stated in subsection (3) of this section, *the council and the investment officer must*:
>
> (a) *Conform to the fundamental fiduciary duties of loyalty* and impartiality;
>
> * * * * *.

ORS 293.726(1), (3), (4)(a) (emphasis added). The investment standards now found in ORS 293.726(1)-(4) reflect changes to the statute made by the legislature in 1993 to align with modern fiduciary obligations of prudence recognized generally in the common law dealing with trusts. Or Laws 1993, ch 75, § 1; Minutes, House General Government Committee (HB 2164), March 29, 1993, Exhibit F (letter dated October 26, 1992 from Robert W. Muir, Assistant Attorney General, to Dan Smith, Investment Manager, Oregon State Treasury); Minutes, House General Government Committee (HB 2164), March 29, 1993, Exhibit G (written testimony of the Oregon State Treasury). Indeed, ORS 293.726(1)-(4) closely tracks section 227 of the 1992 version of the RESTATEMENT (THIRD) OF THE LAW OF TRUSTS ("General Standards of Prudent Investment"), now numbered as section 90 (2007).[7/]

The "Duty of Loyalty" section in the RESTATEMENT (THIRD) OF THE LAW OF TRUSTS, section 78, states in pertinent part:

> (1) Except as otherwise provided in the terms of the trust, a trustee has a duty to administer the trust solely in the interest of the beneficiaries, or solely in furtherance of its charitable purpose.

Comment f to section 78 states in part:

> In administering a trust the trustee has a duty to the beneficiaries not to be influenced by the interest of any third person or by motives other than the accomplishment of the purposes of the trust.

The Reporter's Note to comment f observes that the "comment to Uniform Prudent Investor Act [UPIA] § 5 ('Loyalty') is analogous and relevant here." The UPIA comment in turn relies heavily on the USDOL Interpretive Bulletin, 29 CFR § 2509.94–1, which was updated and replaced by Interpretive Bulletin, 29 CFR 2509.08-01 discussed above. The 1994 USDOL Interpretive Bulletin not only reminded "fiduciary investors that they are prohibited from "subordinating the interests of participants and beneficiaries in their retirement income to unrelated objectives," but also permitted them to select an economically targeted investment (ETI) or to engage in "an investment course of action intended to result in the selection of ETIs" if they adhered to the other prudence requirements of ERISA. 29 CFR 2509.94–1. This suggests that, as with ERISA, the consideration of collateral benefits, like social factors, is not inconsistent with the common law fiduciary duty of loyalty so long as the fiduciary determines that the investment offering the collateral benefits is expected to provide an investment return commensurate to alternative investments having similar risks.

Moreover, the Treasurer's statutory and common law fiduciary duties of prudent investment are subject, respectively, to "laws governing each investment fund," ORS 293.726(1), and "the rule of § 91, dealing primarily with contrary investment provisions of a trust or statute," RESTATEMENT (THIRD) OF THE LAW OF TRUSTS, section 90(d).

F. Prior Attorney General Opinions

Three prior Attorney General opinions discuss the issue of social factors and Treasurer-invested trust funds. While the first opinion (1978) appears to exclude the Treasurer from considering any social factors, the latter two opinions (1989 and 1993) permit consideration of social factors so long as any investment or divestiture in the end also accords with the applicable statutory standards for investments, such as ORS 293.726 and 291.721.

In the first opinion, Attorney General James A. Redden addressed several questions from the Chancellor of the State Department of Higher Education concerning investment roles and standards arising from mounting political concerns over the South African government's apartheid policies of that era. 38 Op Atty Gen 2017 (1978). After stating that the OIC had statutory responsibility for establishing investment policy for the investment funds under discussion, including Higher Education Board investment funds, the Attorney General observed that OIC policy should comply with the productivity objective in ORS 293.721 and the "prudent man" rule expressed in ORS 293.726. *Id*. at 2018, 2022. He further opined that it would not be appropriate or relevant (apparently in keeping with then ORS 237.271(1) and his understanding of the common law duty of loyalty) for the OIC to consider "any factors other than the probable safety of, and the probable income from, the investments * * *." *Id.* at 2018.[8/] This opinion did not consider the impact of statutory investment instructions on this conclusion.

In 1989, Attorney General Dave Frohnmayer addressed South African investments involving higher education funds in the context of the Anti-Apartheid Act of 1987 (Or Laws 1987, ch 193). 46 Op Atty Gen 143 (1989). The Anti-Apartheid Act mandated the "orderly, prudent" divestiture of subject investment funds, including OPERF, "in stocks and bonds in United States business entities directly investing in South Africa and in Namibia." ORS 293.855(2) (1987). Attorney General Frohnmayer acknowledged a legislative finding in the Anti-Apartheid Act of the risks inherent in South African investment as well as the directive for prudent divestiture without abrogation of fiduciary responsibilities. 46 Op Atty Gen at 154. He stated that "the prudent investor rule does not absolutely prohibit divestiture." *Id.* Accordingly, he said that the OIC could "carry out divestiture * * * to the extent that such divestiture can be accomplished while complying with" the applicable statutory standards for investment. *Id.*[9/]

In 1993, Attorney General Theodore R. Kulongoski discussed these two prior Attorney General opinions in the course of analyzing the respective duties of the Treasurer, OIC, and PERB as to OPERF. 46 Op Atty Gen 506 (1993). On the question of social factors generally, he observed:

> Thus, ORS 293.726 would prohibit both the treasurer and OIC from making an investment for social policy reasons if that investment would not maximize the income of [O]PERF and comply with the constraints of ORS 293.726.

Id. at 511.

IV. Current Social Factor or Economic Target Legislation

A. Sudan Divestments

In 2005, the legislature enacted the Oregon Human Rights and Anti-Genocide Act of 2005. ORS 293.811 to 293.817. The legislature makes numerous findings about the human rights abuses in Sudan, concluding that "[t]he investment of subject investment funds in business firms and financial institutions with ties to the repressive regime in Sudan is inconsistent with the moral and political values of the people of Oregon." ORS 293.813(2)(m).

ORS 293.814(1) requires the OIC and Treasurer to "act reasonably and in a manner consistent with ORS 293.721 and 293.726 to try to ensure that subject investment funds are not invested in any company that the council knows is doing business in Sudan for as long as the Sudanese government's campaign of human rights violations, atrocities or genocide continues in Sudan." OPERF is one of the "subject investment funds." ORS 293.812(4)(a).

Subsection (2) of ORS 293.814 requires divestment and reinvestment to be accomplished "without monetary loss to the funds through reasonable, prudent and productive investments in companies and institutions generating returns that are comparable to the returns generated by companies subject to divestment."

Notably, ORS 293.814(1) merely directs the Treasurer to "try to ensure" that funds are not invested in companies doing business in Sudan. The applicable definition of "try" is "to make an attempt to achieve something or carry out some action. WEBSTER'S at 2457. In other words, the Treasurer must *attempt* to avoid those investments, but is not absolutely barred from them.

But the provision *requires* the Treasurer to (the Treasurer "shall") act "in a manner consistent with ORS 293.721 and 293.726." ORS 293.814(2) also requires divestment and reinvestment to be accomplished "without monetary loss to the funds through reasonable, prudent and productive investments in companies and institutions generating returns that are comparable to the returns generated by the companies subject to divestment."

In brief, under ORS 293.814, the Treasurer must avoid those investments or divest and reinvest if he can do so in accordance with ORS 293.721 or 293.726 and without monetary loss to the funds. But if he concludes that he can meet those requirements and that investments with comparable returns exist, then this statute directs him to divest. Given these conditions, ORS 293.814 does not impair or breach the "exclusive benefits" term of the PERS statutory contract. By its very terms, the statute does not permit the Treasurer to subordinate the interests of PERS members and their beneficiaries to an objective unrelated to their benefit.

B. Oregon Venture Capital

A second social investment statute imposes a duty on the Treasurer "[i]n making and implementing investment decisions related to venture capital * * * *to look first at Oregon opportunities for diversification, unless, under the circumstances, it is not prudent to do so*." ORS 293.733 (emphasis added). This law was enacted in 2003. Or Laws 2003, ch 606, §§ 3, 5.

In that law, the legislature finds that the availability of Oregon venture capital "is critical to the continued growth and development of the economy of Oregon," and that the investment in Oregon businesses can "produce substantial positive returns for long-term investors." ORS 293.796(1)(a), (c). Paragraph (1)(d) of that provision finds that "[p]ension funds managed by the [OIC] constitute a major financial resource of the State of Oregon, and that such funds may be prudently invested in start-up and emerging growth businesses in this state under policies established by the [OIC]."[10/]

Those findings express the legislature's belief that prudent and productive investment opportunities in Oregon venture capital exist. The legislature then directs the Treasurer in ORS 293.733 to consider those investments "first" "unless, under the circumstances, it is not prudent to do so." Thus, by the express terms of this statute, the Treasurer does not have to consider Oregon investments "first" for diversification if he does not believe it is prudent under the circumstances.

While ORS 293.733 is less explicit than the Sudan divestment law on its interaction with ORS 293.721 and 293.726, it is similar to the Sudan divestment law in its application for several reasons. First, there is the specific condition of prudence ("unless * * * it is not prudent"). ORS 293.733(1); ORS 293.814(2). As ORS 293.733 was placed in the ORS 293.701 to 293.820 series of the Treasurer's investment statutes by a legislative directive (Or Laws 2003, ch 606, § 2), the word "prudent" in this statute likely was intended to relate to a "prudent" investor in ORS 293.726(1) and (2). *See State v. Carr*, 319 Or 408, 411-12, 877 P2d 1192 (1994) ("Context includes other related statutes"). Second, the legislature did not provide that ORS 293.733 was an exception to ORS 293.726. If the legislature had so intended, it would have been easy to state, "notwithstanding ORS 292.726" at the beginning of ORS 293.733. In interpreting a statute, we are not to "insert what has been omitted." ORS 174.010. Finally, in interpreting the statute as being subject to ORS 293.726 and, specifically, the "fundamental fiduciary duty of loyalty" described in ORS 293.726(4)(a), the ORS 293.733 "duty to look first to Oregon opportunities" avoids any conflict with the exclusive benefit obligation owed to PERS members and their beneficiaries under ORS 238.660(2).

Accordingly, under ORS 293.733, the Treasurer must consider Oregon venture capital investments “first” only if it is prudent and in accordance with ORS 293.721 and 293.726. If he concludes that Oregon venture capital investments meet those requirements and are equal or superior to alternative investments, then ORS 293.733 directs him to consider those investments “first.” Again, given such conditions, ORS 293.733 does not impair or breach the exclusive benefit term of the PERS statutory contract. Properly construed, the statute does not permit the Treasurer to subordinate the interests of PERS members and their beneficiaries to an objective unrelated to their benefit.

V. Compulsory Disregard of Exclusive Benefits Obligation

You also ask whether the legislature could require the Treasurer to make investments that do not comply with the exclusive benefits rule and the Treasurer’s related fiduciary standards. Legislatures generally are free to amend or repeal enactments of earlier legislatures unless doing so impairs a contractual obligation in violation of constitutional guarantees. *See Eckles*, 306 Or at 390-91.

As stated above, we conclude that ORS 238.660(2) establishes a statutory contractual obligation not to use OPERF for anything but the exclusive benefit of PERS members and their beneficiaries. Accordingly, as to prior employer and employee contributions to OPERF and the earnings on those contributions, if the Legislative Assembly altered the exclusive benefits obligation, then that action would impair an obligation of the PERS contract and violate Article I, section 21, of the Oregon Constitution. If the legislature did not alter the exclusive benefits obligation in ORS 238.660(2), but instead unequivocally required the Treasurer to act inconsistently with that obligation as to prior contributions and earnings thereon, then PERS members and their beneficiaries could bring a cause of action for breach of the PERS contract. *See Strunk*, 338 Or at 170 (“legislation that mandated a breach on the state’s part of such a contractual obligation – but did not change or eliminate the obligation itself – did not *contravene* Article I, section 21, although, in accordance with that constitutional provision, such legislation ordinarily would require payment of damages resulting from the breach”) (discussing *Eckles*, 306 Or at 399-402). This action also would imperil the federal tax-exempt status of OPERF under IRC § 401(a).

But the legislature likely could change the exclusive benefit obligation found in ORS 238.660(2) prospectively without impairing a contract in violation of Article I, section 21. *See, e.g.*, Hughes, 314 Or at 31 (“a law impairing an obligation of a contract * * * is a nullity as it relates to PERS retirement benefits accrued or accruing for work performed before the effective date of that [law]”). In this context, such a change could apply only to employer and employee contributions and earnings thereon made or earned *after* the statute’s effective date. In effect, those contributions and earnings would have to be segregated from earlier funds. Such an action also would imperil the tax-exempt status of at least this portion of OPERF.

Sincerely,

David E. Leith
Associate Attorney General and
Chief General Counsel
General Counsel Division

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1/ We have advised that "cash dividends and increases in value of stock, whether or not realized by subsequent sales and repurchases would be ignored in computing the numerator and denominator of the ratio" because they are not "contributions." Letter of Advice to Robert B. Moore, Deputy State Treasurer, January 31, 1985 at 2 (1985 WL 199940, 2).

2/ In 1989, the provision stating that OPERF "is declared to be a trust fund" was codified in ORS 237.271(1) (1989). Or Laws 1989, ch 966, § 9.

3/ In 46 Op Atty Gen 180, 184 (1989), Attorney General David Frohnmayer concluded that a diversion of employer and employee contributions to fund a health insurance supplement for retirees and an intra-fund transfer of gain-loss reserves violated PERS members' contractual and trust rights.

4/ The legislature has similarly declared its "intent" that "the individual account program [of PERS] be established and maintained as a tax-qualified defined contribution governmental plan" pursuant to section 414(k) of the IRC. ORS 238A.021(1).

5/ *See also Sprague v. Straub*, 252 Or 507, 522 n 9, 451 P2d 49 (1969) (holding that "public employers cease to have a proprietary interest in the fund after they have made their contributions to it. The fund then becomes, in effect, a trust fund with the beneficial interest vesting in participating employees.")

6/ *See* ERISA, 29 USC § 1003(b) (2001).

7/ RESTATEMENT (THIRD) OF THE LAW OF TRUSTS, § 90 (2007) states:

> The trustee has a duty to the beneficiaries to invest and manage the funds of the trust as a prudent investor would, in light of the purposes, terms, distribution requirements, and other circumstances of the trust.
>
> (a) This standard requires the exercise of reasonable care, skill, and caution, and is to be applied to investments not in isolation but in the context of the trust portfolio and as a part of an overall investment strategy, which should incorporate risk and return objectives reasonably suitable to the trust.
>
> (b) In making and implementing investment decisions, the trustee has a duty to diversify the investments of the trust unless, under the circumstances, it is prudent not to do so.
>
> (c) In addition, the trustee must:

> (1) conform to fundamental fiduciary duties of loyalty (§ 78) and impartiality (§ 79);
>
> (2) act with prudence in deciding whether and how to delegate authority and in the selection and supervision of agents (§ 80); and
>
> (3) incur only costs that are reasonable in amount and appropriate to the investment responsibilities of the trusteeship (§ 88).
>
> (d) The trustee's duties under this Section are subject to the rule of § 91, dealing primarily with contrary investment provisions of a trust or statute.

[8/] Speaking about certain Higher Education funds subject to express requirements of donors, the Attorney General qualified that advice adding that "[t]he State of Oregon as trustee, acting through the [OIC], is bound to follow the directions of the settlor, just as is any other trustee. ORS 128.065; ORS 351.130."

[9/] The Anti-Apartheid Act of 1987 was repealed in 1999. Or Laws 1999, chapter 295, § 1.

[10/] Also, the OIC "shall have at least $100 million in venture capital investments in Oregon *unless, under the circumstances, it is not prudent to do so***.**" ORS 293.733(2) (emphasis added). The OIC must submit an "annual report to the Speaker of the House of Representatives and the President of the Senate detailing the investments and commitments made by the [OIC] in accordance with ORS 293.733." ORS 293.734.