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LANE TRANSIT DISTRICT
BOARD OF DIRECTORS

FINANCE COMMITTEE MEETING

March 3, 1992
12:00 p.m.

LTD Conference Room
3500 E. 17th Avenue, Eugene
(off Glenwood Blvd.)

AGENDA

I. CALL TO ORDER

II. ROLL CALL

Brandt (Chair)______ Billings______ Parks______

III. LTD DEFERRED COMPENSATION PROGRAM (attachment)

Clarification of legal issues surrounding deferred compensation plans and discussion of Board and staff responsibilities

IV. PAYROLL TAXES ON DEFERRED COMPENSATION

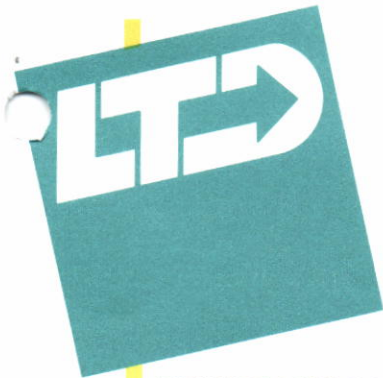
Discussion of proposed amendment to House Bill 2164

V. SELECTION OF INDEPENDENT AUDITOR FOR FISCAL YEAR 1992-93

Discussion of process for auditor selection.

VI. ADJOURNMENT

a:fincomag.jhs



Lane Transit District
P.O. Box 7070
Eugene, Oregon 97401-0470

_(503) 741-6100_
Fax (503) 741-6111

March 3, 1992

MEMORANDUM

TO: LTD Board Finance Committee

FROM: Phyllis Loobey, General Manager

RE: LTD Deferred Compensation Program

BACKGROUND

In October 1984, the LTD Board of Directors approved a plan whereby the Hartford Insurance Company was authorized to provided deferred compensation benefits to all LTD employees. Approximately 66 employees, 29 percent of the labor force, are currently participating in the program. In the seven years that the program has been operating, a number of employees have asked if another deferred compensation carrier could be added to the program. In response, LTD conducted an extensive review and interviews of additional deferred compensation carriers and recommended to the LTD Board of Directors that they approve the addition of PEBSCO as a second deferred compensation carrier.

At the December 1991 meeting, the Board raised a number of questions concerning the legal consequences to LTD and the Board of participating in a deferred compensation program. To answer these questions, staff have been researching the issue. Attached is a memorandum by Craig Smith that discusses the legal questions. Craig Smith provides legal advice to the LTD Board of Trustees for the LTD/ATU and LTD Salaried Employees Pension Plans.

ISSUES

1. Why are the deferred plan assets carried on the LTD Balance Sheet?

To ensure that a plan qualifies for tax deferrals, the plan must be carefully structured to meet specific provisions of Internal Revenue Code Section 457. There is a legal requirement that contributions to deferred compensation plans must be maintained as District assets. This is why the assets are required to be reported on the Balance Sheet of the District. Moreover, because these funds are District assets, the District has a certain degree of fiduciary responsibility to the program participants.

2. What is the extent of the Board members' personal liability by approving LTD participation in a deferred compensation plan?

Mr. Smith states in his memorandum, **"State law prohibits actions against public officials for acts or omissions within the scope of their employment of duties except in the case of malfeasance in office or willful or wanton neglect of duty."** However, as stated in issue #1, the Board does maintain a fiduciary responsibility with regard to LTD's deferred compensation plan. In order to ensure that the LTD Board is protected by the aforementioned state law, Mr. Smith indicates that LTD must adhere to the prudent person rule found in ORS 128.057(1) (see Smith memo, page 4). To ensure that LTD adheres to the prudent person rule, staff are developing a set of procedures for the entire LTD deferred compensation program. In general, the procedures are intended to ensure that LTD has taken every reasonable action to select financially sound carriers (low risk), and that LTD conducts a periodic review of the participating carrier's financial soundness. Further, in case of a potential risk to the District's assets invested with a deferred compensation carrier, LTD has procedures in place to reduce that risk as much as reasonable and prudent.

Staff are still compiling the set of procedures for review and approval at a future Finance Committee meeting, but will discuss them in a general nature at this meeting.

3. Does the Board have to approve a specific carrier or can the Board delegate the task of selecting a carrier to the General Manager?

Mr. Smith indicates that there is no specific legal requirement that the Board approve the individual carrier, but that it cannot delegate the fiduciary responsibility concerning the individual carrier(s). He therefore recommends that the Board approve the individual carrier and implement appropriate procedures to ensure prudent oversight of the deferred compensation program.

After having reviewed all the available material and conferring with other public agencies that have deferred compensation benefits for their employees, staff believe that deferred compensation is an important benefit that should be maintained at LTD and that an additional carrier should be added to the program. We recommend that staff immediately formulate a set of written procedures for management of the LTD deferred compensation program for review by the Finance Committee and approval by the Board. After those procedures are in place, staff would recommend, for Board approval, a second carrier for the program.

h:defcomp1.mjp

HERSHNER, HUNTER, MOULTON, ANDREWS & NEILL
LAW OFFICES

180 E. Eleventh Avenue
P.O. Box 1475
Eugene, Oregon 97440
Telecopy (503) 344-2025
Telephone (503) 686-8511

February 5, 1992

Ms. Tamara Weaver
Lane Transit District
P. O. Box 7070
Eugene, Oregon 97401-0470

RE: Deferred Compensation Plan
Our File No. 13941-87A

Dear Tamara:

Enclosed is a memorandum we prepared regarding the analysis of the responsibilities and duties of the Board of Directors of Lane Transit District as it relates to the selection of insurance carriers who are used to provided the funding vehicle for the deferred compensation plans maintained by the District.

After you have had an opportunity to review it, please contact me if you have any questions.

Yours truly,

CRAIG A. SMITH

CAS:clm
Enclosure

MEMORANDUM

FOR YOUR INFORMATION
HERSHNER HUNTER MOULTON, ANDREWS & NEILL

TO: CAS

FROM: WLP

DATE: February 4, 1992

RE: Lane Transit District / Deferred Compensation Plan
Our File No. 13941-87.A

I. INTRODUCTION.

Our client has asked that we provide them with an opinion regarding the responsibility of Lane Transit District, its governing board and agents regarding the establishment and maintenance of deferred compensation plans.

The District currently has two plans in effect. The plans are voluntary. Both plans provide for deferral of employees' compensation. The deferrals become a part of the employer's general assets and are subject to the claims of the employer's creditors. Although the plans are technically unfunded, the employer purchases annuity contracts to fund the benefits. The payout options are tied to the annuity contracts. The District is specifically concerned about its potential liability if the annuity carriers it chooses should become insolvent.

A. Plan One. This plan is titled "United States Conference of Mayors Deferred Compensation Program The Deferred Compensation Plan for Public Employees" and is dated December 18, 1991. The value of each employee's deferred account is determined by reference to each participant's investment specifications. Those specifications are not set out in the plan. The District is under no obligation to invest the deferred amounts in a particular manner. Thus, it appears that a participant's benefit might exceed the value of the annuity purchased to fund those benefits. This could happen if the participant chose a variable annuity as its "investment specification" and the plan purchased a fixed annuity to fund the benefit and the variable annuity investment specification outperformed the fixed annuity.

Plan One provides that the District will appoint an administrator to administer the plan.

With respect to the District's liability, Plan One provides in Article X that each participant agrees not to seek recovery against the District, the administrator, or their agents for any loss other

than a loss due to fraud or wrongful taking. Article X also provides that the District, the administrator and their agents are to be held harmless from "all court costs and claims for attorney fees arising from any action" brought by a participant or any beneficiary.

B. **Plan Two.** This plan is titled "Deferred Compensation Plan for Lane Transit District" dated October 24, 1984. Like Plan One, Plan Two is a voluntary deferred compensation plan. The value of each participant's account is determined by reference to the participant's statement of investment preference. Those investment preferences are not set out in the plan. Like Plan One, it appears the value of a participant's benefits might exceed the value of the annuity purchased to fund those benefits.

Plan Two provides that the plan is to be administered by an advisory committee. The advisory committee may employ investment counsel, however the advisory committee must make the final determination concerning investments.

Plan Two provides that the District may, but is not required to make investments in accordance with the requests of each participant. The plan also provides that the District and the advisory committee will not be held responsible for any investment results.

II. Summary of Response.

As far as I am able to tell, there are no reported cases concerning the fiduciary liability of public bodies and public officials with respect to deferred compensation plans. In reaching the conclusions in this memo I have applied relevant statutory provisions and general principals of law.

As an initial matter, as long as the payout options chosen by the participants are tied to the annuities the District purchases, each employee effectively assumes the risk of the investment performance of the annuities.

Second, although as a practical matter, each participant assumes the risk of the performance of the chosen annuity contract, the District and its agents who select the insurance carriers made available to the participants have a fiduciary obligation to act prudently in making that selection. The standard applied is the "prudent person rule" which requires the District and its agents to use the judgment and care that a person with similar investments would use.

If the District is not an expert in insurance matters, it must consult appropriate experts. However, responsibility for the

choice of annuity company rests with the District. Although the District may rely on information furnished to it by its agents, the governing board is ultimately responsible for the decisions. The governing board may not escape liability for the District for an imprudent decision by delegating the decision to an administrator or advisory committee. In addition, the District must continue to evaluate the annuity company following purchase of the annuities. If an annuity company became insolvent and a prudent investor would have discovered the impending insolvency and acted to avoid loss, the District would be liable to the participants for violating its fiduciary duties.

Third, to the extent the governing board or its agents are negligent, they may not be sued individually. The participants' recourse would be against the District itself. State law prohibits actions against public officials for acts or omissions within the scope of their employment or duties except in the case of "malfeasance in office or willful or wanton neglect of duty." In addition, public officials are entitled to indemnification and representation by the public body for their ordinary negligence.

Fourth, the exculpatory provisions in the plans are probably unenforceable as against public policy except to the extent they operate to shift the risk of the investment performance of the annuities to the participants. In fact, to avoid violating the county debt limits, the participants must assume the risk of the annuities' investment performance.

Finally, we have been informed by the administrator of the tax qualified plans maintained by the District that the District's fiduciary liability insurance policy, by its terms, doesn't reference these plans as covered by that policy. In addition, the officer and director policy we reviewed specifically excludes from coverage actions taken in a fiduciary capacity.

III. Discussion.

Lane Transit District (District) is a mass transit district governed by ORS 267.010-267.430. The District is a municipal corporation with powers vested in the governing body of the district. ORS 267.090, 267.200. The governing body of the district consists of seven members. ORS 267.090(2). The district is considered to be local government. See ORS 294.004(1). Local government is permitted to invest funds set aside pursuant to a deferred compensation program in the investments listed in ORS 294.035. ORS 294.033. See also 38 OAG 668 (1977).

The District may invest its deferred compensation funds in "fixed or variable life insurance or annuity contracts issued by life insurance companies authorized to do business in this state, for

the purpose of funding deferred compensation." ORS 294.035(9); 43 OAG 186 (1983); 40 OAG 333 (1980).

A. Potential Liability for Choice of Annuity Carrier. Assuming the participants assume the risk of the performance of the chosen annuity contracts, the District and its agents must nevertheless act prudently in choosing annuity companies.

The deferred compensation plans of public bodies are not subject to the funding and fiduciary rules of ERISA. 29 USC § 1004(b)(1). However, public officers holding public funds are in a trust or fiduciary relationship with their principals. See 40 OAG 295, 303 (1980); American Surety Co. v Multinomah County, 171 Or 287 (1943). In Oregon, fiduciaries who invest funds on behalf of their principal are subject to the prudent person rule found in ORS 128.057(1). The District, Plan One's administrator and Plan Two's advisory committee are subject to the prudent person rule in making investment decisions with respect to the plans. See 40 OAG at 304. Under the prudent person rule:

> a fiduciary shall exercise the judgment and care under the circumstances then prevailing, which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not in regard to speculation but in regard to the permanent disposition of their funds, considering the probable income as well as the probable safety of their capital.

ORS 128.057(1).

A state attorney general's opinion has noted that ORS 294.035 largely relieves a local public official of having to apply the prudent person rule with respect to determining which securities to invest in. See 40 OAG 295, 303 (1980). As discussed above, the District is permitted by statute to invest its deferred compensation funds in annuities issued by authorized insurers without respect to the 25 percent limit. See ORS 294.033, 294.035(9); 43 OAG 186 (1983); 40 OAG 333 (1980). An authorized insurer is an insurer that has a certificate of authority to transact insurance in Oregon. ORS 731.066(1). However, the District and its officials must apply the prudent person rule in determining which annuity insurer to use and which annuity contract to purchase.

As a corporate trustee, the District will be liable for the acts of its officers acting within the scope of their employment. The governing board may rely on subordinate officers, employees, etc., for information as to facts, but the ultimate question of the safety of a proposed annuity contract or other investment rests with the governing board. See III Scott on Trusts, § 225.2 (1988); See also Whitfield v Cohen, 9 EBC 1739 (SDNY 1988)

The governing board is not required to be an expert on insurance matters, but if it is not an expert, the governing board must obtain expert advice to assist them in making decisions about investments in insurance contracts and must consider the advice carefully before making any commitment of plan assets. See 60A Am Jur 2d, Pension and Retirement Funds § 621 (1988).

The governing board may not escape liability for a failed insurance carrier by delegating the decision of choice of carrier to the Plan One administrator or Plan Two advisory committee. A fiduciary must ascertain within a reasonable time whether an agent to whom the fiduciary has delegated a trust power is properly carrying out the agent's responsibilities. G. Bogert, Trusts and Trustees, § 557 at 155 (Revised 2d Ed. 1980). If a fiduciary is negligent in selecting, instructing or supervising an agent, the fiduciary will be held liable to the trust beneficiary for any resulting loss. Id. at 156-57. Thus the governing board has a duty to monitor its agents' performance with reasonable diligence and to withdraw from a particular annuity company if it becomes clear or should have become clear that the annuity company is no longer proper for the deferred compensation plan. See Whitfield v Cohen, supra, at 1747.

B. Individual Liability of Plan Administrator or Advisory Committee. It appears that while a participant may recover damages from the District, a participant may not recover directly from an officer or employee of the district to the extent the officer or employee is acting within his or her authority. See ORS 30.265(1), 30.400; Schrader v Veatch, 216 Or 105 (1959); Devlin v Moore, 64 Or 443, 448 (1913).

ORS 30.265(1) provides that while public bodies are subject to action or suit for their torts:

> The sole cause of action for any tort of officers, employees or agents of a public body acting within the scope of their employment or duties and eligible for indemnification under ORS 30.285 or 30.287 shall be an action against the public body only. The remedy provided by ORS 30.260 to 30.300 is exclusive of any other action or suit against any such officer, employee or agent of a public body whose act or omission within the scope of their employment or duties gives rise to the action or suit. No other form of civil action or suit shall be permitted. If an action or suit is filed against an officer, employee or agent of a public body, on appropriate motion the public body shall be substituted as the only defendant.

Please note that ORS 30.265(1) does not apply in the case of "malfeasance in office or willful or wanton neglect of duty." See ORS 30.265(1), 30.285(2). Similarly, with respect to actions based

on contract or quasi-contract, "an action or suit for an injury to the rights of the plaintiff arising from some act or omission of [a public officer] within its authority" may generally be maintained only against the public corporation itself. See ORS 30.310, 30.400. See also Schrader v Veatch, supra.

To the extent that claims against a public officer arise out of alleged acts or omissions occurring in the performance of the officer's duties, and do not involve malfeasance in office or willful or wanton neglect of duty, the public officer is entitled to be defended by the attorney general's office and indemnified against loss. See ORS 30.285.

C. Exculpatory Provisions. Exculpatory contracts are not favored and are strictly construed against the party seeking to limit their liability. As a general rule, liability for negligence (but not for intentional torts, willful or wanton conduct, or gross negligence) may be limited by agreement unless contrary to public policy. See generally, 57A Am Jur 2d, Negligence §§ 49-77 (1989). In addition, a party may not contract away statutory liability. Id. Thus, the District's exculpatory provisions, if effective at all, will only relieve the District of liability for negligence.

Both plans have provisions purporting to absolve the District and its agents from some or all liability. Plan One purports to relieve the District and its agents "for the non-performance of their duties, negligence, or any misconduct ... except fraud or wrongful taking ...." See Article X, § 10.03. At best, section 10.03 will only protect the District from liability based on negligence. In addition, because such provisions are strictly construed against the person seeking to limit their liability, there is a risk a court would find the provision wholly unenforceable.

Plan One also purports to require participants to indemnify the District and its agents for "all court costs and all claims for the attorney fees...." See Article X, § 10.05. For the same reasons that apply to section 10.03, the indemnification provision in section 10.05 would probably be unenforceable.

Plan Two attempts to limit the District's liability only to the extent of the investment performance of the chosen annuity contract. See Article III, § 3.4. To the extent section 3.4 is interpreted as a limitation of the District and its agent's liability for choosing plan investments, this provision will be unenforceable for the reasons discussed above. However, to the extent section 3.4 is categorized as an assumption of the risk by the participant, it operates to shift the risk of investment performance to the participant. As a general rule, a person may assume a risk, if the person knows of and appreciates the risk.

See 57A Am Jur 2d, Negligence §§ 50, 804. As a matter of practice, participants in the deferred compensation plans of public bodies assume the risk of the performance of the annuities which fund their benefits, because their payout options are tied to those annuity contracts. See 40 OAG 295 (1980); 39 OAG 47 (1978).

To the extent the exculpatory provisions in the plans are limited to negligence claims, they may nevertheless be unenforceable as against public policy. One category of agreements that offends public policy are those that exonerate an employer for future liability for injuries negligently inflicted upon employees. Though the contemplated injuries are usually physical injuries, courts may apply this rule to an agreement to limit an employer's liability for future financial injuries to its employees.

A second category of agreement that offends public policy is agreements in which the parties do not have relatively equal bargaining power. Where one is in effect compelled to submit to a stipulation relieving the other from liability for future negligence, the stipulation is invalid. One test is whether the proffered service is voluntary or not. In the District's case, the deferred compensation plans are voluntary. Another test is whether the service is available without the restriction for a higher price. While employees have alternative investment opportunities, one may argue that they have only one opportunity to invest their pretax earning: the District's deferred compensation plans. A counter argument would be that the District maintains two plans, one with exculpatory provisions (Plan One) and one without (Plan Two), therefore the employees have a choice between plans and are not compelled to accept the liability limitations in Plan One.

A third category of agreement that offends public policy is exculpatory agreements found in employee benefit plans. Such agreements are prohibited as a matter of law in all ERISA plans. See 29 USC § 1110(a). As discussed above, the District's plans are not subject to ERISA. Nevertheless, the statutory prohibition in ERISA reflects a strong public policy opposing enforcement of exculpatory provisions in employee benefit plans.

Finally, to the extent the District and its agents' duty is prescribed by statute, e.g., the fiduciary standards of ORS 128.057(1), it is against public policy to contract away that liability. Because exculpatory provisions are not favored and are strictly construed against the party seeking to limit its liability and given the various public policy considerations discussed above, the provisions found in Plan Two are probably unenforceable and should be considered to be so by the District in assessing its potential liability for investment decisions.

HERSHNER, HUNTER, MOULTON, ANDREWS & NEILL
LAW OFFICES

180 E. Eleventh Avenue
P.O. Box 1475
Eugene, Oregon 97440
Telecopy (503) 344-2025
Telephone (503) 686-8511

February 17, 1992

Ms. Phyllis Loobey
Lane Transit District
P.O. Box 7070
Eugene, OR 97401-0470

RE: House Bill 2164

Dear Phyllis:

You have asked that I review ORS 267.380(4) to suggest a possible amendment to that section.

The background for the amendment is that as part of the "reconnect" legislation (Chapter 457, § 23(a)) of the 1991 legislative session (i.e., connecting Oregon tax law to federal tax law), the definition of "wages" was amended to insert the above referenced section. Chapter 457, § 32(2) provided that the effective date of the amendment applied to tax years beginning on or after January 1, 1992.

You have informed me that Lane Transit District did not seek nor do they wish to extend the definition of wages to the categories of compensation described under ORS 267.380(4) which now provides:

> "(4) Notwithstanding any other provision of this section, 'wages' includes:
>
> "(a) Any amount included in the definition of 'wages' under section 3121 of the Internal Revenue Code, as defined in ORS 316.012, by reason of the provisions of sections 3121(a)(5)(C), 3121(a)(5)(D), 3121(v)(1)(A), 3121(v)(1)(B), 3121(v)(3)(A) or 3121(a)(5)(E) of the Internal Revenue Code; or
>
> "(b) Any amount deferred under a non-qualified deferred compensation plan."

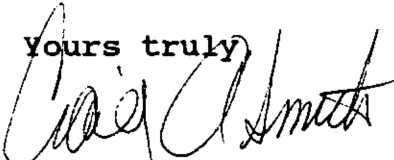
You have asked that I propose an amendment to this section which would have the effect of permitting Lane Transit District to elect not to extend the above expanded definition of "wages" for purposes of the Lane Transit District payroll tax. I would propose the following amended language:

> "Unless a District through a duly adopted ordinance elects otherwise, the term 'wages' includes the following, notwithstanding any other provisions of this section:
>
> "(a) Any amount included in the definition of 'wages' under section 3121 of the Internal Revenue Code, as defined in ORS 316.012, by reason of the provisions of sections 3121(a)(5)(C), 3121(a)(5)(D), 3121(v)(1)(A), 3121(v)(1)(B), 3121(v)(3)(A) or 3121(a)(5)(E) of the Internal Revenue Code; or
>
> "(b) Any amount deferred under a non-qualified deferred compensation plan."

The effective date would likely be January 1, 1994. If you would like any further assistance on the matter, please call.

Enclosed is a form of letter which you asked that I prepare explaining the situation to employers subject to the payroll tax.

Yours truly,



CRAIG A. SMITH

CAS:cc

Enclosure

In a letter dated January 15, 1992, you were informed by the Oregon Department of Revenue that certain deferred compensation plans, as defined in that correspondence, including 401(k) Plans, became subject to Lane Transit District taxes effective January 1, 1992. This legislation was passed in the 1991 session of the Oregon Legislature without our knowledge or support.

Upon learning of this situation, our immediate response was that the District did not wish to add this source of revenue to our payroll tax base. However, we have been advised by legal counsel that we do not have the authority under Oregon statutes to waive the imposition of this tax, unless the Oregon Legislature changes the law.

It is our current intent to lobby the legislature during the 1993 session for such a change to the law. In the meantime, we can provide you with no recourse other than to comply with the terms of ORS 267.380(4) as discussed in the letter you received from the Department of Revenue.