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**COURT OF APPEALS, DIVISION I
OF THE STATE OF WASHINGTON**

WILLIAM F. SERRES
and an Ancillary Class of Similarly Situated Persons,

Respondents,

v.

WASHINGTON STATE
DEPARTMENT OF RETIREMENT SYSTEMS
and KING COUNTY,

Appellants.

**BRIEF OF APPELLANT
DEPARTMENT OF RETIREMENT SYSTEMS**

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I. INTRODUCTION

This case requires this Court to determine whether certain payments made by King County to Mr. William Serres (and an entire group of King County employees) in settlement of a prior lawsuit are “compensation earnable” in the Public Employees’ Retirement System (PERS). If the settlement payments are “compensation earnable,” both employee and employer retirement contributions are due thereon, and the amounts may potentially be included in the calculation of the members’ monthly retirement allowances. On the other hand, if the payments are not “compensation earnable,” no retirement contributions are due thereon, and the amounts will not be included in the calculation of retirement allowances.

The PERS statute, RCW 41.40.010(8), defines “compensation earnable” as salary or wages earned by an employee in remuneration for personal services. The payments to Mr. Serres and others simply were not salary: they were made to settle protracted litigation between King County and its employees, *not* as remuneration for their services. Accordingly, the Department of Retirement Systems (the Department) entered summary judgment holding that the settlement awards were *not* “compensation earnable.” CAR 0052.¹ The Department respectfully requests this Court to

¹In this brief, CAR xx, CP xx, and VPR xx will refer to page xx of the Certified

affirm its final order.

II. ASSIGNMENTS OF ERROR

1. *September 2009 order.* CP 1033-35. In September 2005, Mr. Serres received a settlement award as a member of the *Roberts-Duncan* settlement class. In March 2008, following administrative review under the Administrative Procedure Act, the Department entered an order that Mr. Serres' settlement award *was not* "compensation earnable" under RCW 41.40.010(8). CAR 0051-65. On judicial review, the superior court erred in concluding that Mr. Serres' award *was* "compensation earnable" within the meaning of the retirement statute.

2. *First June 2009 order.* CP 900-01. In June 2009, prior to its ruling on the merits, the superior court entered an ambiguous order granting King County's Motion Regarding RCW 41.50.130(1). CP 741-46. To the extent that the order bars the Department from collecting employee and employer contributions on the "compensation earnable" of persons who received *Roberts-Duncan* settlement awards (if this Court finds those awards to be "compensation earnable" in the first instance), the order is in error.

3. *Second June 2009 order.* CP 902-03. In October 2008, King County and the Department moved the superior court to join

Administrative Record, Clerk's Papers, and Verbatim Report of Proceedings respectively.

approximately 1,900 members of the *Roberts-Duncan* settlement class who would be adversely affected if the settlement awards in question were found to be “compensation earnable.” CP 417-44, 445-54, 455-83.² The superior court erred in denying these motions.

4. *June 2010 order.* CP 1228-31. The superior court erred in granting an incentive award to Mr. Serres and attorneys’ fees to his counsel under the common fund doctrine.

III. ISSUES RELATED TO ASSIGNMENTS OF ERROR

1. Is the monetary award that Mr. Serres received, pursuant to the settlement of the *Roberts-Duncan* class action, “compensation earnable” within the meaning of RCW 41.40.010(8)?

2. If, contrary to the Department’s interpretation of the retirement statute, the monetary awards received by members of the *Roberts-Duncan* settlement class are “compensation earnable,” does the Department have the authority to collect retirement contributions on the awards?

3. In light of the potential for an adverse financial effect on approximately 1,900 members of the *Roberts-Duncan* settlement class and the potential for continued litigation arising therefrom, did CR 19 require their joinder in the judicial review proceeding?

² The Department renewed its motion in March 2009. CP 719-40.

4. If, contrary to the Department's interpretation of the retirement statute, the awards received by members of the *Roberts-Duncan* settlement class are "compensation earnable," is counsel for Mr. Serres entitled to attorneys' fees under the common fund doctrine?

IV. PROCEDURAL HISTORY

A. Two Prior Class Actions Gave Rise to the Present Litigation

In March 1997, a group of King County employees filed a Class Action Complaint for Back Pay against King County (hereinafter, the *Roberts* action). In December 2002, a second group of King County employees filed a Class Action Complaint for Wages against King County (hereinafter, the *Duncan* action). Both actions also included claims for damages, interest, and attorneys' fees. CAR 0053, 0367-87.

In August 2003, the *Roberts* and *Duncan* actions were consolidated for settlement purposes. By October 2003, the parties had settled the dispute.³ CAR 0054-55. Pursuant to the settlement agreement, settlement awards were to be calculated using a formula through which each member of the settlement class received a pro-rated portion of the settlement amount. CAR 0055-56, 0388-421. In December 2003, King County Superior Court entered an order approving the settlement. CAR 0057. The *Roberts-Duncan* settlement class consisted of approximately 2,000

³ The Department of Retirement Systems was *not* a party to the *Roberts-Duncan* action and was *not* a party to the settlement agreement. CAR 0057.

members, including Mr. William Serres. CAR 0055.

B. The Instant Litigation Began With Mr. Serres' Administrative Appeal to the Department of Retirement Systems

Before disbursing the *Roberts-Duncan* settlement awards to settlement class members, King County asked the Department whether the awards were “compensation earnable” within the meaning of the retirement statute. CAR 0058, 0454-56. In March 2005, the Department determined that the settlement awards were not “compensation earnable” under RCW 41.40.010(8). CAR 0058, 0463. Pursuant to this determination,

- (i) the *Roberts-Duncan* settlement awards were not reported to the Department as “compensation earnable” or entered into the Department’s member database;
- (ii) no retirement contributions (either employee or employer contributions) were collected on the settlement awards;⁴ and
- (iii) the settlement awards were not included in the calculation of any recipient’s PERS retirement allowance.⁵

In July 2007, Mr. Serres filed an administrative appeal with the Department under the Administrative Procedure Act, RCW 34.05,

⁴ The settlement awards paid pursuant to the *Roberts-Duncan* settlement agreement totaled \$14 million. CAR 0055. If the amount had initially been determined to be “compensation earnable,” it would have been reported to the Department electronically, and retirement contributions totaling an estimated \$1 million would have been collected immediately.

⁵ A member’s monthly retirement allowance is $x\% * AFC * \text{years of service}$. RCW 41.40.185, .620, .790. AFC is the member’s “average final compensation” over the highest two (or five) years of his career, depending on his retirement plan. RCW 41.40.010(17). If the settlement awards had been reported as “compensation earnable,” the awards could potentially have affected the determination of the recipient’s AFC period, AFC, and monthly retirement allowance.

claiming that his *Roberts-Duncan* settlement award was “compensation earnable” under the retirement statute. CAR 0060, 0566-68. King County intervened in the administrative proceeding. CAR 0547-48. Ultimately, the Department entered summary judgment, holding that Mr. Serres’ settlement award was *not* “compensation earnable.” CAR 0051-65.

C. Mr. Serres Sought Judicial Review of the Department’s Decision on Behalf of Himself and an “Ancillary Class”

In April 2008, Mr. Serres petitioned for judicial review of the Department’s final order and for certification of a class “ancillary” to the judicial review. CP 62-75.⁶ See RCW 34.05.510 (joinder and class certification as “ancillary procedural matters” in judicial review). The putative class consisted of approximately 100 members of the *Roberts-Duncan* settlement class whose retirement allowances would be improved if the settlement awards were found to be “compensation earnable.”⁷

In October 2008, both King County and the Department moved the superior court to join the remainder of the *Roberts-Duncan* settlement class (approximately 1,900 people) as necessary parties. King County and the Department asserted that these people were necessary parties because

⁶ The Petition for Review was amended twice at CP 83-109 and CP 284-99.

⁷ Mr. Serres reasoned that if the settlement awards were held to be “compensation earnable,” the awards would be attributable to prior months in which the member had performed service. For approximately 100 members of the *Roberts-Duncan* settlement class, some of these months would fall within the member’s AFC period and increase his monthly retirement allowance. For the remaining 1,900 members, no settlement awards would fall within their AFC period, and their retirement allowances would be unaffected.

they would be harmed by the result Mr. Serres sought. Specifically, they would be harmed if their settlement awards were found to be “compensation earnable” because they would be required to pay retirement contributions on the awards with no countervailing enhancement of their retirement benefits.⁸

In March 2009, King County filed a Motion Regarding RCW 41.50.130(1), asking the court for a ruling that, as a practical matter, would moot its prior request for joinder of the 1,900. King County appeared to reason that if it prevailed in this motion, the 1,900 would *not* be harmed if Mr. Serres prevailed on the merits. Accordingly, there was no need to join them in the judicial review.

In May 2009, the superior court certified an ancillary class of approximately 100, i.e., those who would benefit if Mr. Serres prevailed on judicial review. CP 874-75. The court left unresolved the question whether the 1,900 who could be adversely affected would also be joined (potentially as another ancillary class).

On June 8, 2009, the court entered an ambiguous Order Granting Defendant King County’s Motion Regarding RCW 41.50.130(1),

⁸ The retirement statutes require that contributions be paid on all “compensation earnable” *regardless* whether the compensation is included in the calculation of the member’s retirement benefit. RCW 41.04.445, 41.40.330, 41.50.125. *See also* RCW 41.45. The Department asserted (and continues to assert) that *if* the settlement awards were “compensation earnable,” *then* retirement contributions would be due on the settlement awards.

potentially holding⁹ that, *if* the settlement awards were subsequently found to be “compensation earnable,” the Department would have *no authority* to collect contributions from the 1,900, i.e., the Department would be barred from collecting approximately \$1 million in retirement contributions. In light of its ruling on the RCW 41.50.130 Motion, the superior court denied the motions to join the 1,900 people. Because the 1,900 would not be “harmed” by a ruling favoring Mr. Serres, the court apparently determined that their joinder was not required.

D. The Superior Court Entered a Final Order in September 2009, Resolving the Merits of the Case

In September 2009, the superior court held that the *Roberts-Duncan* settlement awards *were* “compensation earnable” within the meaning of the retirement statute. CP 1033-35. The Department and King County have appealed the superior court’s decision.

V. STATEMENT OF THE CASE

A. From April 1973 Through August 2001, Mr. Serres Was Enrolled in PERS Plan 1

Mr. William Serres was first employed by the Municipality of

⁹ The June 2009 order provided in relevant part, “[t]he . . . DRS Director does not have the authority to correct its records pursuant to RCW 41.50.130(1) and order King County to pay retirement contributions for those *Duncan/Roberts* class members whose retirement allowance would not be increased by the settlement payment since no overpayment or underpayment has been made to these class members.” CP 900-01.

As indicated, this language is ambiguous. Another possible meaning of the order is that (if Mr. Serres prevailed on the merits) the Department *would* have the authority to collect retirement contributions from the 1,900, *but* its authority would not derive from RCW 41.50.130. This ambiguity is discussed in more detail below.

Metropolitan Seattle (Metro) in April 1973. CAR 0058. Pursuant to a merger of Metro and King County in 1994, Mr. Serres subsequently became an employee of the County. CAR 0058. Beginning in April 1973 (when he began employment with Metro) and continuing through August 2001 (when he terminated employment with the County), Mr. Serres was continuously enrolled in PERS Plan 1. CAR 0058. In September 2001, Mr. Serres retired after 28.4 years of service with an AFC of \$8,250 per month and a retirement allowance of \$4,700 per month.¹⁰ CAR 0058.

B. In December 2003, King County Settled Two Class Action Cases Filed by Certain County Employees, Disputing Their Rates of Compensation

As indicated, in March 1997, certain employees of King County filed a Complaint for Back Pay and Declaratory Relief against the County (the *Roberts* action). The affected employees sought back pay, prejudgment interest, damages, and attorneys' fees. CAR 0053. In December 2002, before the *Roberts* action had been finally resolved, a second group of County employees filed a Complaint and an Amended Complaint for Wages and for Declaratory and Injunctive Relief against the County (the *Duncan* action). They also sought retroactive compensation, interest, damages, and attorneys' fees. CAR 0053.

¹⁰ If Mr. Serres were to prevail in this proceeding, his AFC and monthly retirement allowance would increase approximately \$100 and \$60, respectively. CAR 0059 (figures on which estimate can be made).

In October 2003, class counsel for both the *Roberts* and *Duncan* actions entered a settlement agreement with counsel for King County. In the agreement, counsel agreed to settle both actions. Pursuant to the terms of the agreement, King County *denied all liability* for back pay or retroactive compensation to any County employee. CAR 0396-97.¹¹

14. This Settlement is a compromise and is the product of serious and extended negotiations. King County's entry into this Settlement Agreement is a result of compromise and does not constitute an admission of liability

17. . . . It is understood and agreed . . . that this settlement is a compromise and nothing contained herein, including the payments are to be construed or interpreted as an admission of liability on the part of King County, by whom liability is expressly denied, or an admission as to any issue in dispute or which could have been in dispute between the Parties.

In consideration for the release of *all* the plaintiffs' claims, King County agreed to pay a total of \$24 million, allocated as follows:

\$6 million	Monetary awards to <i>Roberts</i> subclass
\$8 million	Monetary awards to <i>Duncan</i> subclass
\$4.5 million	Attorney fees and costs
\$5.5 million	Future relief, employer-related expenses, other costs

Pursuant to the Settlement Agreement, the \$8 million payable to members

¹¹ In subsequent documents related to the settlement, King County continued to include an express denial of all liability for retroactive compensation. Each of the class notices provided, "[t]his agreement is a result of compromise of disputed claims and does not constitute an admission of liability by King County." CAR 0422-28. Subsequent correspondence also provided: "Please be mindful that changes made to the payroll history for the purpose of the award eligibility determinations or the award calculation do NOT affect the County's payroll records." CAR 0429-33. *See also* CAR 0055 ("the Settlement Agreement consistently recorded the County's disclaimer of any liability, and its denial that any of the claims forming the basis of the suits were valid").

of the *Duncan* subclass was to be allocated among approximately 1,567 class members on a pro rata basis, i.e., each class member was to receive a percentage of the amount [s]he would have had earned in compensation under the plaintiffs' claims. CAR 0055, 0388-421, 0434-38.

Consistent with the requirements of IRS Revenue Ruling 72-268,¹² the Settlement Agreement provided:

Taxability of Payments

19. The payments to class members under the distribution formulas provided in this settlement are W-2 wage payments, subject to federal income tax withholding and deductions and contributions required for FICA, Medicare, and other deductions as required by law. King County shall withhold the customary amount for federal income tax purposes and shall make deductions and contributions for FICA, Medicare, and other deductions as required by law.

CAR 0056, 0398. Although the Agreement contained these explicit provisions for how the payments would be characterized and treated *for tax purposes*, it was silent with regard to how the payments would be characterized and treated *for retirement purposes*. CAR 0058.

¹² In Revenue Ruling 72-268, the IRS considered whether amounts paid by employers for previously unpaid minimum wages and unpaid overtime compensation were “wages” for purposes of the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA), and the Collection of Income Tax at Source on Wages (withholding) provision in the Internal Revenue Code. The IRS concluded that whether such amounts were paid “as a result of a judgment of a court *or* in accordance with a stipulation or settlement agreement reached by the parties involved,” the amounts were “wages” *for purposes of* FICA, FUTA, and income tax withholding. Rev. Rul. 72-268, 1972-1 C.B. 313 (emphasis added) (CP 960-01). In essence, the ruling acknowledges that settlement payments are not *actually* wages; they are only *treated as* wages for tax purposes, thereby ensuring that certain taxes will be paid on the amounts.

The Settlement Agreement further provided:

81. . . . [T]he Settlement Agreement represents a unitary whole and each and every term therein is an integral part of the entire Agreement. Pursuant to Civil Rule 23, the Court determines whether the proposed settlement as a whole is fair and reasonable and determines whether to approve or reject the entire Settlement Agreement. *Except as provided in the Agreement, the Court is not authorized to modify the terms of the negotiated settlement.*

CAR 0419-20 (emphasis added).

In December 2003, pursuant to CR 23(e), King County Superior Court entered an order approving the Settlement Agreement, as follows:

Conclusions of Law . . .

3. The Settlement Agreement, taken as a whole, is fair and reasonable.
4. The Settlement Agreement should be approved and each term therein should be a binding order of the Court.

Order

. . . it is hereby ordered:

1. The Settlement Agreement is approved.
2. Each term in the Settlement Agreement is and shall be a binding order of the Court.

CAR 0439-53.¹³ Like the Settlement Agreement, the order contained no mention of how the monetary awards were to be treated for retirement purposes.

C. Consistent With Its Statutory Authority, the Department of Retirement Systems Reviewed the Circumstances of the *Roberts-Duncan* Settlement and Determined That the Settlement Awards Were Not “Compensation Earnable”

¹³ In its Findings of Fact, the Court stated, “The Settlement Agreement itself determines the rights of class members, not this brief summary.” CAR 0448.

Following entry of the approval order, the County sought the Department's advice as to whether the monetary awards to class members were "compensation earnable" for PERS purposes. CAR 0454-56. Although it has ultimate authority under the retirement statute to determine whether a payment from an employer to an employee is "compensation earnable," the Department needs information from the employer regarding the reason for which the payment was made. WAC 415-108-445.

To complete its analysis, the Department requested additional information from King County and class counsel regarding the nature of the settlement payments. In response, King County indicated that its express denial of liability in the Settlement Agreement was tantamount to a statement that the payments *were not made* as remuneration for past services. CAR 0457-59. Subsequently, counsel for King County and class counsel confirmed that, in drafting the Settlement Agreement, the parties had no intent that the settlement awards would be deemed remuneration for past services. CAR 0460-62.

In March 2005, based on the language in the Settlement Agreement and the confirmation of counsel, the Department concluded that the monetary settlement awards were not "compensation earnable" and should not be reported to the Department as such. CAR 0463.

D. As a Member of the Settlement Class, Mr. Serres Received a Monetary Award of Approximately \$5,000

Between December 2003 and September 2005, King County completed the administrative processes required to determine the amount payable to each class member. Following the court's approval for distribution, the County sent warrants to eligible class members. CAR 0464. As a member of the *Duncan* subclass of the *Roberts-Duncan* settlement class, Mr. Serres received a gross award of approximately \$5,000. CAR 0059.¹⁴

VI. APPLICABLE LAW

The PERS statute defines "compensation earnable" as follows:

"Compensation earnable" for plan 1 members, means salaries or wages earned during a payroll period for personal services

....

(i) "Compensation earnable" for plan 1 members also includes the following actual or imputed payments, which are not paid for personal services¹⁵

RCW 41.40.010(8)(a). The statute does not define "salary" or "wages."

In 1998, the Department promulgated administrative rules intended to clarify whether certain specific types of payments from an employer to an employee were "compensation earnable" for purposes of the PERS statute. Accordingly, WAC 415-108-441 provides,

¹⁴ This was less than the amount Mr. Serres would have received as "back pay" for the period in question.

¹⁵ RCW 41.40.010(8)(a)(i)(A)-(F) lists these payments. None of these payments is relevant in this proceeding. RCW 41.40.010 is found at CP 966-72.

WAC 415-108-443 through 415-108-488 codify the department's interpretation . . . regarding classification of payments as compensation earnable in PERS Plan 1, 2, or 3. These rules will be used to determine the proper characterization of payments occurring prior to and after the effective dates of these sections.¹⁶

WAC 415-108-445(1)(a) reiterates the fundamental statutory provision that a payment from an employer to an employee is “compensation earnable” if and only if one of the following is true: (i) the payment is earned as a salary or wage for personal services provided during a payroll period; or (ii) the payment is defined to be “compensation earnable” in RCW 41.40.010(8) (even though it is not earned as a salary or wage for personal service).

WAC 415-108-445(1)(b) continues,

The department determines whether payments to an employee are compensation earnable *based on the nature*, not the name, of the payment. The department considers the *reason for the payment* and whether the reason brings the payment within the statutory definition of compensation earnable.

WAC 415-108-445(1)(b) (emphasis added). CP 973.

In the rules that follow WAC 415-108-445, the Department performs a careful analysis of the *nature* of many of the types of payments

¹⁶ In these rules, the Department appropriately did not adopt *another* agency’s definition of salary or wage. Rather, it utilized its expertise in administering the retirement statute to adopt a definition consistent with the PERS statutory scheme.

commonly paid by employers to their employees.¹⁷

- (i) WAC 415-108-453 to -459 enumerate various specific types of payments that are “compensation earnable” under the first prong of the statutory definition, i.e., salary and/or wages earned for services during a payroll period.¹⁸
- (ii) WAC 415-108-464 to -469 enumerate various specific payments that fall into the second prong of the statutory definition, i.e., payments that are defined to be “compensation earnable” even though they are not salary and/or wages.¹⁹

These lists are not exhaustive. Other payments may *potentially* be “compensation earnable.” However, if a payment is not included in these rules, it must be analyzed carefully to determine whether its nature brings it within the definition of “compensation earnable.” WAC 415-108-445.

“Retroactive salary increases” are among the enumerated payments in group (i) above. WAC 415-108-457 (CP 974). A “retroactive salary increase” is (i) a “retroactive salary payment” that (ii) is paid pursuant to one of the following:

- (a) An order or conciliation agreement of a court or administrative agency charged with enforcing federal, state, or local statutes, ordinances, or regulations

¹⁷ A chart in WAC 415-108-443 summarizes more than 30 specific payments.

¹⁸ Some of the types of payments enumerated in WAC 415-108-453 to -459 are (i) performance bonuses and (ii) salary contributed by employee to a cafeteria plan or retirement plan through a payroll deduction.

¹⁹ Some of the types of payments enumerated in WAC 415-108-464 to -469 are (i) assault pay; (ii) shared leave payments received while absent from work for medical reasons; and (iii) certain payments received while absent from work on authorized leave.

WAC 415-108-475 to -488 enumerate various specific payments that are *not* “compensation earnable” because they meet neither prong of the two-part statutory definition. These include (i) fringe benefits and (ii) disability insurance payments.

- protecting employment rights;
- (b) A bona fide settlement of such a claim before a court or administrative agency;
- (c) A collective bargaining agreement; or
- (d) Action by the personnel resources board which expressly states the payments are retroactive.

WAC 415-108-457(1). In turn, a “retroactive salary payment” is a payment of additional salary from an employer to an employee for services previously rendered by the employee. WAC 415-108-457.²⁰

Promulgated pursuant to express statutory authority, these rules have the force of law.²¹ See *Wingert v. Yellow Freight Sys., Inc.*, 146 Wn.2d 841, 848, 50 P.3d 256 (2002) (“properly promulgated, substantive agency regulations have the force and effect of law”). Thus, to analyze whether a particular payment from an employer to an employee is PERS “compensation earnable,” it is useful to work from the specific to the general. If the payment in question is one of the *specific* payments enumerated in the rules, the payment is (or is not) “compensation earnable” as indicated in the rule. However, if the payment is not specifically enumerated, the *general* rule, WAC 415-108-445, must be used to determine whether the *nature* of the payment renders it a salary or

²⁰ “A retroactive salary payment to an employee who worked during the covered period is a payment of additional salary for services already rendered.” WAC 415-108-457.

²¹ RCW 41.40.020 provides, “[t]he administration and management of the retirement system [PERS], the responsibility for making effective the provisions of this chapter [RCW 41.40] and the authority to make all rules and regulations necessary therefore are . . . vested in the department.”

wage for personal services (and therefore “compensation earnable”).

VII. ARGUMENT

A. **This Court Must Affirm the Department's Final Order Unless Mr. Serres Can Establish Its Invalidity Under the Error of Law Standard**

Judicial review of an agency’s final order is governed by RCW 34.05, the Washington Administrative Procedure Act (APA). RCW 34.05.510. The reviewing court must affirm the agency’s order unless the petitioner seeking review can demonstrate its invalidity. “The validity of agency action shall be determined in accordance with the standards of review provided in [the APA].” RCW 34.05.570(1).

After the Department dismissed his administrative appeal on summary judgment, Mr. Serres filed both a petition for judicial review and an original class action complaint in the superior court. CP 62-75. On the Department’s motion, the superior court dismissed the original class action, holding that the case would proceed strictly on judicial review of the Department’s final order. CP 675-76. As an “ancillary matter,” the court certified a class within the judicial review, consisting of approximately 100 persons similarly situated to Mr. Serres. RCW 34.05.510.

Although certification of the class was governed by the standards in CR 23, in all other regards the case is postured as the judicial review of

the Department's final order and is governed by the APA. Pursuant to the APA, this Court should affirm the Department's final order unless Mr. Serres demonstrates its invalidity under one of the statutory standards.

1. Under the Error of Law Standard, This Court Should Not Substitute Its Judgment for That of the Department Unless the Presiding Officer Was Clearly Incorrect

Only one of the enumerated APA standards—the “error of law” standard—is potentially relevant to this appeal. RCW 34.05.570(3)(d). *See* CP 284-99. Under this standard, this Court may not grant relief unless it determines that the Department “*erroneously* interpreted or applied the law.” RCW 34.05.570(3)(d) (emphasis added). The court reviews the law *de novo* and applies it to the facts in the record. However, the court may not substitute its judgment for that of the agency unless the agency’s interpretation or statement of the law is incorrect. *Franklin Cy. v. Sellers*, 97 Wn.2d 317, 325, 646 P.2d 113 (1982).²²

Although issues of law are within the court’s province to decide, courts accord substantial weight to an agency’s interpretation when an agency is interpreting the law it administers. This is especially true, where, as here, the agency has expertise in a special field of law. *Chancellor v.*

²² On judicial review, the superior court acknowledged that the question was difficult and that the Department’s interpretation had merit. “I think it’s clear to everybody that this decision has been difficult for the court. I have been greatly assisted by the excellent argument here, and I have great respect for the argument that I am ruling again[st] today.” VRP 22. Under such circumstances, the error of law standard should be applied to affirm the agency.

Dep't of Retirement Sys., 103 Wn. App. 336, 343, 12 P.3d 164 (2000). See also *Grabicki v. Dep't of Ret. Sys.*, 81 Wn. App. 745, 752, 916 P.2d 452 (1996) (courts have consistently deemed the Department to have expertise in the specialized field of retirement law).

In both *Grabicki* and *Chancellor*, the court addressed issues very similar to the issue raised in this proceeding—whether a particular payment from an employer to an employee was “basic salary” within the meaning of the Law Enforcement Officers’ and Fire Fighters’ Retirement System (LEOFF) and, therefore, includible in the employee’s retirement calculation.²³ In *Chancellor*, the Department had found that “vacation conversion pay” was not “basic salary” within the meaning of the LEOFF statute. In upholding the Department’s analysis of “vacation conversion pay,” the court said,

[T]he Department is charged with administration of retirement plans, and the statute is technical and falls within the agency’s area of expertise. Consequently, we afford the agency’s interpretation . . . substantial weight.

Chancellor, 103 Wn. App. at 343.²⁴

2. Deference to the Department’s Interpretation of “Compensation Earnable,” as Set Forth in Its Regulations, Is Appropriate

²³ LEOFF “basic salary” is the statutory counterpart of PERS “compensation earnable.”

²⁴ In both *Grabicki* and *Chancellor*, the superior court had reversed the Department’s Final Order on judicial review. In both cases, the court of appeals reinstated the Department’s determination.

In the superior court, Mr. Serres argued that the court should give no deference to the Department's interpretation of "compensation earnable" as set forth in its properly promulgated rules, and in fact, should ignore the Department's rules entirely. CP 1019-22. To the contrary, the rules cannot simply be ignored. As legislative rules necessary for the implementation of the PERS statute, the Department's rules regarding "compensation earnable" have the force and effect of law and bind this Court's decision. *See Ass'n of Wash. Bus. v. Dep't of Rev.*, 155 Wn.2d 430, 446-47, 120 P.3d 46 (2005).

Further, the Department's interpretation of these rules is entitled to deference. Just as an agency's interpretation of its governing statute is entitled to deference, so is the agency's interpretation of its own properly promulgated rules implementing that statute. Indeed, in *Silverstreak, Inc. v. Dep't of Labor & Indus.*, 159 Wn.2d 868, 884-85, 154 P.3d 891 (2007) (emphasis added), the Washington Supreme Court

made clear that [it would] give great deference to an *agency's interpretation of its own properly promulgated regulations*, "absent a compelling indication" that the agency's regulatory interpretation conflicts with legislative intent or is in excess of the agency's authority. . . . We give this high level of deference to an agency's interpretation of its regulations because the agency has expertise and insight gained from administering the regulation that we, as the reviewing court do not possess.

Under the error of law standard, the Department did not err in

grounding its analysis of “compensation earnable” in its rules and did not err in its interpretation of those rules. Under the standard articulated in *Silverstreak*, Mr. Serres has provided no “compelling indication” that the Department’s interpretation conflicts with legislative intent or exceeds the Department’s authority. Just as the court appropriately deferred to the Department’s interpretation of the technical statutory term “basic salary” in *Grabicki* and *Chancellor*, this Court should defer to the Department’s interpretation of “compensation earnable” as set forth in its rules.

B. The Monetary Award Paid to Mr. Serres Pursuant to the *Roberts-Duncan* Settlement Is Not “Compensation Earnable” Under RCW 41.40.010(8) or the WACs Interpreting It

Payments made from employers to employees are “compensation earnable” only if (i) they are salary and/or wages for services performed; or (ii) they are defined by statute to be “compensation earnable” even though they are not salary or wages. RCW 41.40.010(8); WAC 415-108-445. Only the first category is at issue in this appeal.

Consistent with the organization of the Department’s rules, a full analysis of Mr. Serres’ settlement award logically proceeds from the specific to the general:

- (a) a determination whether the award was one of the *specific* payments enumerated in WAC 415-108-453 to -459 (and therefore, “compensation earnable”); and if not,
- (b) a determination whether the settlement award is a salary and/or wage (and, therefore, “compensation earnable”)

under the more *general* provisions of WAC 415-108-445.

The Department concluded that it was neither. CAR 0061-65.

1. Mr. Serres' Award Is Not "Compensation Earnable" Within the *Specific* Terms of WAC 415-108-457

To qualify as "compensation earnable" under WAC 415-108-457, a payment from an employer to an employee must be a "retroactive salary increase"; i.e., it must *both*

- (i) be a "retroactive salary payment;" and
- (ii) be paid pursuant to one of the four arrangements in WAC 415-108-457(1).

In turn, a "retroactive salary payment" is a payment of additional salary from an employer to an employee. WAC 415-108-457.

The monetary award Mr. Serres received pursuant to the *Roberts-Duncan* settlement is not a retroactive salary payment in the first instance. Thus, it cannot be a "retroactive salary increase" pursuant to WAC 415-108-457. And, therefore, the award does not qualify as "compensation earnable" pursuant to the rule. CAR 0063.

a. Mr. Serres' Award Was Not a Retroactive Salary Payment Under WAC 415-108-457

As recognized in the Department's final order, "[t]he dispute in this case . . . centers on whether the payment was a retroactive salary payment" in the first instance. CAR 0063. A "retroactive salary payment" is a payment of additional salary from an employer to an employee for

services previously rendered by the employee. WAC 415-108-457. “Salary” is not defined in the PERS statute or rules. In the absence of a statutory definition, the Department relied on the dictionary definition of the term, i.e., *remuneration for the services* of an employee.²⁵ *Webster’s II New Riverside Dictionary* 1032 (3d ed. 1994). If a payment is *not* remuneration for services, it simply cannot be “salary.”

To determine whether the settlement award received by Mr. Serres was a “retroactive salary payment,” the Department considered the *nature* of the award to ascertain whether it truly was paid in remuneration for services previously rendered. *See* WAC 415-108-445.²⁶ For the reasons that follow, the Department concluded that the award was not salary, and ipso facto, not a retroactive salary payment. CAR 0062-64.

In the *Duncan* class action, filed in December 2002, the plaintiffs *claimed* that they were entitled to an increased rate of salary effective in 1998 and a retroactive salary payment (i.e., additional salary) for the pay periods between 1998 and 2002. Throughout the pre-trial phases of the litigation, King County consistently *denied* that the plaintiffs were entitled

²⁵ “Absent a specific statutory definition, . . . a non-technical term may be given its dictionary definition.” *State v. Chester*, 133 Wn.2d 15, 22, 940 P.2d 1374 (1997).

²⁶ To analyze a payment under WAC 415-108-457 to determine whether it is a “retroactive salary payment,” the Department must refer to WAC 415-108-445 to determine whether it is a “salary payment.” In essence, WAC 415-108-457 simply clarifies that *certain* salary payments will be deemed “compensation earnable” even though they are made “retroactively.”

to either an increased rate of salary or a retroactive salary payment.

In October 2003, the County entered into a Settlement Agreement with plaintiffs' counsel. In the Agreement, the County *expressly denied all liability*. Through this general denial, the County in effect denied that the plaintiffs were entitled either to an increased salary rate or to a retroactive salary payment in remuneration for their past services. Thereafter, the County continued to deny all liability to the plaintiff class in the class notices, in correspondence with class members, and on its website.

In 2005, the PERS Plan Administrator contacted counsel for both King County and the *Duncan* class to confirm that the settlement payments were not additional salary for past services. Counsel for King County confirmed that the settlement payments were not intended to be paid and were not paid as additional salary for past services; class counsel did not disagree. CAR 0460-62.

If the County had indicated (i) that it had in fact owed additional remuneration to each *Duncan* class member; and (ii) that, through the settlement, it agreed to pay each class member some or all of the amount actually owed on account of the member's past service to the County, *then* such payment may arguably have been a "retroactive salary payment" and "compensation earnable." However, the County *never* indicated that the monetary amounts paid in settlement were in any way *earned by* or *due to*

the class members as salary. To the contrary, the County consistently indicated that the monetary awards were paid in consideration for the release of the plaintiffs' claims, strictly to terminate the protracted litigation. Because the settlement payments were not remuneration for past services, they were not "retroactive salary payments" within the meaning of WAC 415-108-457.

Because the settlement awards were not "retroactive salary payments" in the first instance, they are not "retroactive salary increases" within the meaning of the rule. WAC 415-108-457. CAR 0064.

b. The Characterization of the Settlement Awards as "W-2 Wages" for Federal Tax Purposes Does Not Render Them "Retroactive Salary Payments" for Purposes of the Retirement Statute

The fact that the *Roberts-Duncan* settlement agreement characterized the settlement awards as "W-2 wages" *for tax purposes* may create the misimpression that the awards were wages (and therefore "compensation earnable") *for retirement purposes*. However, the fact that the awards may have been treated as wages for certain purposes does not mean that they were wages for purposes of the retirement statute. CAR 0063-64.

(1) Consistent With IRS Requirements, the Settlement Awards Were Characterized as "Wages" for Taxation Purposes

In general, when parties settle a case, they must determine whether

some or all of the settlement payment will be treated as “wages” and/or “income” *for federal taxation purposes*. See IRS Tech. Adv. Mem. 2002-44-004 (Nov. 1, 2002) (CP 975-83). Various IRS documents and the case law interpreting them provide the necessary guidance for how the parties characterize the settlement amounts for tax purposes:

[w]hether an amount received in settlement of a dispute is . . . subject to employment tax depends on the nature of the item for which the settlement is a *substitute*.

Id. (CP 979). Accordingly, Revenue Ruling 72-268 requires that to the extent that payments made to settle wage claims are a substitute for “back wages,” they are “taxable wages” for purposes of FICA and federal withholding. Rev. Rul. 72-268, 1971-1 C.B. 313 (CP 960-01).

The parties’ characterization of some of all of a settlement amount as “wages” for tax purposes “is generally binding for tax purposes.” TAM 2002-44-004 (CP 980). However, the IRS may override the characterizations set forth in any settlement agreement to which it was not a party. Thus, parties to a settlement may not characterize settlement payments as non-wage payments simply to avoid taxation. Indeed, either the IRS or a court may reverse the parties’ characterization in a settlement agreement if it finds that the characterization does not “accurately reflect the realities of the petitioner’s underlying claims.” *Id.*

The *Roberts-Duncan* settlement is consistent with these tax rulings.

The parties characterized the \$14 million settlement award as “W-2 wages” in paragraph 19 of the Settlement Agreement *for tax purposes*. In so doing, they did not signify that the settlement awards *were* back wages, only that they were paid as a “substitute for” back wages and were, therefore, taxable.

(2) The Federal Scheme for Federal Taxation Does Not Require the Department to Characterize the Settlement Awards as “Wages” for Retirement Purposes

The fact that the County was required to treat and did treat the payments as “W-2 wages” for certain tax purposes does not make them “retroactive salary payments” for retirement purposes. Whether the payments are salary and “compensation earnable” *for retirement purposes* must be determined strictly by the retirement law, not by the way they are characterized *for other purposes*.

This reasoning is well expressed in a Seventh Circuit case, *Licciardi v. Kropp Forge Division Employees’ Retirement Plan*, 990 F.2d 979 (7th Cir. 1993) (CP 996-1002). In *Licciardi*, a chief operating officer (who had been paid \$650,000 in settlement of a *claim* for additional compensation for past services rendered) argued that the payment must be considered “earnings” and included in his retirement calculation.²⁷ The

²⁷ Similar to PERS, the retirement plan in question provided a defined benefit based in part on “earnings” for the employee’s highest earning five years with the

court analyzed the issue as a matter of “multiple contractual interpretation”: (i) interpretation of Licciardi’s severance contract, (ii) interpretation of Licciardi’s pension contract, and (iii) interpretation of a release-of-liability contract. The severance contract had provided that the employer would pay Licciardi “the sum of \$650,000 in settlement of [his] claim with respect to his right to additional compensation for past services rendered.” *Licciardi*, 990 F.2d at 981 (CP 999). In a paragraph captioned “Tax Treatment,” the severance contract stated that the payment was “compensation for services rendered” and “will be so reported by the Company on its federal and state income tax returns.” *Id.*

The *Licciardi* court held that this characterization of the settlement payment in the *severance contract* (done for tax purposes) did not control the analysis of the payment under the terms of the *pension contract*. Rather, the terms of the pension contract governed the analysis of whether the settlement payment was or was not “earnings” for purposes of the member’s retirement calculation. After considering the terms of the pension contract, the court concluded that the settlement payment was not “earnings” within the meaning of the pension plan. *Id.*

As in *Licciardi*, the fact that the *Roberts-Duncan* settlement payments were required to be characterized and were characterized as

employer. *Licciardi*, 990 F.2d at 983.

W-2 wages *for tax purposes* does not control the analysis of whether the payments are “retroactive salary payments” under the terms of the PERS plan. When analyzed under the PERS statute and regulations, the settlement payments are not “retroactive salary payments” and, therefore, not “compensation earnable.”

c. The Fact That the Settlement Award Was Referred to as “Back Compensation” in the Approval Order Does Not Mean That It Was a “Retroactive Salary Payment” for Purposes of the Retirement Statute

The fact that the superior court’s order approving the *Roberts-Duncan* settlement agreement referred to the settlement awards as “back compensation” may also create the misimpression that the awards *were* back compensation (and therefore “compensation earnable”). However, the fact that the awards were loosely referred to as “back compensation” cannot convert them into something they were not.

Under fundamental class action law, “[a] class action shall not be dismissed or compromised without the approval of the court” CR 23(e). “[I]t is universally stated that a proposed class settlement may be approved by the trial court if it is determined to be ‘fair, adequate, and reasonable.’” *Pickett v. Holland Am. Line-Westours, Inc.*, 145 Wn.2d 178, 188, 35 P.3d 351 (2001).

However, this approval process must be “a delicate [and] largely

unintrusive inquiry by the trial court.”

[T]he court's intrusion upon what is otherwise a private consensual agreement negotiated between the parties to a lawsuit must be limited to the extent necessary to reach a reasoned judgment that . . . the settlement, taken as a whole, is fair, reasonable and adequate to all concerned. . . .

[Most importantly, n]either the trial court nor [an appellate] court is to reach any ultimate conclusions on the contested issues of fact and law which underlie the merits of the dispute, for it is the very uncertainty of outcome in litigation and avoidance of wasteful and expensive litigation that induce consensual settlements.

Id. at 189-90 (emphasis in original).

In one paragraph of its order approving the *Roberts-Duncan* settlement, King County Superior Court referred to the settlement payments as “back compensation.” CAR 0444. However, this reference by the court must not be deemed to have converted the *Roberts-Duncan* settlement awards into “back compensation.” If the court’s reference were so interpreted, the court would have ruled on “a contested issue underlying the dispute,” undermining the purpose of the settlement agreement entirely. *See Pickett*, 145 Wn.2d at 190. The superior court must not be deemed to have exceeded its authority in this fashion.

Pursuant to CR 23(e), the superior court simply approved the settlement as fair and reasonable, stating that “each term in the Settlement Agreement is and shall be a binding order of the Court.” CAR 0453. The Settlement Agreement, as approved, itself provided that the court was “not

authorized to modify the terms of the negotiated settlement.” CAR 0420. Thus, the single reference to “back compensation” in the approval order must not be deemed to modify the terms of the settlement agreement, wherein the settlement payments are consistently and deliberately referred to as “monetary awards.”

In summary, even if the language used in the settlement agreement and the approval order was necessary for certain purposes, such language did not and does not convert the settlement awards into something they are not, i.e., it does not convert them into remuneration for past services for purposes of the retirement statute. Accordingly, the payments are neither retroactive salary payments (nor “compensation earnable”) under WAC 415-108-457.

2. Mr. Serres’ Award Is Not “Compensation Earnable” Within the *General* Terms of WAC 415-108-445

As previously indicated, a full analysis of Mr. Serres’ settlement award logically proceeds from the specific to the general. Mr. Serres’ award meets none of the specific requirements. It was not “compensation earnable” within the meaning of WAC 415-108-457 (retroactive salary increases). Nor was it “compensation earnable” pursuant to any *other specific* rule from WAC 415-108-453 to -459.²⁸

Under the *general* rule, WAC 415-108-445, a payment is

²⁸ Mr. Serres has never asserted that it was.

“compensation earnable” only if it is salary for services rendered. To determine whether the settlement award received by Mr. Serres was a salary, the Department was required to consider the *nature* and *reason* for the payment to ascertain whether it truly was paid in remuneration for services rendered. However, this analysis had already been performed to determine that the award was not a “retroactive salary payment” for purposes of WAC 415-108-457. It simply was not a salary payment of any kind (retroactive or otherwise). *See supra* Part VII.B.1.a.

In the proceedings below, Mr. Serres argued that the fact that the *amount* of the settlement award was, in some cases, equal to the *amount* of back pay claimed by an individual settlement class member required a conclusion that the settlement awards were salary.²⁹ CP 1014-32. This argument must fail. Neither the amount of a payment from an employer to an employee nor the method through which the amount is calculated is relevant in determining its “nature,” as required by WAC 415-108-445. CAR 0063-64. A payment from an employer to an employee is “compensation earnable” only if it is paid *in remuneration for services*. The language of the Settlement Agreement makes clear that the nature of the settlement awards was not remunerative. They were not “compensation earnable,” and the Department did not err in so concluding.

²⁹ Mr. Serres’ settlement award was less than the amount of back pay he claimed to have been owed. CAR 0059.

C. If the Settlement Award Is “Compensation Earnable” for Mr. Serres, It Is “Compensation Earnable” for Every Other Member of the *Roberts-Duncan* Settlement Class and Retirement Contributions Are Due Thereon

If this Court concludes that the settlement award received by Mr. Serres *was not* “compensation earnable” within the meaning of the retirement statute, the Department’s second and third assignments of error (and associated issues) are moot. However, if the Court concludes that the settlement award received by Mr. Serres *was* “compensation earnable” (which the Department does not concede), the second and third assignments of error must be addressed.

The Department’s second assignment of error relates to the superior court’s June 2009 order regarding the Department’s authority under RCW 41.50.130(1).³⁰ Entered prior to the superior court’s ruling on the substantive issue, the order was conditional in nature: it was to have effect *only if* Mr. Serres’ settlement award was subsequently determined to be “compensation earnable.”

The order appears to affect the 1,900 persons who received *Roberts-Duncan* awards, but were not included in the ancillary class.

³⁰ The June 2009 order granted King County’s motion, seeking “an order determining that RCW 41.50.130(1) does not allow the DRS Director to collect retirement contributions from King County for those individuals whose retirement allowance would not change if the *Roberts-Duncan* settlement payments are determined to be compensation earnable since no underpayment or overpayment has been made which is necessary to invoke DRS’ statutory correction authority.” CP 741.

However, the precise effect is unclear. The order provides,

The . . . Department . . . does not have the authority to correct its records pursuant to RCW 41.50.130(1) and order King County to pay retirement contributions for those *Duncan/Roberts* class members whose retirement allowance would not be increased by the settlement payment since no overpayment or underpayment has been made to these class members

CP 900-01. To the extent that this [conditional] order³¹ would either

- (i) prohibit the Department from correcting its records to include the *Roberts-Duncan* settlement awards as “compensation earnable” for the 1,900; or
- (ii) prohibit the Department from collecting retirement contributions from the settlement awards of the 1,900,

it is in error.

1. If the *Roberts-Duncan* Settlement Awards Are “Compensation Earnable” for Mr. Serres (and the Ancillary Class), Then the Department May Correct Its Records to Show That the Awards Received by the 1,900 Are Also “Compensation Earnable”

In its motion, King County argued that, if the *Roberts-Duncan* settlement awards were determined to be “compensation earnable,” the Department would have no authority under RCW 41.50.130 to correct its records accordingly. Rather, the County argued, the Department’s authority under RCW 41.50.130 was narrowly limited to the correction of situations in which the Department had overpaid or underpaid benefits to

³¹ To reiterate, the order is conditional because the Department would have no need to correct its records or collect retirement contributions from the 1,900 *if* the settlement awards are not “compensation earnable” in the first instance.

its members. CP 741-45.

To the contrary, in RCW 41.50.130, the legislature delegated to the Department a much broader authority to correct errors in its records. The statute provides, “The director may at any time correct errors appearing in the records of the retirement systems listed in RCW 41.50.030.” RCW 41.50.130(1). RCW 41.50.130 “*does not limit* correctable errors to reporting [errors] or other specific types of errors.” *City of Pasco v. Dep’t of Ret. Sys.*, 110 Wn. App. 582, 589, 42 P.3d 992 (2002) (emphasis added). Indeed, “[t]here is no qualifying or limiting language before the word ‘errors’ in the statute.” *Id.*

In *City of Pasco*, the court affirmed the breadth of the Department’s authority to correct errors in its records. In that case, a member’s *plan membership* had been shown incorrectly in the Department’s records for 20 years. Recognizing this error, the Department had invoked RCW 41.50.130 to correct its records to reflect the fact that the member should have been enrolled in LEOFF Plan 1 (rather than LEOFF Plan 2) 20 years prior. This correction in the Department’s records had various statutory ramifications: among other things, both the member and his employer were required by statute to pay additional retirement contributions for the intervening 20 years.

Over the employer’s objection, the court held that the Department

did have the authority under RCW 41.50.130 to correct its *membership records*. Indeed, “the Department may correct a flawed eligibility determination ‘at any time,’ whether it does so on its own initiative or at the request of an enrollee.” *City of Pasco*, 110 Wn. App. at 596. In so doing, the court held, the Department would meet its obligation for “full compliance” with the retirement statute. *Id.* at 596-97.

Consistent with *City of Pasco*, WAC 415-108-820 provides that a variety of potential errors in the PERS records may be corrected, including without limitation, errors in service credit records, membership records, and benefit calculations.³²

The present case is “on all fours” with *City of Pasco*. In 2005, the Department determined that the *Roberts-Duncan* settlement awards were not “compensation earnable.”³³ Based on this determination, King County did not “report” the settlement awards to the Department through an electronic transmittal, and, as a result, the awards were not entered into the PERS records of individual members as “compensation earnable.”

³² See also RCW 41.50.131 (specifically dealing with the correction of errors in reporting “compensation earnable”). If RCW 41.50.130 did not empower the Department to correct *all* errors in its records, *including the erroneous reporting of “compensation earnable,”* there would have been no need for the legislature to have made a specific provision that the Department was not required to correct erroneous reporting of standby pay that occurred prior to June 1994. RCW 41.50.131 recognizes that after 1994, when standby pay is incorrectly reported as “compensation earnable,” the reporting error *must* be corrected.

³³ The Department’s decision applied to Mr. Serres and all 2,000 members of the *Roberts-Duncan* settlement class.

If, contrary to the Department's determination, this Court were to rule that the *Roberts-Duncan* settlement awards were "compensation earnable," then the Department's existing records would be in error because they would not contain the correct "compensation earnable" for any of the 2,000 members of the *Roberts-Duncan* settlement class.³⁴ Under these circumstances, RCW 41.50.130 would empower the Department to correct this error in order to bring its records into compliance with the retirement statute.³⁵ To the extent that the June 2009 order provides otherwise, it is in error.

2. If the *Roberts-Duncan* Settlement Awards Are "Compensation Earnable," Retirement Contributions Thereon Are Required by Statute

If the *Roberts-Duncan* settlement awards are "compensation earnable," retirement contributions are absolutely due thereon. To the extent that the superior court ruled to the contrary in the June 2009 order, this Court should reverse that decision.

³⁴ In *Williams v. Poulsbo Rural Tel. Ass'n*, 87 Wn.2d 636, 555 P.2d 1173 (1976), the Supreme Court recognized the effect of a judgment regarding the rights of one pension plan member on the rights of other members of the same pension plan. A former employee of a dissolved corporation had sought a declaratory judgment as to her rights under certain pension and profit sharing plans. The Court held that its interpretation of the plan would "define the rights of all the other former employees" who were members of the plan. *Poulsbo*, 87 Wn.2d at 646 (emphasis added).

As in *Poulsbo*, the 1,900 members of the *Roberts-Duncan* settlement class are identically situated to the 100 members of the ancillary class for whom the *Roberts-Duncan* settlement awards have already been found to be "compensation earnable." Each of the 2,000 members had a wage claim against King County; each fully released that claim in exchange for a settlement award; and each received a settlement award.

³⁵Not only would the Department be authorized to correct these errors, it would be obligated to do so. See *City of Pasco*, 110 Wn. App. at 596-97.

A correction in the Department's records pursuant to RCW 41.50.130 may have additional statutory ramifications. For example, in *City of Pasco*, the employer objected to the correction of the member's plan membership precisely because the statutory ramification of that correction was that retirement contributions (including employer contributions) would have to be collected at a higher rate for the intervening 20 years. Similarly here, the statutory ramification of reporting additional "compensation earnable" for members of the *Roberts-Duncan* settlement class is that additional retirement contributions must then be collected thereon.

The members of the *Roberts-Duncan* settlement class are members of the Public Employees' Retirement System (PERS), either Plan 1, Plan 2, or Plan 3. For each of these plans, the PERS statute (RCW 41.40) requires *both* member and employer contributions to the plan. In each case, the required contributions are a percentage of the member's "compensation earnable."

Specifically, the PERS statutes require *employee* contributions on "compensation earnable" from each active member. See RCW 41.40.330(1) (Plan 1); RCW 41.45.061(4) and .067(3) (Plan 2); and RCW 41.34.040(1) and .020(4)(c) (Plan 3). PERS members are deemed to agree to the foregoing contributions as a condition of employment.

RCW 41.40.042. Similarly, PERS *employers* are required to make employer contributions on the total “compensation earnable” of their employees. *See* RCW 41.45.050(1), 41.40.048(2).

Employee and employer contributions are necessary to fund PERS benefits. RCW 41.45.010. Contribution rates are established after detailed actuarial analysis and reviewed every second year to ensure the long-term funding of the systems. Timely payment of these contributions by employees and employers alike is essential for the adequate funding of the pension systems. Collection of both member and employer contributions *over each employee’s entire career* is actuarially required to fund the benefits payable from the systems. *See generally* RCW 41.45. *See also* RCW 41.50.125 (Findings).

The retirement statute and policy could not be clearer. If the settlement awards of Mr. Serres and all other members of the *Roberts-Duncan* settlement class are “compensation earnable” (not conceded), both employee and employer contributions are due thereon. To the extent that the June 2009 order provides otherwise, it is in error.

D. Joinder of the 1,900 Would Promote Judicial Economy by Foreclosing Further Piecemeal Litigation in This Case

As previously indicated, if this Court concludes that the settlement award received by Mr. Serres *was not* “compensation earnable” within the

meaning of the statute, the Department's third assignment of error is moot. However, if the Court concludes that the settlement awards received by Mr. Serres (and the entire settlement class) *were* "compensation earnable," the Court should then reach the Department's third assignment of error—the superior court's failure to join all 2,000 members of the *Roberts-Duncan* settlement class in this proceeding. CP 902-03.

Initially, Mr. Serres moved the superior court (i) to join the subgroup of the *Roberts-Duncan* settlement class who stood to benefit from a decision that the settlement awards were "compensation earnable" (approximately 100 members) and (ii) to certify them as an ancillary class in the judicial review pursuant to RCW 34.05.510. Citing RCW 41.50.130, the Department informed the court that it was not necessary to join the 100 in order to protect their interests. Rather, the Department explained, if the settlement award were determined to be "compensation earnable" for Mr. Serres as an individual, the awards would be "compensation earnable" for all 2,000 members consistent with the principles underlying the doctrine *stare decisis*, and the Department would correct its records accordingly. CP 417-18, 473-74. *See Poulsbo*, 87 Wn.2d at 646.

However, in the alternative, if the superior court were to decide to join (and certify) the 100, the Department asked the court to join all 2,000 members of the *Roberts-Duncan* settlement class. CP 455-75. Although

the Department had clear authority to correct the records of the 2,000 (whether or not they were joined in the proceeding), complete relief for the Department, the County, and the *Roberts-Duncan* settlement class could only be accomplished through their joinder.

1. Joinder of the 2,000 Was Not Required as a Prerequisite to the Correction of Their Accounts Pursuant to RCW 41.50.130

As a preliminary matter, it is important to note that joinder of the 2,000 was not required as a prerequisite to the correction of their accounts under RCW 41.50.130. Included within the Department's broad authority to implement and administer the retirement statute is the authority to correct errors in the records of individual members. RCW 41.40.020, 41.50.130. Nothing in RCW 41.50.130 requires the Department to make retirement system members party to a lawsuit before making necessary corrections in their accounts. Rather, RCW 41.40.068 guarantees that

[a]ny person aggrieved by [a] decision of the department affecting his or her legal rights, duties, or privileges . . . [may] file with the director [of the Department] . . . a notice for hearing before the director's designee.

RCW 41.40.068. Such hearing provides members procedural due process and a full opportunity to be heard. *See also* RCW 34.05.413.

2. Complete Relief for the Existing Parties Required Joinder of the Unjoined Members of the *Roberts-Duncan* Settlement Class

CR 19(a) provides,

A person . . . shall be joined as a party in the action if

1. In his absence complete relief cannot be accorded among those already parties

If the relief granted to the parties within an action could lead to further litigation between an existing party and an unjoined party, “complete relief” has not been granted. Thus, if the relief granted amongst the parties to a proceeding adversely affects the legal rights of an unjoined party (but does not *bind* the unjoined party), the unjoined party may bring suit against one or both of the parties to the original proceeding. As a result, neither of the parties to the original proceeding has been accorded “complete relief.”³⁶

The principle of judicial economy suggests that the goal of litigation should be to settle “disputes by wholes, whenever possible,” i.e., to provide complete relief and closure to the litigating parties. *Republic of the Philippines v. Pimentel*, 553 U.S. 851, 128 S. Ct. 2180, 2193, 171 L. Ed. 2d 131 (2008). Judicial economy is not served when a court resolves issues between parties that *are* present in the litigation, and such resolution leads to further piecemeal litigation between these parties and absent parties.

The portion of the *Roberts-Duncan* settlement class who would be

³⁶ See, e.g., *Nolan v. Snohomish Cy.*, 59 Wn. App. 876, 880, 802 P.2d 792 (1990); *Veradale Valley Citizens’ Planning Comm’n v. Bd. of Cy. Comm’rs*, 22 Wn. App. 229, 588 P.2d 750 (1978).

harmful by the result Mr. Serres seeks (i.e., the 1,900) were necessary parties under CR 19(a) because complete relief to the Department was impossible in their absence. Indeed, if Mr. Serres were ultimately to prevail on the underlying legal issue regarding “compensation earnable” and retirement contributions on those amounts were then required, *each* of the 1,900 members would be required to make contributions on his or her own “compensation earnable” with no corresponding increase in his or her retirement calculation. Under RCW 41.40.068, each of these members would have the right to request an administrative hearing to challenge the Department’s determination.

To ensure complete relief to King County and the Department, all members of the *Roberts-Duncan* settlement class must be joined as necessary parties in this proceeding. To the extent that the superior court’s June 2009 order found otherwise, it is in error.

E. Mr. Serres Should Not Be Permitted to Seek Attorneys’ Fees Under the Common Fund Doctrine in Lieu of the Equal Access to Justice Act

The superior court granted in excess of \$290,000 in attorneys’ fees under the common fund doctrine. From this amount, \$20,000 was to be paid to Mr. Serres as an incentive award. CP 1228-31.

The superior court’s order on attorneys’ fees is in error. On one hand, if Mr. Serres’ prior settlement award was *not* “compensation

earnable” in the first instance, no common fund will have been created and no attorneys’ fees will be payable under a common fund theory. On the other hand, if the award *was* “compensation earnable” (not conceded), the superior court erred in applying the common fund doctrine for the determination of fees on judicial review. Rather, any award of attorneys’ fees on judicial review should be circumscribed by the requirements of the Equal Access to Justice Act (EAJA, RCW 4.84.340-.360).

This is an issue of first impression in the State of Washington.³⁷ It requires this Court to consider how the EAJA should be applied in a judicial review proceeding under the APA in which an “ancillary class” has been joined pursuant to RCW 34.05.510. Where the meaning and applicability of an attorney fee statute is at issue, a trial court's decision to award or not award attorneys’ fees is reviewed de novo as a question of law. *Wachovia SBA Lending v. Kraft*, 138 Wn. App. 854, 858-59, 158 P.3d 1271 (2007). Accordingly, whether the EAJA circumscribes and limits the award of attorneys’ fees on judicial review, preempting the use of any other equitable theory, is a question of law, reviewable de novo by this Court.

- 1. When the Legislature Has Enacted a Clear Statutory Provision Regarding the Availability of Fees, the Courts Must Not Provide an Equitable Alternative**

³⁷ Counsel for the Department has found no case that discusses this exact issue.

The United States Supreme Court has said, “The [American] rule . . . has long been that attorneys’ fees are not ordinarily recoverable [by the prevailing party] in the absence of a statute or enforceable contract providing therefor.” *Fleischmann Distilling Corp. v. Maier Brewing Co.*, 386 U.S. 714, 717, 87 S. Ct. 1404, 18 L. Ed. 2d 475 (1967) (CP 1137). Limited, judicially created, exceptions to the American rule have developed to address situations in which “overriding considerations of justice seem[] to compel” an award of fees. *Id.* at 718 (CP 1138). Among these limited equitable exceptions is the common fund doctrine. *See also Wagner v. Foote*, 128 Wn.2d 408, 416, 908 P.2d 884 (1996) (Washington statement of American rule).

Under the American rule, when there is *no statute or contract* that governs the award of attorneys’ fees in a particular judicial proceeding, a court may consider recognized “equitable exceptions” to determine whether they may be used to provide attorneys’ fees to the prevailing litigant. *Blue Sky Advocates v. State*, 107 Wn.2d 112, 123, 727 P.2d 644 (1986). However, if there *is* an applicable statute and that statute prohibits an award of attorney fees in a particular case (or allows an award only under limited circumstances), the Washington courts will not resort to the common fund doctrine or any other equitable principle to provide that which is not provided by statute. *Delagrave v. Empl. Sec. Dep’t.*, 127 Wn.

App. 596, 111 P.3d 879 (2005); *Leischner v. Alldridge*, 114 Wn.2d 753, 757, 790 P.2d 1234 (1990).³⁸

Indeed, the party seeking an award of attorneys' fees

must also demonstrate that the Legislature *has not preempted such an award by statute*. If the merits of the litigation fall within a statutory scheme which prohibits the award of attorney fees, or allows such an award under narrow circumstances, a party cannot enlarge those circumstances by reference to the common fund doctrine or other equitable powers of the trial court.

Leischner, 114 Wn.2d at 757 (emphasis added). Courts simply do not have authority to award attorneys' fees in excess of the controlling statutory scheme. *Costanich v. Dep't of Soc. & Health Servs.*, 164 Wn.2d 925, 934, 194 P.3d 988 (2008).³⁹

³⁸ See also *Alyeska Pipeline Serv. Co. v. Wilderness Soc'y*, 421 U.S. 240, 95 S. Ct. 1612, 44 L. Ed. 2d 141 (1975) (CP 1107-33). In *Alyeska Pipeline Serv.*, where attorneys' fees were not available under the applicable statute, the Supreme Court was asked to approve fees on an equitable basis. The Supreme Court refused to undermine the statutory scheme, saying,

We are asked to fashion a far-reaching exception to [the] 'American Rule' [. . .] [W]e are convinced that it would be inappropriate for the Judiciary, without legislative guidance, to reallocate the burdens of litigation in the manner and to the extent urged by respondents

It appears to us that the rule suggested [by respondents] here . . . would make major inroads *on a policy matter that Congress has reserved for itself*. Since the approach taken by Congress to this issue has been to carve out [only certain] *specific* exceptions to a *general* rule that federal courts cannot award attorneys' fees . . . courts are not free to fashion drastic new rules with respect to the allowance of attorneys' fees

Alyeska Pipeline Serv., 421 U.S. at 247, 269 (emphasis added) (CP 1112, 1124).

³⁹ See also *Pennsylvania Life Ins. Co. v. Empl. Sec. Dep't*, 97 Wn.2d 412, 645 P.2d 693 (1982). In *Pennsylvania Life*, an employer prevailed against the Employment Security Department on judicial review under the former APA (RCW 34.04). The court declined to grant attorneys' fees under a common fund theory, saying "[t]he authorities make it clear that in a *statutory proceeding* such as this, the court will allow only the attorney fees which are provided for in the statute. . . . This . . . *is a proceeding to review*

2. This Court Should Deny Mr. Serres' Request for Common Fund Attorneys' Fees

For whatever reason, Mr. Serres asked the superior court to ignore the applicable statutory scheme (the EAJA) and “enlarge the circumstances” under which attorneys’ fees may be awarded on judicial review. In granting Mr. Serres’ motion, the superior court exceeded its authority. Because the proceeding was before the superior court on judicial review under the provisions of the APA,⁴⁰ the EAJA circumscribed and set the boundaries for the award of attorneys’ fees. No Washington case provides any authority for the superior court to go beyond the EAJA, to award fees on an equitable basis when an ancillary class is involved.

3. Denial of Common Fund Fees to Mr. Serres Will Promote the Balance the Legislature Intended in the EAJA

When the legislature has allocated the burdens of litigation by statute, the judiciary must not reallocate those burdens. With reference to the award of attorneys’ fees, the U.S. Supreme Court held, “[I]t is not for [the courts] to invade the legislature’s province by redistributing litigation costs” *Alyeska Pipeline Serv. Co.*, 421 U.S. at 271 (CP 1125).

an administrative determination, conducted under the provisions of the administrative procedure act (RCW 34.04). . . [T]here is no authority . . . to award such fees pursuant to equitable or other doctrines.” *Pennsylvania Life*, 97 Wn.2d at 417 (emphasis added).

⁴⁰ See CP 675 (“this case will proceed exclusively as a judicial review”).

Through the APA and the EAJA, the Washington legislature has struck a deliberate balance between ability of individual citizens to seek relief from agency action and the State's sovereign immunity from suit and attorneys' fees. *Costanich*, 164 Wn.2d at 931. The legislature has deemed the fees available through the EAJA to provide citizens with an appropriate ability to defend themselves from inappropriate state agency actions and to protect their rights. Laws of 1995, ch. 403, § 901; *Constr. Indus. Training Coun. v. Apprenticeship & Training Coun.*, 96 Wn. App. 59, 64, 977 P.2d 655 (1999).

If this Court were to determine that substantial common fund fees are available in lieu of fees under the EAJA, simply because Mr. Serres chose to join an "ancillary class" in his judicial review, it would upset this balance. By "reallotat[ing] the burden of litigation" intended by the legislature, the Court would in essence encourage petitioners to join ancillary classes unnecessarily. Rather than weigh the merits of their cases in deciding whether to seek judicial review of agency decisions, litigants will be tempted to focus on the possibility of significant financial reward. This is not the balance the legislature intended.⁴¹ This Court should deny

⁴¹ Under the existing statutory framework, Mr. Serres had ample opportunity to protect his rights (and those of the 100 similarly situated) without an "ancillary class."

Mr. Serres' request for common fund fees.⁴²

VIII. CONCLUSION

For the foregoing reasons, the Department respectfully requests this Court to find that Mr. Serres' settlement award was not "compensation earnable." However, if this Court finds that the *Roberts-Duncan* settlement award was compensation earnable, it should decide that the Department is required by law to collect both employee and employer contributions on the amounts received by all members of the *Roberts-Duncan* settlement class. Regardless what this Court decides regarding the nature of the settlement awards, it should find that there is no authority to award attorneys' fees under a common fund doctrine rather than the EAJA.

RESPECTFULLY SUBMITTED this 6 day of August, 2010.

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⁴² To date, Mr. Serres has not requested attorneys' fees under the EAJA or made any attempt to prove that he is a "qualified, prevailing party" within the meaning of RCW 4.84.350. If Mr. Serres requests fees under the EAJA in his response brief, the Department will use its reply to explain that EAJA fees must be denied because the Department's final order was "substantially justified." *See* RCW 4.84.350.

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NO. 64362-2-I

**COURT OF APPEALS, DIVISION I
OF THE STATE OF WASHINGTON**

WILLIAM F. SERRES and an Ancillary
Class of Similarly Situated Persons,

Respondents,

v.

WASHINGTON STATE
DEPARTMENT OF RETIREMENT
SYSTEMS and KING COUNTY,

Appellants.

CERTIFICATE OF
SERVICE

I certify that I served a copy of this document on all parties or their
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I certify under penalty of perjury under the laws of the state of
Washington that the foregoing is true and correct.

DATED this 6th day of August, 2010.


HEIDI MARTINEZ
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