NO. 40861-9-II

WASHINGTON STATE COURT OF APPEALS
DIVISION TWO

[Thurston County Superior Court No. 05-2-00131-1]

JEFFREY PROBST, and a class of similarly situated individuals,

Plaintiffs,

MICKEY FOWLER, *et al.*, , and a class of similarly situated individuals,

Appellants/Plaintiffs,

v.

DEPARTMENT OF RETIREMENT SYSTEMS,

Respondent/Defendant.

REPLY BRIEF OF APPELLANTS

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INTRODUCTION

DRS says that "the current TRS statute requires 'regular interest'" but provides no express statutory guidance regarding its implementation." DRS Br., p. 18. If DRS is correct that there is "no express statutory guidance" when a teacher/member earns interest on contributions, then the common interest rule that interest accrues daily applies, because the common law is part of the retirement statutes unless expressly repealed by the Legislature. *Price v. Kitsap Transit*, 125 Wn.2d 456, 463, 886 P.2d 556 (1994); *Potter v. Washington State Patrol*, 165 Wn.2d 67, 76-77 and n. 8, 196 P.3d 691 (2008); RCW 4.04.010.

DRS's entire brief is based on the proposition that the teachers earn interest on their accounts **only when** it is **credited** to their accounts at the end of each quarter, for compounding purposes. DRS is wrong to equate crediting interest with earning interest. Its argument is contrary to the common law, contrary to the retirement statutes and the ordinary meaning of the words used in those statutes, contrary to all caselaw, contrary to the industry standard for calculating interest, contrary to the teachers' expectations, contrary to DRS's representations, and contrary to the method DRS uses for calculating interest when teachers owe it money.

Even though the teachers need prevail on only one of these independent reasons why DRS is wrong, the Department is wrong on *all*

accounts. The Court should reverse the trial court's order and direct DRS to transfer unpaid daily interest from the employer's account to the teachers' individual retirement accounts.

ARGUMENT

I. DRS Wrongly Equates The Crediting Of Interest With The Earning Of Interest, Contrary To The Common Law Daily Interest Rule And The Retirement Statutes Implementing That Rule.

A. DRS is Wrong to Rely on Statutes Concerning the Crediting of Interest Because RCW 41.04.445(4) Expressly Requires DRS to Pay Teachers the Interest Earned on Their Accounts But Not Yet Credited ("Accrued Interest"), Consistent With the Common Law, the Industry Standard, and DRS's Method for Calculating Interest When Teachers Owe the Agency Money.

DRS argued below that the Legislature was "silent" on how interest is earned on member accounts, and there was "no guidance" as to how interest is earned. *See* App. Br., p. 17 and pp. 17-18 n. 5 (quoting DRS's arguments below). DRS does not however dispute that the common law rule for more than 250 years is that interest is earned on principal daily, or "de die de diem." App. Br., pp. 22-25 (discussing common law authorities). DRS also does not dispute that the common law is the law of Washington unless it is expressly repealed by the Legislature. App. Br. 19-22. If DRS is correct, and the Legislature was "silent," the common law daily interest rule must apply because the Legislature did not

expressly repeal the common law. *Price, supra,* 125 Wn.2d at 456, 463; *Potter, supra,* 165 Wn.2d at 76-77 and n. 8.

In an effort to evade that established principle, DRS on appeal now argues that "historical" statutes do not "require crediting of daily interest," and that it therefore has the "discretion" to decree that a member earns interest only when interest is credited.[1] DRS's arguments concerning its discretion in "crediting" interest are misplaced because under the common law interest is earned on principal daily regardless when it is credited or paid. *See* App. Br., pp. 22-25.

Under the common law, "**[i]nterest accrues from day to day even if payable only at intervals**[.]" 32 Halsbury's Laws of England, § 127 Interest in General, p. 78 (4th ed. 2005 Reissue) (emphasis added). And **"interest upon money . . . notwithstanding it is expressly made payable half-yearly or quarterly . . . accrues and becomes due *de die de diem* for the forbearance of principal.**" *Clapp v. Astor,* 2 Edw.Ch. 379, 6 N.Y. Ch. Ann. 436 (1834) (emphasis added). *See also* App. Br., pp. 22-25 (discussing common law daily interest rule). The *crediting* of interest thus is not the same as the *earning* of interest.

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[1] DRS Br., p. 13 ("Not Credited Daily"); p. 14 ("Not Credited Daily"); p. 17, p. 18 (DRS discretion over "How to Credit 'Regular Interest'"), p. 32 (DRS discretion over how "'regular interest' was to be credited"); p. 44 ("the amount credited as 'regular interest' to individual accounts has never been directed by statute").

The Legislature knows the difference between the *crediting* of interest and the *earning* of interest, as shown by the "accrued interest" statute, RCW 41.04.445(4), which requires that DRS pay "accrued interest" to all employees who withdraw their contributions from TRS Plan 2: "All members contributions ..., **plus the accrued interest earned thereon, shall be paid to the member upon withdrawal of funds[.]**" (Emphasis added.) Statutory terms not defined in the statute are given their ordinary meaning. *Western Telepage, Inc. v. City of Tacoma, Dept. of Financing*, 140 Wn.2d 599, 609-610, 998 P.2d 884 (2000). The difference between "crediting" and "earning" interest is inherent in the term **"accrued interest,"** which ordinarily means "**interest earned, though not credited** or otherwise paid." Dictionary of Banking Terms (4th ed. 2000), p. 7, AR 684 (emphasis added); *see also* App. Br., p. 28 n. 9 (other dictionaries with consistent definition of accrued interest). **DRS agrees that the "dictionary definition" of "accrued interest" applies here**. AR 713. The Legislature's use of the term "accrued interest" thus implements the common law rule that interest is earned daily, regardless whether it is credited monthly, quarterly, or annually.

The common law rule that interest accrues daily, even if paid or credited monthly or quarterly, is also the "industry standard." AR 484; AR 289. Although interest is normally credited or posted to accounts

monthly, if a person "withdraw[s] everything from [an] account mid-month" the person receives "the interest earned up to the date of withdrawal." AR 484. Indeed, DRS uses this industry standard when teachers owe it interest for withdrawn contributions. *See infra* pp. 20-22 (discussing how DRS's double standard for calculating interest based on whether it owes money or it is owed money is arbitrary and capricious).

DRS also argues that RCW 41.04.445(4) "simply incorporates the existing methodology for the crediting of TRS interest" and that the only "accrued interest" on members' contributions is the interest credited at the end of the prior quarter for compounding purposes, claiming that teachers never earn interest on their contributions before DRS credits at quarter-end. DRS Br., p. 41. But DRS's interpretation of RCW 41.04.445(4) is contrary to the ordinary meaning of the term "accrued interest," because **according to DRS there is never interest earned that is not credited**.

Further, the Legislature did not provide that DRS shall pay members their contributions "plus the **interest credited** thereon." Instead, it required DRS to pay the contributions "plus the **accrued interest earned** thereon." RCW 41.04.445(4). The Legislature's use of the different terms "credited" and "accrued" in the retirement statutes also shows the Legislature intended the terms to have different meanings. *In re Forfeiture of One 1970 Chevrolet Chevelle,* 166 Wn.2d 834, 842, 215 P.3d

166 (2009) (when "the legislature uses certain statutory language in one statute and different language in another, a difference in legislative intent is evidenced").

Here, RCW 41.04.445(4) provides that when a TRS 2 member withdraws contributions, "[a]ll member contributions . . . , plus the accrued interest thereon, shall be paid to the member upon the withdrawal of funds or lump-sum payment of accumulated contributions as provided under the provisions of the retirement systems." DRS argues that the phrase "as provided under the provisions of the retirement system" modifies the term "accrued interest" so that the term is denied its ordinary meaning and instead means only the interest credited by DRS. DRS Br., pp. 40-41.

Not only is DRS's argument contrary to the ordinary meaning of the term "accrued interest" and the common law, but it also is contrary to the rules of statutory construction: Under the last antecedent rule, "qualifying words and phrases refer to the last antecedent." "The last antecedent is the last word, phrase or clause that can be made an antecedent without impairing the meaning of the sentence." *In re Kurtzman's Estate,* 65 Wn.2d 260, 264, 396 P.2d 786 (1964). The "presence of a comma before the qualifying phrase is evidence the qualifier is intended to apply to *all antecedents* instead of only the

immediately proceeding one." *City of Spokane v. County of Spokane,* 158 Wn.2d 661, 673, 146 P.3d 893 (2006) (citation omitted; emphasis in original). The qualifying phrase "as provided under the provisions of the retirement systems" is not preceded by a comma, and the last antecedent is "the withdrawal of funds or lump-sum payment of accumulated contributions." The phrase therefore does not alter the ordinary meaning of the term "accrued interest," assuming *arguendo* it could. Instead, the phrase restricts the withdrawal of funds or lump-sum payment of accumulated contributions "to those provided under the provisions of the retirement systems." *See, e.g.*, RCW 41.32.817(4) (transfer of a teacher's accumulated contributions from TRS Plan 2 to her new Plan 3 account).

DRS also argues, with no citation or authority, that the "accrued interest" statute does not apply because the teachers did "not withdraw their funds," but "merely transferred them from one TRS plan to another." DRS Br., pp. 39-40 n. 31. The word "withdrawal," which is not defined in RCW 41.04.445(4), ordinarily means "***removal from a place of deposit or investment***." AR 666; Webster's Third New Int'l Dict. (1976), p. 2626 (emphasis added). Here, a "transfer" of funds from the teachers' TRS Plan 2 accounts to their new TRS Plan 3 individual accounts necessarily entails the withdrawal of funds from one account to deposit in a second account. AR 666, Webster's Third, *supra*, p. 2626.

The Supreme Court described such transfers to another retirement account as "withdrawals" in *Johnson v. Employment Sec. Dept. of State of Wash.*, 112 Wn.2d 172, 179, 769 P.2d 305 (1989). The Department's argument that transfer from Plan 2 to Plan 3 does not involve a "withdrawal of funds from an individual account" is also contrary to its own witness's testimony that on "April 2, 2002 . . . funds were liquidated . . . representing the Plan 2 member accounts of transferring members," AR 789, Deam Dec., ¶22, and "transferred out . . . for investment in Plan 3 self-directed accounts." *Id.*, ¶21. The teachers thus "withdrew" their funds from TRS Plan 2, and the "accrued interest" statute RCW 41.04.445(4) applies.

Finally, DRS quotes and repeatedly cites a 1947 statute on withdrawals from Plan 2 that provided that teachers could only obtain interest up to June 30 of the previous year, with no "interest for partial periods." DRS Br., p. 16 citing Laws of 1947, ch. 80, §51 (CP 535). DRS characterizes this statute as "historic." A less disingenuous characterization of this statute would be *repealed*: in 1982 the Legislature expressly removed the June 30 limitation from the statute. The Legislature's deletion of this language must be given effect as a "change in legislative purpose." *WR Enterprises, Inc. v. Dept. of Labor and Industries*, 147 Wn.2d 213, 221-22, 53 P.3d 504 (2002) (rejecting an argument based on deleted statutory language and "on practices followed

by the Department during the 70 years" under that repealed statute because "the current intent of the Legislature may [not] be found in a repealed statute."). *Accord, Littleton v. Whatcom County*, 121 Wn. App. 108, 113-14, 86 P.3d 1253 (2004).

Two years after repealing the "historic" statute relied on by DRS, the Legislature enacted RCW 41.04.445(4), requiring DRS to pay members "accrued interest" when they withdrew funds. The law now mandates that DRS pay teachers the "accrued interest" on their contributions. DRS failed to apply this statutory mandate when the teachers withdrew their accumulated contributions from TRS Plan 2 to deposit in their new individual TRS Plan 3 accounts.

B. DRS's Argument That Interest is Earned Only When It is Credited is Contrary to Faulkenbury, the Only Case in the Entire Nation on Point Concerning "Regular Interest," Which DRS Wrongly Tries to Distinguish by Contending the Case Concerns "Judgment Interest."

The only case on point concerning "regular interest" is *Faulkenbury v. Teachers' and State Employees' Retirement Sys. of North Carolina,* 133 N.C. App. 587, 515 S.E.2d 743, 746-47, *rev. denied*, 351 N.C. 102 (1999). In *Faulkenbury*, the retirement statutes were "completely silent as to when the interest is to accrue." 515 S.E.2d at 746. The retirement system in *Faulkenbury* argued that the members earned interest only when it was credited to their accounts to be "compounded

annually." 515 S.E.2d at 746. This is the same argument DRS makes here, except DRS says that the teachers earn interest only when it is credited to their accounts to be "compounded quarterly."

The *Faulkenbury* court rejected the (North Carolina) retirement system's argument that interest is earned by members only when it is paid or credited annually because in the "absence of a specific directive from the legislature," the common law rule is "daily interest." *Id.* at 746-47; *see also* App. Br., pp. 25-28 (discussing *Faulkenbury*). And this rule applies no matter whether the interest is credited annually, as in *Faulkenbury*, or quarterly, as in this case.

DRS does not contend the *Faulkenbury* court was wrong or used faulty logic. Instead, DRS argues that *Faulkenbury* is distinguishable because it involves "regular interest" under "*judgment interest* statutes and the common law, not . . . retirement and pension statutes." DRS Br., p. 37 (emphasis by DRS). This is patently false. *Faulkenbury* concerns "regular interest" under a "Teachers' and State Employees' Retirement System." 515 S.E.2d at 746 (construing "regular interest" in N.C.G.S. §135-1(19), a public employee retirement system statute). Even were it true, the distinction is immaterial. DRS has suggested nothing about the common law governing judgment interest statutes that would be different from the common law governing a teacher's right to accrued regular

interest in her individual retirement account, entrusted to the State for investment.

C. General Grants of Authority to Administer the Retirement System and Develop "Procedures" Do Not Authorize DRS To Overturn the Common Law or Ignore Statutes Requiring That it Pay Members "Accrued" "Regular Interest." DRS's Legal Arguments are Post Hoc Rationalizations for Its Unlawful Conduct.

Although DRS primarily relies on repealed statutory language and the claimed retroactivity of a 2007 statute, DRS also refers to some statutes that were actually in effect at the time of the TRS Plan 2 to Plan 3 transfers at issue in this case. DRS cites RCW 41.32.817, which states that the teachers' accumulated contributions in TRS Plan 2 shall be transferred to their new Plan 3 accounts "*pursuant to procedures developed by the department.*" DRS Br., p. 31 (emphasis by DRS); *accord,* pp. 1, 2, 3, 21-22. DRS also relies on a statute that "empower[s] [it] . . . to decide on *all* questions of eligibility covering [TRS] membership, service, and benefits." DRS Br., p. 17, quoting RCW 41.32.025 (emphasis by DRS). These general grants of authority do not authorize DRS to ignore its statutory duties to pay members "regular interest" and "accrued interest" when they withdraw their funds, or to ignore the common law daily interest rule that is part of the retirement statutes.

All general authority exercised by DRS must comply with the retirement statutes and the common law, because DRS can only take "lawful" measures to carry out its functions, and only the Legislature has the power to repeal the common law. RCW 4.04.010; *State ex rel. Public Disclosure Commission v. Rains*, 87 Wn.2d 626, 630-31, 555 P.2d 1368 (1976) (agency has no authority to amend or change legislative enactments). RCW 41.32.010(38) does provide DRS the authority to determine the "rate" of regular interest: "'Regular interest' means such **rate** as the director may determine." (Emphasis added.) But the discretion to set the "rate" of interest does not give DRS the authority to overturn the common law governing when that interest rate is earned.

"Interest rate" means "[a] percentage that expresses the relationship between the interest for one year and the principal." Dictionary of Banking and Finance, p. 116. AR 123. "Regular" means "steady or uniform in course, practice, or occurrence: not subject to unexplained or irrational variation." Webster's Third, *supra*, p. 1913; AR 665. The Department *admits* that the "regular rate of interest on the member account . . . is 5.5 percent annual interest compounded quarterly." AR 23. And DRS consistently told the legislature and retirement system members that members' contributions earned this rate of interest. AR 207, 232; CP 503, 505. But under its computer program for "crediting"

interest, the Department inevitably pays less than this stated 5.5% annual regular rate of interest compounded quarterly. Indeed, DRS does not dispute that under its computer program members can receive zero interest on their contributions for up to six months. AR 261, 250-56, 643.

DRS nevertheless contends that in 1978 the director determined that "members would not be credited with 'regular interest' for a period shorter than one quarter," and no interest would be allowed for a "partial period," under the statute allowing the director to determine the "rate" of interest. DRS Br., pp. 19-20, citing Wickman Dec., ¶9. AR 860. Not only did the director lack authority to overturn the common law rule on when interest is earned, the director's 1978 interim memorandum explicitly **contradicts** DRS's arguments here.

In the 1978 memorandum relied upon by DRS, the director acknowledged that members were earning interest every month even though it was not added to their accounts for compounding purposes until the end of a quarter. AR 878:

> Regular interest to be applied at the rate of 1.375% per quarter based on the previous quarter accumulated balance. **Programs should be developed to provide the means to credit interest monthly on the prior month end balance.** (Emphasis added.)

The first sentence, stating that the regular interest "rate" is "1.375% per quarter based on the previous quarter accumulated balance," is the

equivalent of stating that the annual rate of interest is 5.5% *compounded quarterly*. The director's memorandum thus confirms interest at "1.375% per quarter based on the **previous quarter accumulated balance.**" AR 878. The ordinary meaning of "compound interest" is "interest paid on both the principal and the **previously accumulated interest**." Black's Law Dictionary (7th ed. 1999), p. 817; AR 669. *See also* AR 232 (Admission No. 1, "rate" of interest on TRS Plan 2 member accounts is "5.5 percent annual interest compounded quarterly.")

More importantly, the director did not equate the crediting of interest at the end of the quarter with the earning of interest, as shown by the second sentence of this memorandum, in which the director states that DRS should develop programs to "credit interest monthly on the prior month end balance." AR 878. The director thus recognized that TRS Plan members were earning interest throughout the quarter, and not just when it was added to the account balance at the end of the quarter for compounding purposes. This is why the director said that DRS should change its computer program to "credit interest monthly." *Id.* DRS's argument (pp. 19-20) that interest is not earned for a "partial period" less than a quarter is thus contradicted, not supported, by the director's 1978 memorandum.

The Legislature's general grants of authorities to DRS to administer the system and develop procedures for the teachers who

transfer from TRS Plan 2 to Plan 3 do not give DRS the discretion to ignore or change the common law; instead, the agency must exercise its discretion within the confines of the existing law. DRS argues that the Court should give "substantial weight" to its "interpretation of the statutes that it implements," DRS Br., p. 28, but DRS has no statutory "interpretation" independent of this litigation. Indeed, DRS previously admitted that it has "no document" supporting its position that the accrued interest statute, RCW 41.04.445(5), does not apply when a retirement system member transfers from a Plan 2 to a Plan 3. AR 238 (Admission No. 22). DRS's litigation position is entitled to no deference. *Cowiche Canyon Conservancy v. Bosley,* 118 Wn.2d 801, 815, 828 P.2d 549 (1992) (rejecting an agency's "attempts to bootstrap a legal argument into the place of agency interpretation.").

II. DRS's Interpretation Of The 2007 Statute Would Result In An Unconstitutional Taking Of The Teachers' Earned Interest; DRS's Argument That The Teachers' Contributions Are "The Property Of The Retirement System" Is Contrary To The TRS Statutory Scheme, The Common Law, And The Evidence In This Record.

The 2007 statute concerns discretion over the *crediting* of interest, not the *earning* of interest. (*Supra* pp. 4-6) The Legislature in the 2007 statute did not "clearly express" any intent to repeal the common law rule on when interest is earned. *See also* App. Br., pp. 34-36 (discussing

specific language in 2007 statute). Moreover, a "statute may not be given retroactive effect, regardless of the intention of the legislature, where the effect would be to interfere with vested rights." *Hearde v. City of Seattle,* 26 Wn. App. 219, 221-22, 611 P.2d 1375, *rev. denied,* 94 Wn.2d 1021 (1980) (citation omitted). DRS's interpretation of the statute would result in an unconstitutional taking of the teachers' earned interest, and it should be rejected in favor of the teachers' constitutional interpretation.

DRS does not dispute that it did not pay the teachers all of the interest earned on their contributions, and that some of this interest remains in the employers' Plan 2/3 account. DRS's primary argument why the 2007 statute supposedly authorizes it to retroactively take the interest earned on the teachers' contributions is that the teachers' contributions are "**the property of the retirement system,**" DRS Br., p. 1 (emphasis added), that "**members have no property interest in . . . their own contributions,**" *Id.*, p. 8 (emphasis added), that the teachers' contributions are "not *deposits*," and that "TRS Plan 2 members cannot have any expectation or entitlement to have their contributions to be treated as such." *Id.* p. 42 (emphasis by DRS).

DRS's arguments are baseless. Under the common law, "**[i]nterest earned belongs to the owner of the funds** that generated the interest" and "**interest earned by deposit of money. . . is an increment**

that accrues to that money and to its owners." *Phillips v. Washington Legal Foundation*, 524 U.S. 156, 165-66 and n. 5, 118 S.Ct. 1925 (1998) (IOLTA case) (emphasis added). *See also* App. Br., pp. 39-40 (discussing common law). And in *Dean v. Lehman*, 143 Wn.2d 12, 34-36, 18 P.3d 523 (2001), the Supreme Court held that a statute providing that inmates shall receive "accrued interest" on their deposits created a constitutionally-protected property right. As previously discussed (*supra* pp. 4-8), RCW 41.04.445(4) also provides the teachers "accrued interest" on their contributions.

Taking the position that inmates have more property rights than teachers, DRS argues, with no authority, that *Dean* is distinguishable because the teachers made contributions "in exchange for statutorily defined benefits" "based upon salary and length of service." DRS Br., p. 42. DRS's argument is groundless. The teachers withdrew all of their accumulated contributions from TRS Plan 2, they are no longer members of that plan, and they will not therefore receive any "statutorily defined benefits" in TRS Plan 2. Instead, when the teachers became members of Plan 3, the teachers voluntarily reduced their defined benefit pension by one-half and **the Legislature required DRS to fund the teachers' <u>TRS Plan 3 defined benefit pension</u> solely by the "<u>employer contributions</u>" and the earnings on those contributions**. AR 343; RCW 41.32.840(1).

In addition to confusing TRS Plan 2 with TRS Plan 3, DRS also erroneously argues that the "Washington Supreme Court has made clear that pension contributions . . . are not the property of pension plan members. Pension plan members 'have no legal claim' upon funds contributed to their pension plans 'until they qualify for benefits under [the statutory act governing the plan].' *Marysville v. State*, 101 Wn.2d 50, 56, 676 P.2d 989 (1984)." DRS Br., p. 8 n. 8, pp. 48-49. DRS's quotation from *Marysville* omits the phrase showing that the case concerns *employer contributions,* not the employee's contributions: "**Individual members have no legal claim <u>upon the employer contribution fund</u> until they qualify for benefits** under the act's provisions." *Marysville,* 101 Wn.2d at 56 (emphasis added).

Consistent with the common law and the Supreme Court's opinion in *Dean*, the entire TRS statutory scheme assumes that each individual teacher's contributions remain the property of that individual teacher up to the date of retirement. For example, RCW 41.32.010 recognizes that each teacher has an "individual account," and that the "accumulated contributions for Plan 2 members" is all of the teachers' contributions "together with the regular interest thereon." Under RCW 41.04.445(5), upon a "withdrawal of funds" or "lump-sum payment of accumulated contributions" DRS must pay the teacher all "member contributions . . .

plus the accrued interest earned thereon[.]"[2] RCW 41.04.445(4) affirms the teachers' property right in their contributions and the interest on those contributions because it provides members "shall" receive all "accrued interest" when they withdraw their funds.

In addition to the common law and the retirement statutes recognizing the teachers' property rights in their contributions and interest, DRS itself continuously promised the teachers that their contributions would earn "5.5 percent annual interest compounded quarterly." AR 232 (Admission No. 1); AR 207; CP 503 and 505. DRS sent the teachers an "Annual Statement" that contained a "beginning balance," "contributions" made through the year, "interest" for the year, and an "ending statement balance." *See, e.g.*, CP 347. Mickey Fowler's undisputed testimony is that he always believed that his "contributions would earn daily interest from the date of deposit up to the date the contributions were withdrawn from [his] account," and his belief was based on the "industry standard" for calculating interest. CP 331; *see also* CP 330-34 (explaining why

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[2] RCW 41.04.445 is the "pick-up statute" that "allowed mandatory employee contributions to be made on a pre-tax basis" by characterizing the contributions for IRS purposes only "as *employer* contributions." DRS Br., p. 39 n. 31 (emphasis added). A fundamental purpose of the "accrued interest" statute is to make it clear that although the teachers' contributions are characterized as employer contributions for tax purposes, "[a]ll members contributions . . . plus the accrued interest earned thereon" remain the property of the teachers in the event they withdraw their funds or receive a lump-sum payment of accumulated contributions.

DRS's annual statement was insufficient to provide notice that its computer program was calculating interest by a method different from the industry standard).

The teachers have a property interest in their contributions and the interest that accrues on those contributions. The Court should therefore reject DRS interpretation of the 2007 statute because it would result in an unconstitutional taking in the teachers' individual retirement accounts.

III. DRS's Double Standard In Calculating Interest, Using An Inaccurate Method That Shortchanges The Teachers When It Owes Them Interest But An Accurate Method When The Teachers Owe The Agency Interest Is Arbitrary And Capricious.

A. The Statutes Authorizing DRS to Collect Interest From the Teachers are Not "Different" From the Statutes Requiring It to Pay Interest to the Teachers.

An agency must treat similar situations with "consistency." It is arbitrary and capricious for an agency to have a double standard. *Seattle Area Plumbers v. Washington State Apprenticeship and Training Council*, 131 Wn. App. 862, 879, 129 P.3d 838 (2006); *Puget Sound Nat. Bank v. State Dept. of Revenue*, 123 Wn.2d 284, 291, 868 P.2d 127 (1994); *Trustees of California State University v. Riley*, 74 F.3d 960, 966-77 (9th Cir. 1996); App. Br. pp. 42-47. Here, when teachers owe DRS interest when restoring withdrawn contributions, DRS recognizes that interest accrues and is earned on a daily basis - the 250-year old common law rule and industry standard. AR 433; CP 479; WAC 415-114-400. But when

DRS owes teachers interest on contributions, DRS does not pay them daily interest, and instead uses an undisclosed computer program that pays teachers no interest for at least a quarter, and sometimes up to six months. AR 250-56, 261, 643. DRS does not dispute that it never told the teachers that it was not paying them daily interest on their contributions, even though DRS recognized this was information material to when a teacher chose to transfer to TRS Plan 3. DRS therefore has a double standard for calculating interest, based on whether it is paying interest or receiving interest.

DRS argues that its double standard is not arbitrary and capricious because the statutes governing interest in the two situations are "different." DRS Br., p. 43, citing RCW 41.50.125. The statute DRS cites for the alleged difference, RCW 41.50.125, says that DRS "**may charge interest**" on member contributions owing to TRS and other retirement systems. (Emphasis added.) RCW 41.04.445(4) says that DRS **"shall" pay members "accrued interest"** when they withdraw their contributions. (Emphasis added.)

Thus, the only "difference" between the statutes is that DRS has the ability to decline to charge interest when it is owed money, while DRS's duty to pay accrued interest is mandatory. *Scannell v. City of Seattle,* 97 Wn.2d 701, 704-05, 648 P.2d 435 (1982) ("'shall' [is]

construed as mandatory and 'may' as permissive"). There is thus no "difference" in the statutes that authorizes DRS to use the industry standard and common law daily interest rule when the teachers owe it money, but to use a different undisclosed method that is contrary to the common law and industry standard when it owes teachers interest. DRS's double standard for calculating interest is arbitrary and capricious.

B. Jeff Probst's Facts, Which Illustrate How DRS's Computer Program Uses Arbitrary Fictional Deposit and Withdrawal Dates, are Relevant Here, as DRS Expressly Agreed and Admitted. DRS's Own Internal Training Documents Show Probst's Facts are Not Unique.

A method for calculating interest is also arbitrary and capricious if it is not based on the real dates of deposit and payment, particularly when the agency has the ability to correctly calculate interest (shown here by how DRS calculates interest when the teachers owe it money). *Trustees of California State Univ. v. Riley,* 74 F.3d 960, 966, 106 (1996); *Rios v. Dept. of Labor and Industries,* 145 Wn.2d 483, 39 P.3d 961 (2002) (denial of requested rulemaking was arbitrary and capricious because such rules were both "necessary and doable"). DRS recognizes the specific facts concerning Jeff Probst's transfer from PERS Plan 3 to Plan 2 illustrate how its computer program for calculating interest is arbitrary and capricious, because the program treated his funds as transferred from TRS Plan 2 to Plan 3 on "March 27" when his funds were actually transferred

from his Plan 2 account to his Plan 3 account on April 2. AR 253-59. As a consequence, because the computer program showed his account as "zeroed out" before the quarter ended on March 31, Probst did not receive any interest at all on his entire account balance for over three months, and zero interest on his contributions made during the prior six months. AR 250-56.

Consistent with Probst's facts, an internal DRS document used to train DRS employees on "contribution processing" shows that DRS considers an employee to have "no account balance at end of quarter" (March 31), and therefore the computer provides the employees "no interest for quarter" on the previous quarter's balance – even when actually the "transfer occurs" after the quarter ends, on April 2. AR 643:

Earnings example – Plan 2 to Plan 3 Self-Directed Accounts

March 15	March 28	March 31	April 2
Transfer reported by employer	Account balance begins process of transfer to Plan 3;	*No account balance at end of quarter – no interest for quarter*	*Transfer occurs* – member then earns return on investments

(Emphasis added.) DRS's computer program uses arbitrary, fictional deposit and withdrawal dates for calculating interest on member contributions.

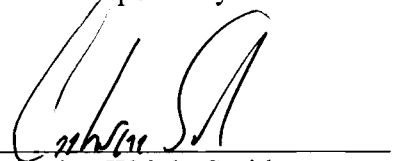
Probst's facts are not unique, as illustrated by DRS's own internal training document. AR 643. DRS nevertheless argues that "the facts of Mr. Probst's transfer are not relevant" because "the TRS process . . . is different from the PERS process." DRS Br., p. 22 n. 22. Not only is there is nothing in the record to support DRS's factual statement, but it is contrary to DRS's discovery answers that "**TRS and PERS plans apply the same practices concerning interest"** and "**there are no material differences in the procedures for calculating and crediting interest on members' accounts in the TRS and PERS Plans.**" CP 54 (Interrogatory Answers Nos. 6 & 7 (emphasis added)).

Finally, when this action partially settled the PERS claims and the TRS claims for transfers after January 20, 2002, DRS expressly agreed that the remaining claims "will be litigated based on the agency record developed in the *Probst* administrative proceeding, supplemented by any party with any matter related to TRS or to timeliness issues, or any specific to the plaintiffs in the case." CR 275 (settlement agreement, ¶69). Probst's facts are thus relevant here, as DRS both expressly agreed in the partial settlement and admitted in response to discovery.

CONCLUSION

The common law, the statutory scheme, all Supreme Court decisions, industry standards, the teachers' expectations, DRS's representations, and the method DRS uses to calculate interest when the teachers owe it interest, all compel the conclusion that the teachers are entitled to regular accrued interest on their individual retirement accounts. DRS does not dispute its ability to transfer the interest in dispute from the employer's Plan 2/3 account to the teachers' individual plan 3 accounts. *See* App. Br., pp. 47-48. This is exactly what DRS did in the Probst partial settlement. CP 276. The Court should order the same relief here.

Respectfully submitted this 27th day of May, 2011.



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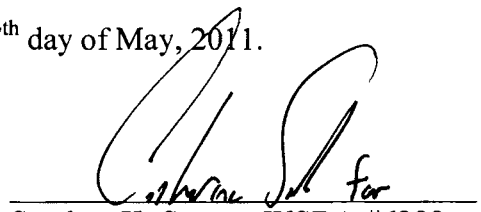

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DECLARATION OF SERVICE

The undersigned declares under penalty of perjury, under the laws of the State of Washington, that the following is true and correct:

That on May 27, 2011, I arranged for service of the foregoing Reply Brief of Appellants, to the court and to the parties to this action as follows:

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