

N. 45128-0-II

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

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MICKEY FOWLER, *et al.*, , and a class of TRS Plan 3 members,  
Appellants/Plaintiffs (in Supplemental Complaint),  
JEFFREY PROBST, and a class of similarly situated individuals,  
Plaintiffs,

v.

DEPARTMENT OF RETIREMENT SYSTEMS,  
Respondent/Defendant.

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**OPENING BRIEF OF FOWLER APPELLANTS**

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ORIGINAL

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## INTRODUCTION

This case involves the failure of the Department of Retirement Systems (“DRS”) to provide thousands of public school teachers the interest that their contributions earned when the teachers withdrew those contributions from Teachers’ Retirement System (“TRS”) Plan 2 to deposit the funds in TRS Plan 3. Appellants Mickey and Leisa Fowler and the class of teachers they represent (collectively the “teachers”) prevailed in the first appeal. *Probst v. DRS*, 167 Wn.App. 180, 271 P.3d 966 (2012).<sup>1</sup>

The teachers’ second appeal is brought to enforce this Court’s mandate in *Probst*. Rather than comply with the mandate, the trial court erred by remanding the action to DRS to start the entire action over. The trial court wrongly accepted DRS’s argument that a 2007 statute authorized the agency to conduct rulemaking in 2014 to determine how much interest the teachers earned in their TRS Plan 2 retirement accounts more than 15 years ago. The trial court erred for multiple reasons, and this Court should reverse.

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<sup>1</sup> The first appeal was titled *Probst* because the actions below are a consolidated class action complaint and petition for review filed by Jeffrey Probst (settled in 2008) and a supplemental class action complaint filed by the Fowlers in the same cause number after the *Probst* cases were settled. *Probst*, 167 Wn.App. at 183-84.

### **ASSIGNMENTS OF ERROR**

1. The trial court erred by remanding the case to DRS to start the litigation process over after ten years of litigation.
2. The trial court erred by failing to comply with the *Probst* mandate.
3. The trial court erred by failing to order DRS to pay the teachers the daily interest earned on their contributions that DRS had arbitrarily and capriciously withheld.

### **ISSUES PERTAINING TO ASSIGNMENTS OF ERROR**

1. Did the trial court fail to comply with the *Probst* mandate when it remanded the action the action to DRS for rulemaking to “renew” the very interest practice this Court held is arbitrary and capricious? (Assignments of Error 1, 2, 3.)
2. Does DRS’s failure to pay the teachers daily interest earned on their contributions constitute an unconstitutional taking because the owner of funds on deposit with the government that generates interest has a constitutionally protected property right to the interest? (Assignments of Error 1, 3.)
3. Is DRS barred by due process from enacting a rule in 2014 that retroactively determines the amount of interest the teachers earned in their TRS Plan 2 accounts more than 15 years ago because the teachers have a vested right in the daily interest earned in those accounts under the

common law and under DRS's repeated promises? (Assignments of Error 1, 3.)

### STATEMENT OF THE CASE

*DRS Interest Practices.* Teacher contributions to the TRS Plan 2 accounts earn interest at the rate of 5.5% annual interest, compounded quarterly. Administrative Record ("AR") 232; CP 896-905.<sup>2</sup> The 5.5% annual interest rate was never in dispute. DRS, however, kept some of the interest that was earned on the teachers' contributions at this 5.5% rate when the teachers closed their TRS Plan 2 accounts and transferred their accumulated contributions to new Plan 3 individual retirement investment accounts. CP 1066; AR 248-59, 261, 310, 320.

Plaintiffs Mickey Fowler and Leisa Fowler, public school teachers, illustrate how the withholding occurred. They were members of TRS Plan 2, under which the teachers must contribute part of each paycheck toward retirement. RCW 41.32.780; RCW 41.32.042. DRS manages the teachers' contributions by tracking the contributions and interest in individual member accounts. RCW 41.32.042. In TRS Plan 2, when a

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<sup>2</sup> The parties agreed the teachers' claims would be resolved "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 anything specific to the plaintiffs in the case." CP 514. The parties agreed to resolve the teachers' claims based in large part on the *Probst* administrative record because DRS acknowledged that the "TRS and PERS plans apply the same practices concerning interest" and "there are no material differences for calculating and crediting interest on members' accounts in the TRS and PERS Plans." CP 293.

teacher retires, these funds go to fund the pension payments.

In 1996, the Legislature created TRS Plan 3 and gave TRS Plan 2 members an option to transfer their employee contributions and accrued interest to Plan 3. RCW 41.32.817. That transfer cut a teacher's pension benefit in half, while creating an individual retirement investment account out of the teachers' Plan 2 funds and subsequent contributions. The employers' contributions for transferring members remained in the TRS Plan 2/3 fund to provide a pension at one-half the usual defined benefit formula. RCW 41.32.840(1); AR 343. The teachers' funds (accumulated contributions with interest) are withdrawn from TRS Plan 2 and transferred to TRS Plan 3 individual investment (defined contribution) accounts. AR 349; RCW 41.32.817(5); 41.32.831(2); RCW 41.34.060. The retirement benefits for the transferring teachers in their individual defined contribution (Plan 3) accounts are the sum of the contributions plus interest and investment gains. AR 345. In addition, TRS provided a transfer incentive payment to encourage transfers to Plan 3 before January 1998, by matching a portion of the funds placed by the teachers in their Plan 3 accounts. RCW 41.32.8401.

The teachers asserted that DRS was required to calculate and transfer to Plan 3 individual retirement accounts all the interest that their funds had earned in Plan 2 accounts at the stated 5.5% rate. CP 863-95. DRS had affirmatively assured the teachers that "your [Plan 2]

contributions are earning 5.5 percent interest compounded quarterly” (CP 900) and that “DRS pays 5.5 percent annual interest compounded quarterly on employee contributions[.]” CP 902. Consistent with what DRS told them, and the normal practice of the financial industry, the Fowlers believed during the time they were TRS Plan 2 members, and thereafter until this litigation, that their Plan 2 retirement contributions earned daily interest, *i.e.*, that their contributions earned interest on funds in the account from the date of deposit to the date of withdrawal and transfer to TRS 3. CP 637-38, 800.

DRS did not, however, calculate daily interest on the teachers’ contributions. Instead, DRS had an undisclosed practice under which DRS “posts” or credits interest to TRS members’ individual accounts on the fourth Saturday of the last month in each quarter, and the amount of interest credited by DRS is based only on the ending account balance in the prior quarter. It did not include any interest on the contributions deposited during that quarter. AR 261, 310, 320; CP 801, 1070, 1077-79, 1080; 167 Wn.App. at 183, 192. Thus, DRS pays no interest on contributions during the quarter in which they are deposited. AR 320. The deposits made during a quarter do not even receive simple interest, *i.e.*, interest to be added to the principal and compounded at the end of the quarter. AR 261. The teachers effectively earn less than the 5.5% annual interest rate compounded quarterly that DRS told them they were earning.

AR 261. (See also pp. 6-8 *infra*.)

In addition, due to a design flaw in DRS's computer software, when a member's Plan 2 account is shown as zero (\$0) in DRS's database on the fourth Saturday of a quarter on which interest is credited, for whatever reason — even when the zero balance is just a computer accounting entry and the money actually remains in the account through the end of the quarter — DRS pays no interest at all for that entire quarter on the teacher's balance at the end of the previous quarter, as well as no interest for the deposits made either during that quarter or the previous quarter. AR 261, 320, 643; 167 Wn.App. at 183, 193. This occurs because in DRS's software, the data entry (posting) dates, rather than the dates money is actually withdrawn, determine whether members receive any interest in a quarter. DRS's computer program treats employee contributions as withdrawn before the end of a quarter even though the transfer occurs after the quarter ends. AR 643; AR 253-59; 167 Wn.App. at 183.

Jeff Probst's transfer from PERS Plan 2 to Plan 3 illustrates DRS's computer program for calculating interest.<sup>3</sup> The agency's computer program posted Probst's funds as transferred from PERS Plan 2 to Plan 3

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<sup>3</sup> The parties agreed to litigate the claim here based on the *Probst* administrative record because the TRS and PERS plans have the same practices concerning interest. See *supra* p. 3 n. 2.

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 shows that DRS considers an employee to have no account balance at the end of the 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:

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	<i>No account balance at end of quarter – no interest for quarter</i>	<i>Transfer occurs – member then earns return on investments</i>

AR 643 (emphasis added).

DRS never told the teachers that it was not paying them all of the interest earned on their funds, and based on their account statements it was “mathematically impossible” for the teachers to determine DRS was not paying daily interest on their retirement contributions in TRS Plan 2. CP 801, 1077-79. DRS thus kept its interest practice secret (*id.*), while at the

same time repeatedly telling the teachers that their contributions earned 5.5% annual interest compounded quarterly. CP 896-905; AR 207, 232.

This Court in *Probst* described the teachers' argument against this DRS practice as the "daily interest" argument because the teachers maintained that irrespective of when interest is posted to their accounts or compounded, DRS is required to pay them 5.5% interest earned on their contributions from the day the contributions were deposited in the accounts to the day they were withdrawn. 167 Wn.App. at 183.

DRS contended that it could keep any interest earned on employee contributions that were in the TRS Plan 2 accounts for less than a whole quarter (and sometimes up to 4-6 months), because that accrued interest was never "posted" to their accounts by its computer system. 167 Wn.App. at 183, 192. The only interest posted at the end of March, for example, is the amount accrued on the balance at the end of December in the prior quarter. AR 261, 320, 643. DRS maintained that the teachers have no property rights in their own contributions (DRS Br. [3/24/11] in *Probst*, No. 40861-9-11 at 1 and 8),<sup>4</sup> and therefore they have no entitlement to interest except to the extent that interest is eventually posted to their accounts by DRS's computer software.

DRS's prior-quarter-end method is referred to as the "quarterly

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<sup>4</sup> The DRS respondent's brief in the first appeal is referred to as "DRS Br. [3/24/11]" in this second appeal.

interest” method or quarter-end method because posting occurs at the end of a quarter and DRS kept all interest earned during that quarter on deposits made within the quarter. AR 261, 320; 167 Wn.App. at 183, 192-93. And it keeps all interest when the accounts are posted with a zero balance in its computer program, even when the funds actually leave the accounts in the next quarter. AR 643.

**Prior Proceedings.** In 2002, Public Employee Retirement System (“PERS”) member Jeff Probst discovered that DRS was keeping interest that had been earned on his contributions when he transferred from PERS Plan 2 to Plan 3. 167 Wn.App. at 183. He filed both an administrative claim with DRS and a class action in the Thurston County Superior Court. The class action was consolidated with a petition for review after DRS rejected his administrative claim. 167 Wn.App. at 184.

Probst settled his petition for review and the class action claims of all PERS members (and a few TRS members) prior to a dispositive ruling from the trial court. The settlement preserved the claims of those who transferred from TRS Plan 2 to Plan 3 prior to January 20, 2002.<sup>5</sup> *Probst*, 167 Wn.App. at 184.

While the *Probst* settlement was pending, DRS went to the

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<sup>5</sup> DRS argued that these pre-2002 TRS claims were barred by the statute of limitations. The trial court below rejected this defense. See *infra* pp. 44-45 (discussing trial court’s decision).

Legislature in 2007, unbeknownst to affected members of the retirement system, and obtained enactment of a statute that provided DRS some discretion on crediting interest. Ch. 493, Laws of 2007, codified at RCW 41.50.033. The teachers and DRS disagreed as to whether the discretion DRS obtained in the 2007 statute allows it to keep some interest that was earned on TRS accounts and whether the statute could apply retroactively to allow DRS to keep the interest that accrued before the TRS transfers at issue here.

The teachers brought this action in a supplemental complaint in 2009, filed under the same cause number as the settled *Probst* claims. 167 Wn.App. at 684. The trial court, the Honorable Paula Casey, ruled the teachers' claim was not barred by the statute of limitations under the discovery rule, CP 1070, 1080,<sup>6</sup> but the trial court said the 2007 statute gave DRS authority to determine what interest was credited to the teachers' contributions more than a decade earlier. 167 Wn.App. at 185.

The teachers appealed. This Court reversed, ruling that even if DRS had some discretion over interest under the 2007 statute, it had abused its discretion in the 1990s (and earlier) by arbitrarily and capriciously withholding some of the interest earned while the teachers' funds were in their TRS Plan 2 accounts, *i.e.*, the daily interest earned on

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<sup>6</sup> DRS did not appeal the statute of limitations ruling.

funds held in their accounts. *Id.* at 191-94. It was arbitrary and capricious for DRS to keep that interest because, among other reasons, DRS's quarterly posting method was contrary to industry standards and unfair because it deprived the teachers of some of the interest earned on their contributions. *Id.* at 193-94. The Court thus "reverse[d] the DRS's order as it pertains to the class that the Fowlers represent and remand[ed] for further proceedings." *Id.* at 194.<sup>7</sup>

DRS moved to reconsider this Court's *Probst* decision. It also made an inconsistent argument in objecting to the teachers' cost bill on the basis that it had actually prevailed in the decision; DRS claimed that it was going to submit new evidence after remand and thereby prevail.<sup>8</sup> This Court denied DRS's motion to reconsider and the Commissioner awarded costs to the teachers as the prevailing parties. CP 132-35 (copies of rulings).

Following remand to the trial court, the teachers filed a motion to require DRS to calculate the interest that it had withheld from the teachers. CP 22-33. DRS maintained, however, that this Court had not resolved the

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<sup>7</sup> This Court did not address the teachers' argument that DRS keeping earned interest and/or applying the statute retroactively to permit DRS to keep accrued interest is an unconstitutional taking of the teachers' property. *Probst*, 167 Wn.App. at 183 n. 1. The Court said it would not reach the constitutional issues because it would decide and resolve this case on other grounds. *Id.*

<sup>8</sup> DRS maintained that it prevailed because upon remand it "will provide additional documentation to show that its quarterly interest policy was neither arbitrary and capricious." DRS Objection to Cost Bill at 3, CP 107.

case at all. CP 136-49. DRS re-asserted its position (earlier asserted in its objection to the cost bill) that it prevailed in the *Probst* appeal. CP 146, 169, 171 (quoted on p. 16, *infra*). DRS argued that this Court's mandate required a remand to DRS for rulemaking to create a new factual record and to issue a new retroactive rule that "can be applied in this case [to actions in 1996-97] and [upon which] a new administrative decision can be issued, which can then be appealed for further review if necessary." CP 148.

The trial court, the Honorable Christopher Wickham, granted DRS's motion to remand the case to DRS. CP 208-09. Although there had been 10 years of litigation and the trial court said "[n]o case should take as long as this case has taken," and "this case needs closure[,]," the trial court ruled that under the Administrative Procedure Act ("APA") procedures, it was required to remand the case to DRS. VRP [6/20/13] at 16 and 23, respectively. DRS has since started a rulemaking process to renew the interest policy that this Court said was arbitrary and capricious. WSR 13-15-128.

### **SUMMARY OF THE ARGUMENT**

In *Probst*, this Court held that it was arbitrary and capricious for DRS to fail to pay and transfer the daily interest earned on the teachers' contributions in their individual TRS Plan 2 accounts when they withdrew those funds and placed the funds in new TRS 3 individual retirement

accounts. 167 Wn.App. at 183, 191-94. This Court specifically reversed the trial court and DRS on this point. *Id.* at 183 and n. 1, 191, 194. Although this Court said it decided and resolved the case, *id.* at 183 n. 1, after the Court's remand, the trial court remanded the action to DRS to start the entire process over. CP 148, 208-09.

The trial court's remand to DRS was based on DRS's argument that this Court left the arbitrary and capricious issue unresolved. CP 148. But this Court *did* resolve this issue, and the Court should therefore enforce its mandate in *Probst*. 167 Wn.App. at 183, 191-94.

Assuming *arguendo* that the trial court's remand to DRS was not contrary to this Court's mandate in *Probst*, this Court should decide DRS's failure to pay the teachers the interest earned on their contributions is an unconstitutional taking because the teachers have a constitutionally protected property right to the interest and the government cannot keep it.

In addition, DRS's intent to enact a rule in 2014 to determine the amount of interest the teachers earned in their accounts more than 15 years earlier is contrary to the teachers' vested rights. The teachers have a vested right to the daily interest their contributions earned in TRS Plan 2 under both the common law and DRS's repeated promises to the teachers. Any statute retroactively affecting the teachers' vested rights would violate due process.

Accordingly, the Court should reverse the trial court's decision remanding the action to DRS and direct the trial court to order DRS to pay the teachers the interest it wrongly withheld.<sup>9</sup>

### **ARGUMENT**

**I. THE TRIAL COURT FAILED TO COMPLY WITH THIS COURT'S MANDATE WHEN IT REMANDED TO DRS FOR RULEMAKING BECAUSE THE ONLY MATTER LEFT UNDER THE MANDATE WAS DETERMINING THE AMOUNT OF INTEREST THAT DRS HAD ARBITRARILY AND CAPRICIOUSLY WITHHELD.**

**A. A Trial Court Must Strictly Follow The Court's Mandate.**

This Court's mandate is "binding on the parties . . . and governs all subsequent proceedings[.]" RAP 12.2. Our Supreme Court is in accord: "[t]he mandate of [the appellate court] is binding on the superior court and must be strictly followed." *Harp v. America Surety Co. of N.Y.*, 50 Wn.2d 365, 368, 311 P.2d 988 (1957); *Morton Organ Co. v. Armour*, 179 Wash. 392, 396, 38 P.2d 257 (1934).

The mandate includes not only the matters addressed in the opinion of the appellate court, *Kolatch v. Rome & Sons*, 137 Wash. 268, 270, 242 P. 38 (1926), but also any other matters raised in the case, including those in a motion to reconsider, even if they are not specifically addressed by the

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<sup>9</sup> The teachers previously moved to recall the mandate. No. 40861-9-II. The motion was denied, perhaps because the record of that appeal no longer exists. Ruling 8/1/13; Clerk's Letter 8/21/13. Consequently, this appeal raises both the mandate issue and other remaining issues. RAP 12.9(a); *Bank of America v. Owens*, \_ Wn.App. \_, 311 P.3d 594 (2013).

court. *Gudmundson v. Commercial Bank & Trust Co.*, 160 Wash. 489, 498-99, 295 P. 167 (1931). The Supreme Court in *Reeploeg v. Jensen*, 81 Wn.2d 541, 548, 563 P.2d 99 (1972) applied *Gudmundson* and held that any order issued by the appellate court was binding and could not be reconsidered by either the appellate court or the trial court after the formal mandate had issued. *Id.* at 548-50 (vacating both the appellate court order reinstating an appeal after the appeal had been dismissed and the subsequent opinion in favor of the appellant).

Accordingly, this Court's *Probst* mandate includes not only its opinion, but also its order denying reconsideration, and its order on costs determining that the teachers are the prevailing party. *Reeploeg*, 81 Wn.2d at 548-549; RAP 12.2. And this Court's "mandate must be strictly followed and carried into effect according to its true intent and meaning" in order that the litigation may end and not be unduly prolonged. *Ethredge v. Diamond Drill Contracting Co.*, 200 Wash. 273, 276, 93 P.2d 324 (1939); *Gudmundson*, 160 Wash. at 496. As our Supreme Court explained in *Gudmundson (id.)*:

Public interests require that an end shall be put to litigation, and when a given cause has received the consideration of a reviewing court, has had its merits determined, and has been remanded with specific directions, the court to which such mandate is directed has no power to do anything but obey; otherwise such litigation would never be ended, and the reviewing tribunal would be shorn of that authority over inferior tribunals with which it is invested by fundamental law.

After the 10 years of litigation resulting in this Court's decision that DRS was arbitrary and capricious in withholding interest, *Probst*, 167 Wn.App. at 183, 191-94, DRS and the trial court treated this Court's decision as leaving the arbitrary and capricious issue "unresolved." CP 148; VRP [6/20/13] at 23. And even though the trial court expressly recognized that no case should take as long as this case has taken and this case needed closure (VRP [6/20/13] at 16, 23), the trial court accepted DRS's contention that under this Court's opinion the trial court had to remand for DRS rulemaking and then start the entire litigation process over. CP 148, 208-209. Under this Court's mandate, the trial court should have ruled as a matter of law that the teachers were entitled to the interest.

**B. DRS and the Trial Court Failed To Comply with this Court's Holding That DRS's Failure to Pay Daily Interest Was Arbitrary And Capricious.**

DRS told the trial court that this Court agreed with DRS's rejection of the daily interest rule: "The Court of Appeals decision on the daily interest rule . . . adopted DRS's position in its entirety. . ." CP 171. And DRS said the Court "did not find fault with the quarterly interest policy as such, but found fault with the formulation of the policy. . ." CP 169. DRS also asserted that this Court did not "address whether [its interest] methodology (the 'failure' to apply daily interest) was arbitrary and capricious." *Id.*

DRS misstates what this Court said it did. The Court held that

DRS's "historical interest calculation method" was "unfair," was contrary to financial industry standards, and continued to be used for years without due consideration of the facts and circumstances. 167 Wn.App. at 193. The trial court, apparently agreeing with DRS, believed the arbitrary and capricious issue was not resolved by this Court (CP 148) and said if the issues had been resolved, this Court needed to clarify the decision. VRP [6/20/13] at 18.

These DRS arguments — that the Court entirely agreed with DRS and/or left the arbitrary and capricious issue unresolved — conflict with the Court's opinion. The entire case concerned DRS's historical *practice* of withholding the interest earned daily on the teachers' funds. The Court summarized the original trial court decision (which this Court reversed) as "DRS was not required to pay daily interest," *i.e.*, not pay interest at the annual rate of 5.5% for all the days that the funds were held in their Plan 2 accounts. *Probst*, 167 Wn.App. at 185. And, the Court said, the teachers' appeal from that trial court decision raised three issues, one of which was whether "DRS's *failure to pay daily interest* was arbitrary and capricious" (*id.* at 183):

The Fowlers appeal, arguing that (1) common law required the DRS to *pay daily interest*, (2) the DRS's *failure to pay daily interest* was arbitrary and capricious, and (3) failing to *pay daily interest* effected an unconstitutional taking. *We reverse . . . .*  
[Emphasis added.]

In its footnote to this same paragraph, in which the Court said it

*reversed* the trial court ruling that “DRS was not required to pay daily interest,” *id.*, the Court said that its decision finding that DRS’s conduct was arbitrary and capricious was intended to *decide* and *resolve* the case — using these precise words — thereby not needing to reach constitutional issues. 167 Wn.App. at 183 n. 1 (emphasis added). And this Court also said, *id.* at 191, “[w]e agree” with the teachers’ argument “that if the DRS had discretion to determine how interest is earned, the way the DRS calculates interest is arbitrary and capricious[.]” Because the Court “decide[d] this case on the grounds of arbitrary and capricious agency action,” the Court did “not reach the Fowlers’ constitutional takings argument.” *Id.* at 183 n. 1. This Court thus concluded, “[w]e accordingly reverse the DRS’s order as it pertains to the class that the Fowlers represent and remand for further proceedings.” *Id.* at 194.

The *Probst* opinion therefore did not intend to leave the daily interest issue “unresolved,” as DRS argued on remand. CP 148. And if it had, the Court said it would have had to rule on the constitutional takings argument. *Id.* at 183 n. 1. Moreover, the Court did not remand the case to DRS for rulemaking, particularly since rulemaking was never at issue and never discussed in this case. The teachers did not challenge a rule, did not challenge the interest rate (5.5%), and did not challenge the compounding period (quarterly); rather, they challenged DRS’s historical practice of withholding accrued interest earned on teachers’ funds held in their TRS

Plan 2 accounts due to DRS's posting practice (*i.e.*, withholding all accrued interest that is earned but not posted at the end of each quarter by computer software). 167 Wn.App. at 183, 193-94.

DRS's arguments, accepted by the trial court, violate this Court's mandate in other respects as well. DRS argued that a remand to DRS was necessary because the Court's opinion left the arbitrary and capricious issue unresolved, CP 148, and therefore, according to DRS, the Court authorized a "remand for additional evidence" on DRS's interest policy. CP 148, 147-49.<sup>10</sup> But DRS expressly agreed — before the original trial and first appeal — that the Fowlers' TRS claims would 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, or anything specific to the plaintiffs in the case." CP 274-75; 167 Wn.App. at 184. Consistent with the parties' agreement, both parties supplemented the record before the trial court and no party was prevented from filing any materials. *Id.*

Despite the parties' stipulation as to the record, DRS now contends that the teachers' claims should be re-decided administratively and eventually re-tried in court after DRS creates additional evidence and

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<sup>10</sup> As noted *supra* at p 11 n. 8, DRS made the same argument to this Court in its objection to the teachers' cost bill -- that it would submit additional evidence after remand and eventually prevail. The Commissioner rejected this argument. This issue was thus resolved against DRS. *Reeploeg*, 81 Wn.2d at 548-50.

issues a retroactive rule based on that additional evidence. CP 147-49. This is not only contrary to its stipulation concerning the record for the superior court trial, which was also the record on the prior *Probst* appeal, but this Court expressly relied on the stipulated record in its decision. *Probst*, 167 Wn.App. at 184.

*All* contemporaneous evidence, and *all* evidence the parties wanted to include, was thus in the stipulated *Probst* record before the trial court and this Court. *Id.* at 184, 185 n. 1. Any additional evidence can only be a *post hoc* rationalization for DRS keeping the accrued interest that was long ago earned on the teachers' employee contributions (up to 1996-97). This Court's mandate did not remand to the trial court to permit DRS to re-open the agency record, nor did it allow DRS to create new evidence to retroactively justify the historical practice that the Court found was arbitrary and capricious. 167 Wn.App. at 191-94.

Contrary to the mandate, DRS also argued that additional evidence and a remand to DRS for rulemaking should be allowed because the arbitrariness of DRS's action "was not an argument raised in the *Probst* administrative appeal and the petition for judicial review." CP 147. But this Court denied the DRS motion to reconsider in which DRS made this exact argument, contending that the Court had "gone outside the proper scope of judicial review," deciding an issue the teachers "never made" that was "raised for the first time by the Court." DRS Mot. to Reconsider, pp.

6-10; CP 45-49.<sup>11</sup> DRS's argument, accepted by the trial court, thus further violates the Court's mandate because the Court denied the motion for reconsideration, resolving the matters raised in the motion. *Reeploeg*, 81 Wn.2d at 548; *Gudmundson*, 160 Wash. at 498-99.

Accordingly, the trial court failed to follow the Court's mandate when it remanded the case to DRS. This Court decided that DRS's historical interest calculation method was arbitrary and capricious.

**C. The Trial Court Erred In Accepting DRS's Argument That the APA Required a Remand to DRS For Rulemaking.**

DRS argued below that a remand to DRS for rulemaking is required because this Court supposedly overturned the 1977 DRS policy on regular interest, in which DRS's director set the regular interest rate at 5.5% annual interest, compounded quarterly. CP 146-48. And, DRS argued, after this Court's decision, there was no interest rate or any interest policy at all. *Id.* DRS said that "[u]nder the APA the [trial] court could not adopt an interest rate policy," CP 146, and therefore the case had to be remanded to DRS to renew and replace the 1977 interest policy through rulemaking. CP 146-49, 171-72.

DRS's argument, accepted by the trial court, disregards the entire

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<sup>11</sup> DRS's Motion to Reconsider was incorrect because the Court's rulings were on issues that were always part of the record and briefing. CP 157, 886-89; Br. of Appellants in *Probst*, No. 40681-9-II, pp. 43-46.

ten years of litigation in this case. The 5.5% annual interest rate was *never* an issue.<sup>12</sup> Nor did this Court overturn the 1977 policy. *Probst*, 167 Wn.App. at 183, 191-94. The teachers' argument, with which this Court agreed, was that DRS's historical practice of withholding interest (earned at the established 5.5% rate) on some funds held in the teachers' Plan 2 accounts was arbitrary and capricious. *Id.*; see Br. of Appellants, *Probst*, No. 40861-9-II, pp. 42-47. DRS has no basis in the Court's opinion, nor in the history of this litigation, for asserting that the entire 1977 policy, interest rate and all, were held invalid by this Court's opinion. CP 146-49.

DRS also argues that because the Court applied *standards* under the Administrative Procedures Act, RCW 34.05 ("APA"), for overturning agency action in RCW 34.05.570(3)(i) (arbitrary and capricious) to the stipulated record, under RCW 34.05.510 APA judicial review *procedures* also apply "exclusive[ly]," and therefore a remand under RCW 34.05.574 was required. CP 143. RCW 34.05.510, however, says precisely the opposite with respect to judicial review procedures because it includes exceptions that apply here.

APA judicial review procedures do *not* apply to a civil action to obtain monetary compensation or to a class action. RCW 34.05.510. And this TRS claim is both—a supplemental class complaint to obtain

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<sup>12</sup> See AR 232; Br. of Appellants, *Probst*, No. 40861-9-II, p. 9.

withheld interest, filed in the same cause number as the now-settled *Probst* petition for review and class action, and certified as a class action.<sup>13</sup> *Probst*, 167 Wn.App. at 184-85. The teachers seek only *monetary* compensation (the unpaid interest) for the class and, therefore, the specific exception to APA review procedures in RCW 34.05.510 applies. *Judd v. Am.Tel. & Tel. Co.*, 152 Wn.2d 195, 204-05, 95 P.3d 337 (2004).

RCW 34.05.510 also states that class actions are governed by the civil rules, not the APA. RCW 34.05.510(2). Nothing in the civil rules permits DRS to remove the case from the courts, especially after the teachers won on appeal. DRS itself recognized that it has no authority as an agency to entertain class actions or provide relief for a class. In the *Probst* administrative proceeding, DRS's presiding officer said (AR 1040):

Class actions are regulated by Rule 23 of the Rules for Superior Court. The [presiding officer] is aware of no source in Washington State authorizing Washington State administrative agencies to entertain litigation for class relief. . . . Superior Court, not this agency, is thus the proper forum for any possible class action related to Mr. Probst's claim.

In addition, assuming *arguendo* that the Court of Appeals' "arbitrary and capricious" holding were still open for further litigation, DRS ruled that the agency itself could not determine the issue. AR 16-17 (the presiding

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<sup>13</sup> DRS itself argued below that this case does not involve a petition for review, but is "unquestionably" only a civil action for a class. CP 190-91. DRS won that point, CP 1070, lines 15-17, and DRS is bound to that position now as a matter of judicial estoppel. *Johnson v. Si-Cor, Inc.*, 107 Wn.App. 902, 909, 28 P.3d 832 (2001).

officer “will not examine whether the challenged Department actions are arbitrary and capricious”). If liability were still an issue, the constitutional takings issue would also be open as well. *Probst*, 167 Wn.App. at 183 n. 1. And constitutional issues are not decided by an agency, but by the courts. Administrative agencies have no authority to determine constitutional issues. *Yakima Clean Air v. Glascam Builders*, 85 Wn.2d 255, 257, 534 P.2d 33 (1975) (no administrative remedy to determine constitutionality; agency is without authority); *Bare v. Gorton*, 84 Wn.2d 380, 383, 526 P.2d 329 (1974) (no administrative remedy for constitutional issue; only courts have that authority). The class action, the arbitrary and capricious issue, and the constitutional issue are all entirely matters for the courts.

In addition, even assuming RCW 34.05.574(1) applied, the section specifically authorizes a reviewing court to set aside agency action, which is what the Court did. Indeed, this Court expressly “reversed the DRS’s order as it pertains to the class that the Fowlers represent.” 167 Wn.App. at 194. And the precise DRS decision this Court *reversed* was that “*DRS was not required to pay daily interest[.]*” *Id.* at 185 (emphasis added). Under the Court’s opinion, DRS is therefore required to pay the interest that it arbitrarily kept. There is no agency discretion on interest policy that needs to be exercised all over again. The only thing left for the trial court to do upon remand is to implement this Court’s decision by requiring DRS to recalculate all the daily interest earned on the teachers’ accounts at the

annual rate of 5.5% and determine the appropriate remedies.

Finally, RCW 34.05.574(1) states that a court will not remand to an agency where the “remand is impracticable or would cause unnecessary delay.” If there were ever a case of unnecessary delay, this is it — DRS is seeking a remand to re-write a 1977 policy and then re-run the entire litigation. CP 148-49. That would certainly constitute an excessive and unnecessary delay under RCW 34.05.574(1). The trial court agreed the delay would be excessive and unfair to plaintiffs, but the trial court erroneously believed it was required to remand as a matter of law. VRP [6/20/13] at 16, 23. And, as stated above, a remand is impracticable because DRS has no authority over class relief, over the arbitrary and capricious issue, or over the constitutional issues.

Nothing in the APA or the Court’s mandate requires or permits a remand of this class action to DRS.

**D. This Court’s Arbitrary and Capricious Decision Was Based on the Substance of DRS’s Interest Practices — They Are Unfair and Contrary to Financial Industry Standards — Not Due to the Formulation of DRS’s Interest Policy.**

DRS contended on remand (and its Motion to Reconsider in this Court) that this Court did not decide that DRS’s withholding of daily interest was arbitrary and capricious (see p. 16, *supra*), contradicting *Probst*, 167 Wn.App. at 183, 191, 193-94. It said this Court only found fault with the formulation of DRS’s interest policy, and DRS would fix the

formulation problem by re-writing the facts and renewing its 1977 interest policy with a new rule. CP 146-49, 169, 171.

This Court's determination that DRS's withholding of earned interest from TRS members who transfer from Plan 2 to Plan 3 is arbitrary and capricious was based on the substance of this practice, not formulation of the policy supporting it. The Court's arbitrary and capricious finding was based on a factual record showing that DRS's historical interest calculation method was "unfair" and the method "did not conform to [financial] industry standards." 167 Wn.2d at 193. And despite knowledge of these problems, DRS continued to use the method "without due consideration of the facts and circumstances." *Id.* at 193-94.

The Court's conclusions on DRS's arbitrary and capricious practice, the unfairness of its method, and DRS's failure to follow common financial industry standards regarding daily interest calculations are strongly supported by the record. First, DRS has a double standard, *i.e.*, when DRS is owed money by teachers restoring withdrawn contributions, DRS recognizes that interest accrues and is earned *on a daily basis*, AR 433, but when DRS owes employees interest on contributions, DRS does not pay them the same daily interest. It instead uses a computer program that pays the teachers zero interest for at least a quarter, and sometimes for up to six months. AR 250-56, 261, 643. Because it applies a double standard on calculation of interest, DRS's

action is unfair, inconsistent, and capricious. *Puget Sound National Bank v. Dep't of Rev.*, 123 Wn.2d 284, 291, 868 P.2d 127 (1994).

In addition, an “[a]gency action is arbitrary and capricious if it willful and unreasoning and taken without regard to the attending facts or circumstances.” *Rios v. Dept. of Labor & Indus.*, 145 Wn.2d 483, 501, 39 P.3d 961 (2002). A method for calculating interest is arbitrary and capricious if it is not based on the real dates of deposit and payment, and is therefore inaccurate.

Here, DRS used an undisclosed computer program with fictional deposit and withdrawal dates that inaccurately calculated interest in at least four ways. First, it treats the teachers' funds as withdrawn when the funds are still in their account and should therefore earn interest. AR 250-56; 643. Second, it treats teachers' deposits made during a quarter as if they were made in the next quarter and they therefore *earn no interest* during the quarter they are actually made. AR 261. Third, it does not properly compound interest on employee contributions made during a quarter because these deposits *earn no interest* during the quarter to be added to the principal at the end of the quarter. AR 261. Fourth, it does not calculate and add interest on employee deposits on an annualized basis — the 365-day year that DRS uses when it is owed money by the employees and others — but only on  $\frac{3}{4}$  or  $\frac{1}{2}$  of the year. AR 250-56, 261, 643. (See also *supra*, pp. 6-7 (discussing erroneous computer program)).

This Court noted that DRS knew of these errors and decided to do nothing. 167 Wn.App. at 192-94. DRS recognized that it could have accurately paid the teachers daily interest on their contributions if it would have simply “change[d] computer programs.” AR 542. DRS clearly had the capability to correctly calculate accrued interest because it correctly calculates accrued interest when employees, employers, and third parties owe DRS money, imposing annual interest on a daily basis from the first calendar day that the receivable is overdue until the payment date. WAC 415-114-400; AR 433.<sup>14</sup>

DRS also was aware that it should change its inaccurate computer program so that the employees would receive the stated interest rate. DRS Senior Counsel Pete Cutler recommended in 1997 that employees who transfer to Plan 3 should receive “any interest which has accrued before

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<sup>14</sup> DRS’s Employer Handbook further explains that “interest charges are posted once a month,” but “[i]nterest accrues daily” under WAC 415-114-400. See CP 479, quoting DRS Employer Handbook:

**How is Interest Calculated?**

*Interest accrues daily* on outstanding debit balances for each receivable, and *interest charges are posted once a month* to each receivable.

As of January 1999, interest is charged on each past due receivable balance, rather than on the overall account balance. *Interest is calculated daily on the daily balance and posted once a month* on the balance of each receivable with a debit balance. Multiply the daily rate times the outstanding balance times the applicable number of days to determine the amount of interest due. [Emphasis added.]

$$\frac{12\%}{365 \text{ (days per year)}} = .0003288 \text{ daily rate}$$

([http://www.drs.wa.gov/Employer/EmployerHandbook/chpt10/rms\\_interest.htm](http://www.drs.wa.gov/Employer/EmployerHandbook/chpt10/rms_interest.htm))

that date [for calculating the account balance], even though the . . . interest had not yet been posted to the member accounts.” AR 452. Cutler also advised that DRS's “new database system . . . allows for more timely posting of member contributions and timely posting of interest,” noting that “more timely” posting of interest would “bring DRS interest credit practice closer to industry standard”<sup>15</sup> that would provide “a real rate of interest that is closer to the 5.5% indicated rate” AR 287. The Department, however, took *no action* on these recommendations. AR 520-26.

Accordingly, DRS knows how to properly calculate interest, and it does so when TRS members and others owe DRS money. The Department could have changed its inaccurate computer program to calculate the interest actually earned by employees, but it did not. Due to DRS’s undisclosed and inaccurate computer program for calculating interest owed to members, employees never receive the established rate of 5.5% annual interest compounded quarterly.

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<sup>15</sup> DRS documents explain the “industry standard,” which is the same as the common law daily interest rule (AR 484):

Industry Standard

As you’re aware, the banking industry will normally post interest monthly. However, if you withdraw everything from your account mid-month, they will post the interest earned up to the date of withdrawal.

Also, the 3<sup>rd</sup> party administrator for Deferred Compensation under contract with DRS follows the industry standard.

This Court thus held that DRS's historical interest calculation method was arbitrary and capricious. 167 Wn.App. at 191-94. The Court said that "the relevant question" its decision addressed was "whether [DRS] acted in willful and unreasoning disregard of the facts and circumstances." *Id.* at 191 n. 9, 194. And, because the method was held to be an unfair and inaccurate historical practice that did not meet financial industry standards, *id.* at 193, DRS cannot retroactively re-write the facts now to make that practice fair, accurate, and in accordance with industry standards.

**II. DRS'S FAILURE TO PAY THE TEACHERS THE DAILY INTEREST EARNED ON THEIR CONTRIBUTIONS IS AN UNCONSTITUTIONAL TAKING OF THEIR PROPERTY.**

If the Court finds DRS's failure to pay the teachers the daily interest earned on their funds is contrary to the *Probst* mandate, then the Court does not need to reach the issue of whether DRS's failure to pay the interest constitutes an unconstitutional taking of private property. The *Probst* Court said that "[b]ecause we decide this case on the grounds of arbitrary and capricious agency action, we do not reach the Fowlers' constitutional takings argument." 167 Wn.App. at 183 n. 1.

Assuming *arguendo* that the arbitrary and capricious issue was for DRS to decide, the Court will need to reach the takings argument. *Id.* The Court should rule that DRS's failure to pay the daily interest earned on the teachers' funds is an unconstitutional taking. The teachers have a

constitutionally protected property right in the interest earned on their contributions and, as explained in this section, neither DRS nor the Legislature has the authority to take that interest from the teachers.

“Pursuant to the Takings Clause of the Fifth Amendment, ‘private property [shall not] be taken for public use, without just compensation.’ U.S. Const. amend. V. This provision is applied to the states through the Due Process Clause of the Fourteenth Amendment.” *Dean v. Lehman*, 143 Wn.2d 12, 31, 18 P.3d 523 (2001). “In order to state a claim under the Takings Clause, a plaintiff must first demonstrate that he possesses a ‘property interest’ that is constitutionally protected.” *Schneider v. Cal. Dep’t of Corrections*, 151 F.3d 1194, 1198 (9th Cir. 1998).<sup>16</sup>

“Although an explicit statutory provision may indeed be a *sufficient* condition to the creation of a constitutionally cognizable property interest,” a statutory provision “assuredly is not a *necessary* one.” *Schneider*, 151 F.3d at 1199 (Court’s emphasis). “[P]roperty rights can-and often do-exist wholly independently of statutes recognizing them as such.” *Id.* Indeed, “constitutionally protected property rights can-and often do-exist *despite* statutes . . . that appear to deny their existence.” *Id.* (Court’s emphasis).

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<sup>16</sup> *Schneider* is cited in *Dean* for the legal principles governing the Takings Clause with respect to interest. *Dean*, 143 Wn.2d at 35-36.

“The States’ power vis-a-vis property . . . operates as a one-way ratchet of sorts: States may, under certain circumstances, confer ‘new property’ status on interests located outside the core of constitutionally protected property, but they *may not* encroach upon traditional ‘old property’ interests found within the core.” *Schneider*, 151 F.3d at 1200-01 (Court’s emphasis). And one of the core property rights that States may not encroach upon is that interest follows principal and there is a protected property interest in earned interest income. *Id.* at 1199-200, *citing Phillips v. Washington Legal Foundation*, 524 U.S. 156, 165-66, 118 S.Ct. 1925, 141 L.Ed.2d 174 (1998) (IOLTA case).

In *Phillips*, the United States Supreme Court explained that interest follows principal and therefore interest earned belongs to the owner of the funds that generated the interest. *Phillips*, 524 U.S. at 165-66 and n. 5. The common law rule is also that interest is earned daily up to the day the interest is paid. *Probst*, 167 Wn.App. at 189 n. 6.

Accordingly, “any interest that *does* accrue” on deposited funds is “a property right incident to the ownership of the underlying principal.” *Phillips*, 524 U.S. at 168 (Court’s emphasis); *accord, Schneider*, 151 F.3d at 1200-01. In *Dean*, our Supreme Court agreed with *Schneider* that the property interest earned on an owner’s principal cannot be taken by statutory directive because “interest income ‘is sufficiently fundamental

that States may not appropriate it without implicating the Takings Clause.” *Dean*, 143 Wn.2d at 35, quoting *Schneider*, 151 F.3d at 1201.

The common law therefore created a constitutionally protected core property right in the interest that is earned on the teachers’ funds.<sup>17</sup> And assuming *arguendo* that the Legislature’s 2007 statute, RCW 41.50.033, or some other statute, authorized DRS to appropriate or take the interest earned on the teachers’ Plan 2 funds when they move those funds to Plan 3, the statute would be an unconstitutional taking because the teachers have a fundamental property right to the interest earned on their contributions. *Dean*, 143 Wn.2d at 34-35; *Schneider*, 151 F.3d at 1200-01; *Phillips*, 524 U.S. at 165-68.

DRS does not dispute that it did not pay the teachers all of the interest their contributions earned, and that some of the interest remains in the employers’ Plan 2/3 account.<sup>18</sup> In the previous appeal, DRS tried to

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<sup>17</sup> The teachers’ property right in the interest on their contributions is also expressly recognized by the Legislature, which said that upon a teachers’ withdrawal of funds the teacher “shall” receive all “accrued interest” on their contributions. RCW 41.04.445(4). In *Dean*, our Supreme Court held a very similar statute providing that inmates shall receive “accrued interest” on their deposits created a constitutionally protected property right. *Dean*, 143 Wn.2d at 34-35.

In *Probst*, this Court said that the “accrued interest” language does not “appear in the relevant TRS statutes” and the language is “in a tangentially related statute[.]” 167 Wn.App. at 189 n. 7. The Court erred on this point because RCW 41.04.445 expressly “applies to all members who are . . . under the retirement systems established by chapter 41.32 [TRS].” RCW 41.04.445(1)(c). The DRS presiding officer made this same error in the administrative action, saying the statute did not apply to PERS, and DRS itself asked the presiding officer to correct this part of her decision. AR 948-49.

<sup>18</sup> Due to DRS’s quarter-end accounting method, there are periods of up to six months  
(continued)

justify its seizure by arguing that the teachers' contributions are "the property of the retirement system" and "members have no property interest in . . . their own contributions[.]" DRS Br. [3/24/11] at 1 and 8, respectively. DRS said 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].'" DRS Br. [3/24/11] at 8 n. 8, quoting *Marysville v. State*, 101 Wn.2d 50, 56, 676 P.2d 989 (1984); DRS Br. [3/24/11] at 48-49.

DRS's quotation from *Marysville*, however, is quite misleading because it omits the phrase showing that the case concerns employer contributions, not employee contributions: "Individual members have no legal claim *upon the employer contribution fund* until they qualify for benefits under the act's provisions." *Marysville*, 101 Wn.2d at 56 (emphasis added). Unlike *Marysville*, this case concerns the *employees'* contributions, not the employer contributions.<sup>19</sup>

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where the employees' funds earn returns, AR 577, 624-27, 791-94, 800, but the employees themselves receive *no* interest (not 5.5% or any other amount) because DRS says no interest earnings are credited or posted to the accounts of these individuals. AR 643; See also *supra* pp. 6-7 (discussing DRS's computer program).

<sup>19</sup> Rather than the employer contribution fund at issue in *Maryville*, the teachers' own employee contributions and interest here were tracked in individual accounts for the members. CP 800-01, 816.

DRS's argument that the teachers' (employee) contributions and the interest on the earned on those contributions are the property of the retirement system is directly contrary to two Supreme Court opinions. *Bowles v. DRS*, 121 Wn.2d 52, 847 P.2d 440 (1993); *State ex. rel. State Ret. Bd. v. Yelle*, 31 Wn.2d 87, 201 P.2d 172 (1948). In *Bowles*, the Supreme Court held that "employees contributions [to the retirement system] are not public funds" and are instead employee funds of a "proprietary nature." 121 Wn.2d at 75. Using the funds to advance the members' attorney fees therefore did not involve an unconstitutional lending of state credit. *Id.* at 74-75.

The *Bowles* Court cited *Yelle* as supporting its holding. In *Yelle*, our Supreme Court considered whether employee contributions and the interest earned on those contributions in the state employees' retirement system are public funds. 31 Wn.2d at 95-113. The Court held that the employee contributions and interest in the employees' individual accounts "are not *state funds*." *Id.* at 111 (Court's emphasis). One of the reasons the Supreme Court gave for its holding is that "any member withdrawing his contributions from the employees' savings fund is entitled to interest thereon[.]" *Id.* at 113. DRS is therefore wrong to argue that the teachers' contributions are "the property of the retirement system." DRS Br. [3/24/11] at 1, 8. The contributions, and all the interest earned on them,

are the teachers' property. *Bowles*, 121 Wn.2d at 74-75; *Yelle*, 31 Wn.2d at 111-13.

DRS also tried to obfuscate this issue in the earlier appeal by arguing the teachers made the contributions in exchange for statutorily defined benefits based upon salary and length of service. DRS Br. [3/24/11] at 42. DRS's argument is groundless because the teachers withdrew all of their accumulated contributions from TRS Plan 2, they are no longer members of that plan, and they will not 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' TRS Plan 3 defined benefit pension *solely* by employer contributions and the earnings on those employer contributions. AR 343; RCW 41.32.840(1). The employee contributions and interest are instead in the teachers' new TRS Plan 3 individual retirement accounts.

Accordingly, when the teachers withdrew their contributions and interest from their accounts, the teachers had a constitutionally protected property right to the daily interest that their contributions earned, which no statute or administrative rule can authorize DRS to take from the teachers. DRS's failure to pay the teachers the daily interest earned on their funds is an unconstitutional taking of their property. *Dean*, 143 Wn.2d at 34-35; *Schneider*, 151 F.3d at 1200-01; *Phillips*, 524 U.S. at 165-68.

**III. DRS CANNOT ADOPT A RULE IN 2014 TO TAKE AWAY INTEREST EARNED ON THE TEACHERS' CONTRIBUTIONS MORE THAN 15 YEARS AGO BECAUSE IT WOULD VIOLATE THE TEACHERS' VESTED RIGHTS.**

**A. The Teachers Have a Vested Right in the Interest Earned on Their Contributions in TRS Plan 2 Based on the Common Law Daily Interest Rule Existing at the Time of the Contributions.**

This Court stated in *Probst* that “the TRS statutes do not require the DRS to pay daily interest on balances transferred from Plan 2 to Plan 3” and DRS has discretion under the 2007 statute to pay interest in a manner inconsistent with the traditional common law rule. *Probst*, 167 Wn.App. at 186-91. This Court did not rule, however, that the TRS statutes *prohibit* DRS from paying daily interest in accordance with the common law (and the industry standard) or that the common law does not fill gaps in legislative enactments. *Id.*

Now, more than 15 years after the vast majority of teachers transferred their accumulated contributions TRS Plan 2 to Plan 3, DRS’s position is that the 2007 statute passed by the Legislature, RCW 41.50.033, authorizes the agency to determine through rulemaking in 2014 how much interest the teachers earned on their contributions in TRS Plan 2 *prior to 1998*, a breathtakingly retroactive application of the statute. DRS argued to the trial court to remand the matter back to DRS for such rulemaking (CP 148):

This case will remain unresolved until DRS can adopt an interest policy to renew or replace the policy considered to be arbitrary and capricious by the Court of Appeals. *Once a policy is adopted, it can be applied in this case* and a new administrative decision can be issued, which can then be appealed for further judicial review if necessary. [Emphasis added.]

DRS's notice of rulemaking states that the "court remanded to the department the determination of the interest policy for the accounts containing funds that were transferred from TRS Plan 2 to TRS Plan 3." WSR 13-15-128. The notice says DRS is authorized to issue such a rule by the 2007 statute, RCW 41.50.033. WSR 13-15-128.

DRS argues rulemaking is necessary because, it says, "the historic [quarter-end] DRS interest policy is invalid, so there is no . . . crediting methodology until DRS renews the prior policy or adopts a new one after due consideration." CP 146; CP 168 (DRS "interest policy found invalid by Court of Appeals"). While DRS is correct that the Court found its quarter-end method invalid, DRS is incorrect that there was no interest rule for the teachers' accounts in the 1990s because the common law "address[es] *gaps* in *existing* statutory enactments" and "the common law may serve to 'fill interstices that legislative enactments do not cover.'"<sup>20</sup>

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<sup>20</sup> Not only did the Court hold DRS's quarter-end method is invalid, but DRS's presiding officer previously found there was "legislative silence" on when members earned interest on their funds (AR 22, ¶29), and DRS repeatedly agreed with this finding. CP 414, lines 18-19 ("The Legislature did not provide any guidance on how interest is to be calculated on member accounts; when a member's contributions begin to accrue and earn interest[.]"); CP 417, lines 8-9 and 13-14 ("There is no statute or regulation that

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*In re Parentage of L.B.*, 155 Wn.2d 679, 689, 122 P.3d 161 (2005) (Court's emphasis), quoting *DSHS v. Personnel Bd.*, 61 Wn.App. 778, 783, 812 P.2d 500 (1991). Insofar as the common law is not inconsistent with the existing law, the common law "shall be the rule of decision in all the courts of this state." *Potter v. Washington State Patrol*, 165 Wn.2d 67, 77 n. 7, 196 P.3d 691 (2008) (quoting RCW 4.04.010).

In *Probst*, this Court said that "DRS does not contest" that under the common law "interest was deemed to accrue daily, regardless of when it was payable." *Probst*, 167 Wn.App. at 189 n. 6.<sup>21</sup> DRS did not disagree because the legal right to receive the interest earned daily on funds held in an account has been part of the common law since at least 1755,<sup>22</sup> and

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requires the department to calculate interest in [any] manner ... there is no requirement for how interest must accrue, how the rate must be calculated, or that pro rata interest must be paid when funds are withdrawn."); CP 418, lines 19-20 ("The PERS statutes, including the transfer statute at issue here, do not define or dictate any interest calculating method.").

<sup>21</sup> *Halsbury's Laws of England*, cited in *Probst* as the common law (167 Wn.App. at 189 n. 6), explains that "interest accrues from day to day even if payable only at intervals":

**Interest in General.** Interest is the return or compensation for the use or retention by one person of a sum of money belonging to or owed to another. *Interest accrues from day to day even if payable only at intervals*, and is, therefore, apportionable in respect of time between persons entitled in succession to the principal. (Bold in original, italics added, footnote omitted.)

<sup>32</sup> *Halsbury's Laws of England*, § 127 Interest in General, p. 78 (4th ed. 2005).

<sup>22</sup> In 1755 the English High Court of Chancery noted the rule that "interest is supposed to grow due from day to day to be sure; and the person intitled to the produce is intitled to it to the last hour of the day" *Wilson v. Harmon*, 2 Ves. Sen. 671, 672 (1755). The common law rule derives from the fact that interest is paid to compensate the person for the time loss use of their money: "the principle of apportionment is therefore TIME, ... the total payment being distributed in proportion to the respective periods of enjoyment."

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numerous American cases in the 1800s applied the common law rule that interest accrues and is earned daily (“*de die in diem*”).<sup>23</sup>

Accordingly, since the Court of Appeals found DRS’s quarter-end interest practice “invalid” and the statutes are silent on how interest is earned, both points DRS acknowledges (*supra* p. 38 and n. 20), the teachers earned interest on their contributions in TRS Plan 2 on a daily basis because the common law daily interest rule filled this gap in the statutory scheme. *In re Parentage of L.B.*, 155 Wn.2d at 689; *DSHS v. Personnel Bd.*, 61 Wn.App. at 783-84.

Any rule that DRS adopts in 2014 concerning how interest is earned on members’ contributions is subject to the same principles as a statute. *Mader v. Health Care Authority*, 149 Wn.2d 458, 472, 70 P.3d 931 (2003). Here, DRS says the 2014 rule is authorized by the 2007 statute, which the Legislature said is “curative, remedial, and

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*Ex Parte Smyth*, 1 Swan. 337, 348 (1818) (capitalization in original).

<sup>23</sup> *Clapp v. Astor*, 2 Edw.Ch. 379, 6 N.Y. Ch. Ann. 436 (1834) (“interest upon money . . . accrues and becomes due *de die in diem* for the forbearance of the principal”); *McKeen’s Appeal*, 42 Pa. 479 (Penn. 1862) (interest “becomes due *de die in diem* for forbearance of the principal”); *In re Flickwir’s Estate*, 136 Pa. 374, 382 (Penn. 1890) (“Interest accrues *de die in diem*, but it is calculated at a rate per annum”); *Mann v. Anderson*, 32 S.E. 870, 871 (Ga. 1899) (“Interest was apportionable at common law, because it was held to accrue *de die in diem*, and, therefore, to be susceptible of immediate division. This is the rule of the common law....”); *Owens v. Graetzel*, 126 A. 224, 227 (Md. Ct. App. 1924) (the “rule is that interest accumulates day to day”). “*De die in diem*” is a Latin phrase used in the law meaning “from day to day; daily.” Black’s Law Dictionary (7<sup>th</sup> ed. 1999), p. 421.

retrospectively applicable.” RCW 41.50.033(3).<sup>24</sup> But a “statute may not be given retroactive effect, regardless of the intent of the legislature, where the effect would be to interfere with vested rights.” *Gillis v. King County*, 42 Wn.2d 373, 376, 255 P.2d 546 (1953). This principle is based on the due process clauses of the Fifth and Fourteenth Amendments. *Godfrey v. State*, 84 Wn.2d 959, 962-63, 530 P.2d 630 (1975); *In re McGrath’s Estate*, 191 Wash. 496, 509, 71 P.2d 395 (1937).

While due process generally does not prevent new laws from going into effect, it does prohibit changes to the law that retroactively affect rights that are vested under the prior law. *Godfrey*, 84 Wn.2d at 962-63. A vested right, entitled to protection from legislation, includes the “legal or equitable” right “to the present or future enjoyment of property[.]” *Id.* at 963 (Court’s emphasis); *Gillis*, 42 Wn.2d at 377.

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<sup>24</sup> In *Probst* this Court erred when it decided RCW 41.04.445 is an immaterial “tangentially related statute” (167 Wn.App. at 189 n. 7), when in fact the statute governs the very situation here -- withdrawals of funds from TRS Plan 2. See *supra* p. 33 n. 17. This Court also erred when it decided that the Legislature’s 2007 statute is inconsistent with the common law because not only is that decision contrary to RCW 41.04.445(4), which requires that the teachers receive all “accrued interest” on their funds upon withdrawal and the ordinary meaning of accrued interest is “interest earned, though not credited or otherwise paid.” AR 684 (dictionary); *accord*, AR 662, 668, 672 (dictionaries). But this Court’s decision is also contrary to the rule that the common law is not changed unless a statute is clearly and explicitly “repugnant” to the common law, which the 2007 statute is not. *Potter*, 165 Wn.2d at 76-77 and n. 8.

The Court may correct this erroneous part of the *Probst* decision under RAP 2.5(c)(2). *Eserhut v. Heister*, 62 Wn.App. 10, 14, 812 P.2d 902 (1991). But the Court does not need to reach this issue concerning the 2007 statute because the matter can be resolved on other grounds, *i.e.*, by enforcing the *Probst* mandate, by finding DRS’s failure to pay the interest is an unconstitutional taking, or by finding any retroactive rule that supposedly authorizes DRS to keep the interest would violate the teachers’ vested rights.

Here, the teachers had a core common law property right to the interest earned on their funds in TRS Plan 2 when they withdrew those funds. (See *supra* at 31-33.) Therefore, assuming *arguendo* that it were not unconstitutional for DRS to keep the daily interest earned on the retirement system members' contributions, in 2014 DRS could enact a prospective rule governing how interest is earned on member contributions that is different from the common law daily interest rule. But DRS cannot enact a rule in 2014 to deny the teachers the daily interest earned on their contributions more than 15 years ago because the teachers have a vested property right to that interest based on the law existing at the time the contributions were earning interest, which was the common law daily interest rule.

**B. The Teachers Have a Vested Right in the Interest Earned on Their Contributions in TRS Plan 2 Based on the Promises DRS Made at the Time They Were in Plan 2.**

When an employee works in a job to which a retirement plan is applicable, the employee contracts for the promised rights in the retirement plan at that time and those rights cannot later be changed. *Bakenhus v. Seattle*, 48 Wn.2d 695, 701, 296 P.2d 536 (1956). Recently, our Supreme Court explained that while “the *Bakenhus* court admitted that applying contract theory to secure a vested right in pension benefits ‘may not be flawless in a purely legalistic sense,’ such a conclusion ‘gives effect to the reasonable expectations of the employee.’” *Navlet v. Port of*

*Seattle*, 164 Wn.2d 818, 835, 194 P.3d 221 (2008), quoting *Bakenhus*, 48 Wn.2d at 701. Promises made to an employee in a retirement system are thus considered vested rights after work by the employee. *Navlet*, 164 Wn.2d at 837-38.

Here, DRS assured the teachers that their contributions would earn “5.5 percent annual interest compounded quarterly.” AR 207, 232 (Admission No. 1); CP 896-905. DRS’s promise that the teachers’ contributions would earn interest on an “annual” or “per annum” basis meant that interest was earned daily because annual interest must be calculated on a daily basis using a 365-day year. *Chern v. Bank of America*, 544 P.2d 1310, 1312 (Cal. 1976); *Silverstein v. Shadow Lawn Savings & Loan Ass’n*, 237 A.2d 474, 481 (N.J. 1968); *In re Oil Spill by the “Amoco Cadiz,”* 794 F.Supp. 261, 264-66 (N.D. Ill. 1992).<sup>25</sup>

Due to DRS’s quarter-end interest practice, however, the teachers’ deposits during a quarter did not earn any interest in that quarter, and DRS therefore did not use a 365-day year to calculate the interest on teachers’ contributions. Instead, DRS used at most three-quarters of the 365-day year in calculating interest on the teachers’ monthly deposits, and sometimes only half of the 365-day year (as it did for Jeff Probst). AR

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<sup>25</sup> DRS itself used a 365-day calendar to determine the interest owed by employers, employees, and others to DRS. CP 876 (quoting DRS Employer Handbook). See p. 28 n. 14, *supra*.

643, AR 250-56, AR 261. DRS's presiding officer expressly acknowledged that DRS did not in fact pay the promised 5.5% annual rate compounded quarterly, but she said the interest earned on the teachers' accounts is "what the agency determines it to be, not simply the stated rate." AR 23, ¶33.

This DRS quarter-end practice was *secret*. As part of the trial court's ruling that the discovery rule applied and the teachers' claims were not barred by the statute of limitations, the trial court found that "plaintiffs in this case did not know and had no reason to know that interest was not calculated to the date that they believe it should have been calculated until they were advised in 2006." CP 1079. Indeed, "[i]t is most likely that they would have had the expectation that interest was being calculated as of the date of the transfer[,]" *i.e.*, DRS was paying them the daily interest earned on their contributions. CP 1078. Consistent with the trial court's findings, representative teacher Mickey Fowler submitted undisputed testimony that he in fact always believed "based on [his] dealings with financial institutions that [his] contributions would earn daily interest from the date of deposit up to the date the contributions were withdrawn from the account." CP 800. Based on the statements DRS provided to Fowler tracking his contributions and interest, it was "mathematically impossible for anyone to determine . . . that DRS was not paying daily interest on [his] retirement contributions in TRS Plan 2." CP 801.

The trial court further found that DRS never told the plaintiffs that it did not pay them the daily interest earned on their contributions, that DRS was paying interest only on the prior quarter's balance, or that this could impact their decision on when to transfer to TRS Plan 3:

It is my understanding that the Department acknowledges and there is no dispute that the plaintiffs received no notice of the particular formula of computing interest on the transfer from Plan 2 to Plan 3 prior to the transfer. The plaintiffs received no advice, notice, or warning that the date of transfer from Plan 2 to Plan 3 could make a difference in the amount that was being transferred[.]

CP 1077. The trial court thus ruled "the discovery rule should apply in this case" and the teachers' claim is not barred by the statute of limitations. CP 1070, 1079. DRS did not appeal these findings or the trial court's decision, and the findings are therefore verities on appeal.

*McCleary v. State*, 173 Wn.2d 477, 514, 269 P.3d 227 (2012).

Accordingly, the teachers have a vested right to the interest earned on their contributions because DRS promised them a certain rate of interest (5.5% annual interest, compounded quarterly), and DRS's secret practice of denying the teachers some of that interest is invalid -- as DRS acknowledges (*supra*, p. 38). Any rule promulgated by DRS in 2014 under the 2007 statute concerning how members earn interest on their contributions therefore cannot apply retroactively, but instead only prospectively (assuming the rule did not create an unconstitutional taking).

**IV. CLASS COUNSEL SEEK A COMMON FUND ATTORNEY FEE AWARD, BUT NOT UNTIL THE CONCLUSION OF THE LITIGATION.**

Class counsel seeks a common fund attorney fee under *Bowles*, 121 Wn.2d at 71-72, and *Serres v. Dep't of Retirement Systems*, 163 Wn.App. 569, 580, 588-89, 261 P.3d 173 (2011). The fee award is based on the total amount recovered, however, and thus awaits the conclusion of this litigation when the common fund can be valued. *Id.*; RAP 18.1(b). The Court, however, should award costs on appeal to the teachers.

**CONCLUSION**

The teachers prevailed in their appeal. This Court ruled that even if DRS had discretion on interest under a 2007 statute, it was arbitrary and capricious for DRS to exercise that discretion more than a decade earlier to withhold from the teachers the interest that their contributions earned. The trial court failed to comply with this Court's mandate when it remanded the action to DRS for rulemaking to start the entire litigation over. This Court's *Probst* opinion required the trial court to determine the amount of interest due the teachers and did not require DRS to engage in new rulemaking calculated only to allow DRS to overturn this Court's decision.

In addition, any statute or rule that purportedly allowed DRS to keep the interest earned on the teachers' funds in their TRS Plan 2 accounts would be an unconstitutional taking of their property because the

teachers have a core constitutionally-protected property right in the interest. The teachers also have a vested right to the interest earned on their contributions in TRS Plan 2 under both the common law existing at the time of the contributions and DRS's repeated promises. And neither the 2007 statute nor a 2014 administrative rule can apply more than 15 years retroactively to interfere with the teachers' vested rights because it would be contrary to due process.

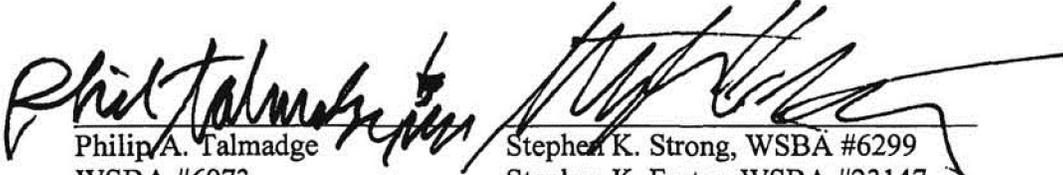
This Court should require compliance with its *Probst* decision by instructing the trial court to (1) calculate the interest that DRS wrongly withheld from the teachers from the dates the teachers made the contributions to the dates they were withdrawn, (2) calculate the separate "transfer payment" paid into the TRS members accounts to include the interest DRS wrongly withheld,<sup>26</sup> and (3) calculate the earnings or interest on the funds that were not transferred from the dates the teachers transferred to TRS Plan 3 and from the date of the transfer payment respectively, to the date the money is finally deposited into their Plan 3 accounts.

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<sup>26</sup> The "transfer payment" is explained *supra* p. 4.

Respectfully submitted this 21st day of November, 2013.

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**PROOF OR SERVICE**

I, Monica Dragoiu, declare under penalty of perjury that I am over the age of 18 and competent to testify and that defendant, Department of Retirement Systems, was served as follows:

On Thursday, November 21, 2013, I personally served a true and correct copy of Appellants' Brief and this Certificate of Service as

follows: Michael Tardif ([miket@fjtlaw.com](mailto:miket@fjtlaw.com))  
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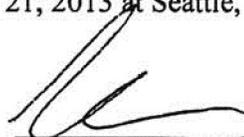
VIA EMAIL and US MAIL, POSTMARKED November 21, 2013

In accordance with the laws of the State of Washington, the original and one copy of Appellants' Brief and this Certificate of Service were filed on November 21, 2013 via ABC Legal Messengers as follows:

Court of Appeals of Washington, Division II  
950 Broadway, Ste 300  
Tacoma WA 98402

I declare under penalty of perjury of the laws of the State of Washington that the foregoing is true and correct.

DATED: November 21, 2013 at Seattle, Washington.



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MONICA DRAGOIU  
*Legal Assistant*