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NO. 87424-7

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Corrected SUPREME COURT OF THE STATE OF WASHINGTON

WASHINGTON EDUCATION ASSOCIATION; et al, and all others
similarly situated,

Respondents/Cross-Appellants,

v.

STATE OF WASHINGTON and DEPARTMENT OF RETIREMENT
SYSTEMS,

Appellants/Cross-Respondents.

CHERYL COSTELLO, STEPHEN GORE, RICHARD MORVAN, and
JERALD NEWELL, on behalf of themselves and a class of persons
similarly situated,

Respondents,

v.

STATE OF WASHINGTON and DEPARTMENT OF RETIREMENT
SYSTEMS,

Appellants.

WASHINGTON FEDERATION OF STATE EMPLOYEES, PAULETTE
THOMPSON and DANA HUFFORD,

Respondents/Cross-Appellants,

v.

STATE OF WASHINGTON and DEPARTMENT OF RETIREMENT
SYSTEMS,

Appellant/Cross-Respondents

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**ERRATA TO AMICUS CURIAE BRIEF OF THE WASHINGTON
STATE LEGISLATURE**

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The Washington State Legislature, *Amicus Curiae*, filed its *Amicus Curiae* Brief with this Court on September 24, 2013. The Washington State Legislature respectfully requests the following corrections in its *Amicus Curiae* Brief. Accompanying these errata is a Corrected *Amicus Curiae* Brief, which has been served on all parties and incorporates these corrections:

1. Page 2, last paragraph: "III(B)" should be "(A)"
2. Page 14, end of first paragraph: Insert "See Appendix."
3. An appendix is attached containing the following publication submitted to the Legislature on August 30, 2013:

Office of the Washington State Actuary, *Report on the Financial Condition of the Washington State Retirement Systems* (2013)

RESPECTFULLY SUBMITTED this 26th day of September,
2013.

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CERTIFICATE OF SERVICE

I, Jeanine M. Gorrell, certify under penalty of perjury under the laws of the State of Washington that, on September 26, 2013, the original of the attached errata sheet, together with the accompanying corrected *Amicus Curiae* Brief of the Washington State Legislature, was filed in the Washington Supreme Court; and that I caused a true and correct copy to be served via email and United States Mail to the following recipients:

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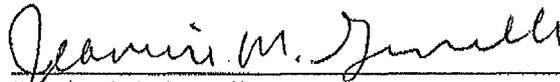
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AMICUS CURIAE BRIEF OF THE WASHINGTON STATE
LEGISLATURE (CORRECTED)

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I. IDENTITY AND INTEREST OF AMICUS CURIAE

Amicus curiae is the Washington State Legislature, the Senate and House of Representatives acting collectively (the "Legislature"), which together form the constitutionally created legislative branch of the government of the State of Washington. Const. art. II, § 1. As the branch of government that enacts, repeals, and amends statutory laws, the Legislature has a strong interest in preserving its authority to enact legislation. The Legislature is vested with plenary law-making authority, with its policy-setting ability limited only by the state and federal constitutions. The state constitution further establishes the Legislature as the state's budget-writing authority, with the power to tax and spend in order to fund the costs of public services.

The Legislature submits this brief¹ in support of the positions taken by the State of Washington and the Department of Retirement Systems. Pursuant to RAP 12.4(i), the Legislature addresses this Court regarding the soundness of the legal principles applied in *Washington Education Association et al. v Washington Department of Retirement Systems and State of Washington*, *Costello et al. v Washington Department of*

¹ Identical motions and proposed briefs have been filed in the gain-sharing (87424-7) and Uniform COLA (88546-0) appeals.

Retirement Systems and State of Washington, and Washington Federation of State Employees v. Washington Department of Retirement Systems and State of Washington, 87424-7 (King 07-2-17203-3, 07-2-15861-8, 07-2-16122-8 & 07-2-23022-0 SEA) (hereinafter "the reservation of rights cases").

II. SUMMARY OF ARGUMENT

The core constitutional principle at issue in the reservation of rights cases is the point at which statutes enacted by the Legislature become "contracts" to which the protections of Article I, section 23 (the "Contracts Clause") apply, thereby placing the statutes beyond amendment or repeal by the Legislature and obligating future Legislatures--and taxpayers--to fund costs associated with the statutes.

The reservation of rights cases require the Court to return to the constitutional principles that underlie the Court's adoption of the California Rule in *Bakenhus v. City of Seattle*, 48 Wn.2d 695, 296 P.2d 536 (1956), to consider their application in a new context: where the Legislature explicitly states that it is creating no contract rights and reserves the right to repeal a pension enhancement. As described at (A), *infra*, *Bakenhus* considered a variety of ways to analyze public pension statutes, and from them it chose the California Rule of a vested contractual

rights analysis. 48 Wn.2d at 701. Under this rule, the Contracts Clause protects the contractual rights of the employee based on the statutes in effect at entry to employment, while also preserving the Legislature's ability to enact statutes that keep the public pension system flexible and maintain its integrity. This Court has continued to apply the *Bakenhus* rule in other cases involving public pensions, e.g. *Weaver v. Evans*, 80 Wn.2d 461, 478, 495 P.2d 639 (1972) (contractually protected rights include legislatively enacted plan of systematic funding), and other public retirement benefits, *Navlet v. Port. of Seattle*, 164 Wn.2d 818, 194 P.3d 221 (2008). This potential for "constitutionalization" of ordinary statutes runs the risk of elevating legislation to the status of a constitutional amendment without the safeguards of a 2/3 legislative supermajority and approval by the voters. Const. Art. XXIII.

The reservation of rights cases involve a different scenario than previous public retirement cases. They require the Court to consider the nature of rights established under the body of *statutory* pension law where the inclusion of a disclaimer shows that the Legislature clearly expressed its intent to *avoid* creating contractual rights. As explained below, the California Rule's contractual rights analysis has many analytical and policy advantages, but the analysis must originate in the *statutes*--pension rights are *implied* contracts that are judicially derived from *legislation*.

When the legislature has explicitly rejected any intent to create binding contractual rights, judicial use of the contracts clause to set pension statutes in "constitutional concrete" occurs at great risk to separation of powers principles.

Further, if such "constitutionalization" were to occur, the legislative branch would have to make the fiscal decisions necessary to deal with the aftermath. In these cases, the consequences of constitutionalizing the benefits for the employees contrary to legislative intent will have immediate and significant impact on the state budget.

Finally, if the Legislature's unambiguous reservation of the right to change or repeal the gain-sharing and Uniform COLA benefits is found by the Court to be constitutionally ineffective, it should not delete language from an unambiguous statute. Rather, it should find that the reservation of rights clauses are intimately connected to the statutes that confer benefits, and non-severable from the benefits themselves. The benefits and the reservations of rights should be invalidated together, and the Legislature's authority to enact constitutional benefit provisions will operate consistent with the legislature's expressed intent.

III. ARGUMENT

A. The Contracts Clause does not bind future Legislatures by prohibiting amendment or repeal of a statute where the

Legislature has clearly expressed that the statute does not create a contract.

1. Each Legislature is vested with the plenary power to make, repeal, and amend statutory laws.

Under the state constitution, the powers of the state Legislature are plenary rather than enumerated. *Wash. State Farm Bureau v. Gregoire*, 162 Wn.2d 248, 301, 174 P.3d 1142 (2007). The Legislature is vested with all powers of government not allocated to the executive or judicial branches or reserved to the people. Further, *each* Legislature is vested with this plenary power. In general, any law enacted by one Legislature may be amended or repealed by another. *Farm Bureau*, 162 Wn.2d at 301. If the laws enacted by one Legislature could bind another, a past Legislature could through the enactment of ordinary police power legislation deprive future legislatures of the power to govern as they--and the voters who elected them and the taxpayers who fund state government--believe best suits the interest of the state.

This axiomatic principle of plenary legislative power, together with specific provisions of the state constitution, establishes a principle of contemporaneous government. Each newly elected Legislature is vested with plenary power to adopt the public policies favored by it and the citizens who elected it, limited only by the state and federal constitutions. Under Article VIII, Section 4, each Legislature may appropriate only for

the biennium for which it sits-- and these appropriations are limited to the following two-year fiscal biennium. One Legislature may not appropriate for a future biennium and thereby bind future legislators, voters, and taxpayers. *Wash. Ass'n of Neighborhood Stores v. State*, 149 Wn.2d 359, 368, 70 P.3d 920 (2003).

2. The Contracts Clause establishes a limited exception to this otherwise plenary power, and the Legislature was aware of that exception.

Under a limited exception to this general principle of plenary power, the state and federal constitutions prohibit the Legislature from enacting laws that result in the impairment of contracts. This principle limits the state from passing laws that impair contracts such as the state's collective bargaining agreements, *e.g.*, *Carlstrom v. State*, 103 Wn.2d 391, 694 P.2d 1 (1985), the state's contracts with service providers, *e.g.*, *Caritas Servs. v. Dep't of Soc. & Health Servs.*, 123 Wn.2d 391, 869 P.2d 28 (1994), or the state's financial agreements with its bondholders, *e.g.*, *Tyrpak v. Daniels*, 124 Wn.2d 146, 153, 974 P.2d 1374 (1994), *Pierce County v. State*, 159 Wn.2d 16, 34, 148 P.3d 1002 (2006).

In rare circumstances the very statutes enacted by the Legislature may function as contracts that are protected under the Contracts Clause.

[A] legislative enactment may contain provisions which, when accepted as the basis of action by individuals, become contracts between them and the State or its

subdivisions within the protection of *Art. I, § 10*. If the people's representatives deem it in the public interest they may adopt a policy of contracting in respect of public business for a term longer than the life of the current session of the legislature.

Gruen v. Tax Commission, 35 Wn.2d 1, 54, 211 P.2d 651 (1949)

(overruled on other grounds in *State ex rel. Wash. State Fin. Comm. v.*

Martin, 62 Wn.2d 645, 384 P.2d 833 (1963)) (citing *Indiana ex rel.*

Anderson v. Brand, 303 U.S. 95, 58 S. Ct. 443, 82 L. Ed. 685 (1938)).

Courts may find that statutes create rights protected by the Contracts Clause "when the language and circumstance demonstrate a legislative intent to create rights of a contractual nature binding against the state." *Washington Fed'n of Employees v. State*, 127 Wn.2d 544, 561, 901 P.2d 1028 (1995) (citations omitted).

Under the "unmistakability doctrine" of the U.S. Supreme Court, the statutory language must evince a clear and unmistakable indication that the legislature intends to bind itself contractually. *U.S. v. Winstar Corp.*, 518 U.S. 839, 116 S. Ct. 2432, 135 L.Ed. 2d 964 (1996). Mere implication is not enough. *Strunk v Public Employees Retirement Board*, 338 Or. 145, 171, 108 P.3d 1058 (2005).

Taken together, the unmistakability doctrine and the principle of contemporaneous government require that only where the language and circumstances of a statute clearly demonstrate a legislative intent to create

enforceable contractual rights may a court *infer* that a law creates rights enforceable under the contracts clause. Absent unmistakability, judicial conversion of statutes into "constitutional concrete" not only breaches separation of powers, but converts ordinary legislation into a constitutional amendment without the safeguards of a 2/3 legislative vote and approval by the people as required under Article XXIII, section 1.

As a result, contracts derived from statutes are the exception, not the rule. Statutes are enacted under constitutionally prescribed procedures that require constitutional majority approval, bicameralism, and presentment, not bilaterally negotiated elements such as mutual assent and consideration. Const. art. II § 22; art. III, § 12.

Under *Bakenhus*, pension statutes can in some cases form one of these exceptions. 48 Wn.2d at 698. But in the reservation of rights cases, the Legislature clearly expressed its intent to avoid creating contractual rights. The same section of statute that created the gain-sharing benefits states:

The legislature reserves the right to amend or repeal this section in the future and no member or beneficiary has a contractual right to receive this distribution not granted prior to that time.

Former RCW 41.31.030 (2006) (Plans 1). See also Former RCW 41.31A.020(4), -.030(5), -.040(5) (2006) (Plans 3). California – the source of the rule adopted in *Bakenhus* – refused to apply the California Rule in

precisely the circumstances present here: when the Legislature has reserved the right to amend or repeal a statutorily granted pension benefit it may do so without violating the Contract Clause. *Walsh v. Board of Administration*, 6 Cal.Rptr.2d 118, 129, 4 Cal.App.4th 682 (1992) (“The modification of a retirement plan pursuant to a reservation of the power to do so is consistent with the terms of any contract extended by the plan...”).

In enacting such a reservation, the Legislature is presumed to be well aware of *Bakenhus* and its progeny. See Brief of Respondents and Cross-Appellants at 27 n. 134. The legislation included the assurance to employees that distributions of benefits that had been granted in the past - a distribution of funds made by either gain-sharing or the Uniform COLA in the form of an increase in monthly benefits for Plan 1 members, or a distribution to individual member accounts in Plan 3 - would not subsequently be taken away if the law was changed. In addition, the right of the Legislature to make future changes was explicit, both in the legislation and in the official bill summaries that accompanied the gain-sharing legislation through the legislative process. See, e.g. Wash. H. R., House Bill Analysis to HB 2491, (1998) available at <http://apps.leg.wa.gov/documents/billdocs/1997-98/Pdf/Bill%20Reports/House/2491.HBA.pdf>.

The Court in *Bakenhus* made a deliberate choice to adopt the California Rule of a statutory contractual analysis. It considered and expressly rejected other possible legal analyses, including equitable theories such as waiver, or promissory estoppel. 48 Wn.2d at 701-703. See also *Retired Public Employees v. Charles*, 148 Wn.2d 602, 622, 62 P.3d 470 (2003) (rejecting trust analysis). The Contracts Clause protection gives the employee the full benefit objectively created by the statute, while avoiding results utterly inconsistent with legislative intent.

In later cases, the *Bakenhus* constitutional contracts clause analysis has been applied in contexts that lacked the clear boundaries that supported the original analysis. In *Navlet v. Port of Seattle*, for example, the Court examined employees' subjective expectations in the context of a collective bargaining agreement negotiated by the employees with their employer, not a statute enacted by the Legislature. *Navlet*, 164 Wn.2d at 841. This approach, based upon a collective bargaining agreement rather than a statute, avoided the acknowledgement in *Bakenhus* that the Legislature must have "the freedom necessary to improve the pension system and adapt it to changing economic conditions." *Bakenhus* 48 Wn.2d at 701.

This returns the inquiry to the core constitutional principle: What is the source and scope of the right under the contracts clause analysis? A constitutional contracts clause analysis must focus on the objectively ascertainable legal source of the right: the statute. The concept of a constitutionally protected statutory contract should not reflexively protect all unreasonable or variable expectations of employees, when those expectations are objectively inconsistent with the statute. This notion was rejected in *Bakenhus* itself, where the court declined to apply the doctrines of waiver or estoppel alongside the contractual rights framework, and only gave "effect to the *reasonable expectations* of the employee." *Bakenhus* 48 Wn.2d at 701 (emphasis added). And reasonable, objective expectations about statutory provisions cannot conflict with the plain language of the statute itself. *McAllister v. City of Bellevue Firemen's Pension Bd.*, 166 Wn.2d 623, 631, 210 P.3d 1002 (2009).

In the reservation of rights cases, the Legislature expressly reserved the right to change the benefits in the future. There is no other meaning that can reasonably be ascribed to the reservation of rights clauses that accompanied the gain-sharing and Uniform COLA benefits.

The Court has in fact already recognized that the Legislature may limit the formation of contractual rights in the beneficiaries of the state pension systems in circumstances where the Legislature clearly expresses

such an intent. In *McAllister v. City of Bellevue Firemen's Pension Bd.*, 166 Wn.2d 623, 210 P.3d 1002 (2009), the Court rejected a retiree's claim for retirement benefits because the retiree's position conflicted with the Legislature's intent, as the retiree had relied upon statutory language that never became effective, because the Legislature had included a delayed effective date, giving itself time to thoroughly reconsider the legislation the following session. In refusing to adopt a more favorable benefit than that finally provided by the legislature, the court noted, "We cannot 'delete language from an unambiguous statute.'" *McAllister*, 166 Wn.2d at 632 (citation omitted).

In this context, the Legislature created a limited new benefit, and expressly chose to reserve the power to amend that new benefit. The reservation of rights cannot be separated from the law that created the benefit. Therefore, employees' reasonable expectations--and more significantly, their statutory and constitutional rights--were necessarily limited by the express terms of the statute. *McAllister* at least means that not every expectation of an employee creates a binding contract, particularly when that expectation conflicts with the statute.

Given the express statutory reservation of rights found in both the gain-sharing and Uniform COLA legislation, these statutes simply do not

meet the "unmistakability" required to convert a law into a constitutionally protected contract.

B. A judicially created contractual right that is contrary to Legislative intent would impose a vast financial burden on state and local governments.

If the Court determines that the gain-sharing and uniform COLA statutes are a matter of protected contractual rights, contrary to the clear intent of the Legislature expressed in the law itself, future Legislatures will be both deprived of the right to decide matters of policy, but will also be shouldered with immediate and substantial financial burdens. These financial burdens will quickly fall upon the state, local governments, school districts, and the taxpayers and citizens that support and rely on these governmental entities.

There are no "extra" funds available in the Washington State Retirement Systems to pay for court-ordered additional benefits. The systems already have liabilities that account for all money in the retirement funds, all future earnings on those funds, and all future anticipated employer and employee contributions. When new benefits are added, additional contributions must begin to be made in order to accumulate money to pay those additional benefits in the future.

The State Actuary has provided the State with an updated estimate of the impact that a finding for the plaintiffs in the challenges to repeal of

the gain-sharing and Uniform COLA statutes would have on state and local government budgets during the 2015-17 fiscal biennium that begins July 1, 2015. Office of the Washington State Actuary, *Report on the Financial Condition of the Washington State Retirement Systems* 11 (2013) (illustrating "2015-17 Estimated Budget Impacts"). See Appendix.

The Actuary's report indicates an estimated \$616 million General Fund-State impact for the 2015-17 fiscal biennium if the Gain-Sharing and UCOLA (Uniform COLA) benefits were reinstated by the court. For all funds paid by state, local government, and school district employers, the two year impact is estimated to be over \$1.3 billion. *Id.* These are not long-term costs: these are the additional contributions that will be required of these employers during the 2015-17 fiscal biennium. These are not one-time costs: similar amounts will continue to be required to be provided by the state and local government employers in the fiscal biennia to follow. *Id.*

The official Budget Outlook prepared by the Washington Economic Revenue Forecast Council indicates that there is already an anticipated increase in pension contributions from the General Fund of about \$256 million. Washington State Economic & Revenue Forecast Council, *Budget Outlook Based on 3ESSB 5034*, 1 (2013) available at <http://www.erfc.wa.gov/forecast/documents/20130729BudgetOutlook.pdf>

With the increases that would be required by a ruling in favor of the plaintiffs in the (gain-sharing and Uniform COLA) cases now before the Court, almost \$900 million of additional General Fund-State revenues would be directed to increased pension contributions in addition to other constitutionally based claims for funding being required by this Court.

C. If the reservation of rights provisions are not constitutional, the Court should find these provisions non-severable from the gain-sharing and Uniform COLA statutes themselves, as the Legislature would not likely have enacted them otherwise.

If the Court determines that a pension statute enacted with a reservation of rights is defective, the appropriate remedy is not a judicial creation of a constitutionally-protected right that the Legislature never intended. Rather the Court should find that the gain-sharing and uniform COLA benefits would not have been enacted by the Legislature without the reservations of contractual rights, and are non-severable from the gain-sharing and uniform COLA provisions themselves. If the reservation of rights clauses are invalidated, the benefits to which they were attached should be invalidated as well.

Whether provisions should be severable depends on “whether the constitutional and unconstitutional provisions are so connected ... that it could not be believed that the legislature would have passed one without the other; or where the part eliminated is so intimately connected with the

balance of the act as to make it useless to accomplish the purposes of the legislature." *State v. Abrams*, 163 Wn.2d 277, 285-86, 178 P.3d 1021 (2008) (alteration in original) (internal quotation marks omitted) (quoting *Hall v. Niemer*, 97 Wn.2d 574, 582, 649 P.2d 98 (1982)); *League of Educ. Voters v. State*, 176 Wn.2d 808, 826, 295 P.3d 743 (2013).

That the Legislature intended the reservation of rights clauses to be part of the enactment of the gain-sharing and Uniform COLA benefits is clear from the plain language of those provisions. The goal when construing a statute is to ascertain and give effect to the Legislature's intended meaning. Legislative intent is determined "from the meaning of the words at issue, the context of the statute in which the provision at issue is found, related provisions and statutes that bear on the meaning of the language at issue, and the statutory scheme as a whole." *Barton v. Dept. of Transportation*, 2013 Wn. Lexis 662, August 15, 2013, at 69, citing *Manary v. Anderson*, 176 Wn.2d 342, 352, 292 P.3d 96 (2013); *Lowy v. PeaceHealth*, 174 Wn.2d 769, 779, 280 P.3d 1078 (2012); *Dep't of Ecology v. Campbell & Gwinn, LLC*, 146 Wn.2d 1, 11, 43 P.3d 4 (2002).

While nonseverability clauses are rarely enacted in Washington,² where a law is silent on severability, the court lacks any legislative

² For example, see Laws of 1985, ch. 433.

expression that the remainder of the act would have been passed without the invalid portion. *Lynden Transp. v. State*, 112 Wn.2d 115, 124; 768 P.2d 475 (1989).

Without that indication, the Court will "first look to see if the meaning of the statute is plain on its face." *In the Matter of the Personal Restraint of Devon Adams*, No. 87501-4, 2013, Wash. Lexis 750 (Wash, September 12, 2013) at *8, citing *Advanced Silicon Materials LLC v. Grant County*, 156 Wn.2d 84, 89-90, 124 P.3d 294 (2005). In *Adams*, the Court examined the statute on collateral attack petitions which provided an exception to the one year time bar for ineffective assistance of counsel claims where a judgment and sentence was not "valid on its face," and determined the subsection must be examined not in isolation, but as part of the complete statutory scheme. *Id* at *10.

The sections creating gain-sharing and the Uniform COLA, and reserving the legislature's right to change them in the future, should not be severed from one another, as "individual subsections are not addressed in isolation from the other sections of the statute, especially where to do so undermines the overall statutory purposes." *Id* at *8.

In addition, if an act or provisions of an act are found to "operate to limit the scope of the act in such a manner that by striking out the proviso the remainder of the statute would have a broader scope either as to

subject or territory, then the whole act is invalid..." *Seattle v. State*, 103 Wn.2d 663, 678, 694 P.2d 641 (1985).

Here, the reservation of rights clauses were passed without severability clauses and were connected to the gain-sharing and Uniform COLA provisions to the closest extent possible by being placed in the same sections of law that created the benefits, rather, for example, than being placed in separate sections of law that would more clearly provide the possibility of disparate treatment, including a veto. *See, e.g.* Laws of 1998, ch. 341, § 312(4) (creating the Washington School Employees' Retirement System, and TRS and SERS Plan 3 gain-sharing). Severability should not be construed.

The Court's "primary duty in interpreting any statute is to discern and implement the intent of the legislature." *Washington Farm Bureau*, 162 Wn.2d at 300, quoting *State v. J.P.*, 149 Wn.2d 444, 69 P.3d 318 (2003). The Court should uphold the validity of the Legislature's limited use of reservation of contract rights clauses in the state retirement system statutes. However if the Court determines otherwise, the contractual right disclaimer subsections should not be carved out of the sections of law in which they were enacted, thereby creating something wholly different than the Legislature intended. The employees should not be "entitled to select the best parts" of the pension statutes that apply to them. *McAllister*, 166

Wn.2d at 631. Instead, the Court should find the entire sections creating gain-sharing and the Uniform COLA intimately connected to the reservation of rights clauses and invalidate them entirely.

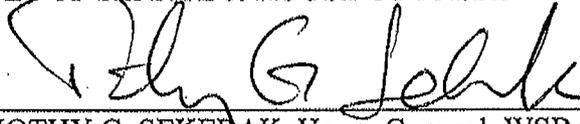
IV. CONCLUSION

The Court should refrain from establishing a new doctrine that provides constitutional protection to the subjective expectations of employees, when those expectations are contrary to the clearly expressed intent of the Legislature, and should instead enforce the reservation of rights provisions. If the Court finds that a pension benefit offered to employees in a statute containing a reservation of rights clause is constitutionally infirm, then the statutes creating those benefits should not be edited by the Court to create results radically different in meaning and consequence than what the Legislature unmistakably intended. Rather, the sections of statute containing the reservation of rights clauses should be found non-severable and invalidated entirely for purposes of the benefits not guaranteed by the gain-sharing and Uniform COLA statutes, and the Legislature be permitted to address the consequences in future legislation.

RESPECTFULLY SUBMITTED this 26th day of September, 2013.

OFFICES OF SENATE & HOUSE COUNSEL

By:



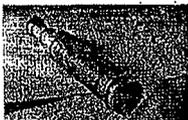
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Attorneys for Amicus Curiae
The Washington State Legislature

Appendix

Report on Financial Condition *and* Economic Experience Study

Prepared for the Pension Funding Council



Office of the State Actuary

"Securing tomorrow's pensions today."

August 30, 2013

Report on Financial Condition

As required under RCW 41.45.030, we present this **Report on Financial Condition** (Report), along with the **Economic Experience Study**, to assist the Pension Funding Council in evaluating whether to adopt changes to the long-term economic assumptions identified in RCW 41.45.035. We do not advise readers of this report to use the information contained herein for other purposes. Please see the **Actuarial Certification Letter** for additional considerations.

In this report, we focus on the funded status as a measure of the plans' health and financial condition. We measured the funded status by dividing the plan's assets by the liabilities at a single point in time. The assets of the plan are based on the actuarial or smoothed value, which helps limit the fluctuation in results from year to year that would occur if the market value of assets was used in this measure. The liabilities are today's value (present value) of all future benefits that will be paid out to current members and retirees based on what has been "earned" as of the measurement date. In determining the present value, we discount future benefit payments by the expected annual rate of return on assets.

At the highest level, this funded status measurement helps evaluate whether a plan is on target with its funding policy (or financing plan). A plan with a funded status of at least 100 percent is on target with its financing plan; whereas a plan with a funded status below 100 percent is off target. Generally speaking, a plan that's off target will require additional contributions over time to get back on track. The degree of increase and the length of time required will depend on other measurements (i.e., plan maturity, amount of remaining benefits, salary and revenue available to collect additional contributions, etc.) However, it's important to note that a plan with less than a 100 percent funded status is not automatically "at risk" of not being able to meet future benefit obligations. Conversely, a plan with a funded status above 100 percent is not necessarily over funded.

In reviewing the financial condition of the plans, we also look at the changes since the *2011 Report on Financial Condition* and how we expect the financial condition to change in the future. This helps determine the path of financial health the plans are on and identify certain risks the plans face in the future. We discuss these changes in the context of the funded status and what is impacting either the assets or liabilities.

Under current funding policy, investment returns primarily drive changes to asset levels while the main drivers to changes in the liabilities include the discount rate (or future investment return expectations) and changes to the current benefit structure. The following sections discuss these key drivers and their impact on the financial condition of the plans.

Recent Investment Return Experience Expected To Improve Financial Condition, Short Term Decline in Funded Status Still Expected

Since the Great Recession of 2009, short-term investment returns have continued to, on average, exceed long-term expectations. We saw higher than expected investment returns in 2010, 2011, and 2013 with 13.22 percent, 21.14 percent, and 12.36 percent respectively. Since the recession, we have seen only one year (2012) with lower than expected investment returns at 1.40 percent. However, on average, we have seen investment returns below long-term expectations over the past six years.

Historical Plan Performance		
Fiscal Year Ending 30-Jun	Actual Investment Return	Expected Investment Return
2008	(1.24%)	8.00%
2009	(22.84%)	8.00%
2010	13.22%	8.00%
2011	21.14%	8.00%
2012	1.40%	7.90%
2013	12.36%	7.90%
Average	2.95%	7.97%

The higher than expected returns since the Great Recession improved the funded status of the plans. However, primarily because average annual investment returns over the past six years are below expectations, we are continuing to see the funded status for some plans decline as shown in the table below.

Plan	Funded Status as of June 30		
	2010*	2011	2012**
PERS 1	77%	71%	69%
PERS 2/3	113%	112%	111%
TRS 1	84%	81%	79%
TRS 2/3	116%	113%	114%
SERS 2/3	113%	110%	110%
PSERS 2	129%	132%	134%
LEOFF 1	127%	135%	135%
WSPRS 1/2	118%	115%	114%

*After Uniform Cost Of Living Adjustment repeal (consistent with 2010 Actuarial Valuation Report).

**Based on 2012 AVR results.

Although we're seeing a decline in the funded status for some plans, this decline is less than we expected in our last report due to the higher than expected returns over the past few years. We also expect to see the funded status begin to improve for all plans. However, actual funded status in the future will depend on future contribution levels, actual future investment returns, and actual future benefit levels, which may vary from our expectations.

Lower Investment Return Assumption Increases Liabilities in the Short Term, Improves Long-Term Risk

Chapter 7, Laws of 2012, First Special Session lowered the prescribed rate of investment return assumption from 8.0 percent to 7.7 percent over a three-biennia period beginning in 2013-15. Lowering the investment return assumption (discount rate) increases the present value of the liabilities and puts downward pressure on the funded status and financial condition of the plans in the short-term. However, the closer the investment return assumption is to our best estimate for future returns, the lower the financial risk we expect for the plans. While we expect the plans will experience a short term decline in funded status during the phase-in of the lower investment return assumption, we expect they will be in a better financial position over the longer-term due to the lower investment return assumption.

Recent Benefit Changes For New Hires Will Improve Financial Condition

Chapter 7, Laws of 2012, First Special Session also reduced subsidized Early Retirement Factors (ERFs) for members hired after May 1, 2013, in Plans 2/3 of PERS, TRS, and SERS retirement systems. All else being equal, lowering benefits lowers the liabilities of the plan which increases the funded status. However, because this recent benefit change is effective after the date of our measurements we do not see any impact to the liabilities in this report. Also, since this benefit change only impacts new members joining the plan after May 1, 2013, it will take some time before this change will start to impact the liabilities and funded status.

Current Litigation May Increase Benefits and Impact the Financial Condition

We assessed the financial condition of the pension systems based on the plan provisions that exist in current law. However, there are currently two pending Supreme Court cases scheduled to be heard in the fall of 2013. The decisions in those cases could impact the financial condition of the pension systems.

The Legislature repealed gain-sharing provisions available to certain members of the state retirement systems in 2007 and adopted replacement benefits, including alternate early retirement benefits, for PERS, TRS, and SERS Plans 2/3 members, and an addition to the PERS and TRS Plan 1 Uniform Cost Of Living Allowance (UCOLA) (collectively, the "replacement benefits"). In 2011, the Legislature repealed the UCOLA benefit, an annual benefit increase for PERS 1 and TRS 1 retirees. The trial court reinstated gain-sharing, but found constitutional the repeal of the replacement benefits for Plan 1 and Plan 3 members, and reinstated the UCOLA for those Plan 1 members who worked at any time after the UCOLA was enacted. Both the state and the plaintiffs appealed these decisions. The Supreme Court will hear both the gain-sharing and UCOLA lawsuits as companion cases. Should the Supreme Court uphold lower court decisions, gain-sharing and UCOLA benefits would be reinstated for certain members, and the replacement benefits would continue only for PERS, TRS, and SERS Plan 2 members.

The potential reinstatement of these benefits would pose a unique risk to the pension systems. Generally, when we model risks to the pension systems and show a range of

possible outcomes, most of the outcomes occur between the extremes. In other words, a broad spectrum of possibilities exists and the worst-case scenario is highly unlikely to occur. Also, each risk usually occurs many times (e.g., investment returns occur each year), and a bad outcome one year can be offset in the future. However, for purposes of modeling, these litigation risks have only two possible outcomes — either the repeal of the benefits stands or the benefits are reinstated. They are also, for purposes of modeling, one-time decisions that would not be offset in future years.

If gain-sharing is reinstated, certain members of the state retirement plans will receive a benefit for the 2014 gain-sharing event based on investment returns in the prior four fiscal years and receive future gain-sharing benefits when a gain-sharing event occurs. The 2014 gain-sharing benefit would be smaller than the one seen in 2008 but would still affect the financial condition of the pension systems through an unexpected release of assets or an unexpected increase in future Plan 1 benefit payments. The larger impact on the affected plans' financial condition would occur from the unexpected increase in liability from the recognition of the cost of future gain-sharing benefits beyond 2014.

Estimated Funded Status on an Actuarial Value Basis					
(Dollars in Millions)	PERS		TRS		SERS
	Plan 1	Plan 2/3	Plan 1	Plan 2/3	Plan 2/3
2012 AVR ¹	69%	111%	79%	114%	110%
w/ Gain Sharing (GS) ²	66%	111%	76%	108%	103%
w/UCOLA ³	60%	111%	65%	114%	110%
w/ GS & UCOLA ⁴	57%	111%	63%	108%	103%

¹ Based on 2012 Actuarial Valuation results (AVR).

² Based on AVR results after restoration of gain sharing and continuation of replacement benefits.

³ Based on AVR results after restoration of UCOLA.

⁴ Based on AVR results after restoration of gain sharing and UCOLA.

sharing or UCOLA benefits (assuming the repeals are upheld). (For PERS 1 and TRS 1, note the effect of reinstating both benefits is larger than the effect of reinstating each on their own due to the interaction of these benefits).

In addition to the funded status decreasing, the reinstatement of both benefits, under current funding policy, would have an impact on employer contribution rates and state and local government budgets.

The tables on the following page shows the estimated impact on contribution rates and budget impacts when we assume an effective date at the beginning of the 2015-17 Biennium under current funding policy. The actual effective date and funding policy may vary from what we assumed.

The table to the left shows the estimated funded status, as of June 30, 2012, of the affected plans if the court reinstates gain-sharing, the UCOLA, or both. Please note, the first row of numbers, labeled 2012 Actuarial Valuation Report (AVR), displays the funded status measured at June 30, 2012, without future gain-

Estimated 2015-17 Impact on Contribution Rates				
System/Plan	PERS	TRS	SERS	PSERS
Reinstatement of Gain-Sharing				
Employee (Plan 2)	0.00%	0.00%	0.00%	0.00%
Employer				
Normal Cost	0.26%	1.56%	2.40%	0.00%
Plan 1 UAAL	0.42%	0.73%	0.42%	0.42%
Total	0.68%	2.29%	2.82%	0.42%
Reinstatement of UCOLA				
Employee (Plan 2)	0.00%	0.00%	0.00%	0.00%
Employer				
Normal Cost	0.00%	0.00%	0.00%	0.00%
Plan 1 UAAL	1.77%	4.18%	1.77%	1.77%
Total	1.77%	4.18%	1.77%	1.77%
Reinstatement of Gain-Sharing and UCOLA				
Employee (Plan 2)	0.00%	0.00%	0.00%	0.00%
Employer				
Normal Cost	0.26%	1.56%	2.40%	0.00%
Plan 1 UAAL	2.30%	5.15%	2.30%	2.30%
Total	2.56%	6.70%	4.70%	2.30%

The table below shows the estimated 2015-17 budget impacts.

2015-17 Estimated Budget Impacts					
(Dollars in Millions)	PERS	TRS	SERS	PSERS	Total
Reinstatement of Gain-Sharing					
General Fund	\$24	\$139	\$35	\$2	\$199
Non-General Fund	37	0	0	0	37
Total State	\$61	\$139	\$35	\$2	\$237
Local Government	65	71	44	1	180
Total Employer	\$126	\$209	\$79	\$3	\$417
Total Employee	\$0	\$0	\$0	\$0	\$0
Reinstatement of UCOLA					
General Fund	\$67	\$293	\$28	\$7	\$395
Non-General Fund	105	0	0	1	106
Total State	\$172	\$293	\$28	\$8	\$501
Local Government	184	149	35	2	370
Total Employer	\$356	\$441	\$62	\$10	\$871
Total Employee	\$0	\$0	\$0	\$0	\$0
Reinstatement of Gain-Sharing and UCOLA					
General Fund	\$95	\$447	\$65	\$9	\$616
Non-General Fund	148	0	0	1	150
Total State	\$243	\$447	\$65	\$11	\$766
Local Government	260	227	81	3	570
Total Employer	\$502	\$675	\$145	\$14	\$1,336
Total Employee	\$0	\$0	\$0	\$0	\$0

Note: Totals may not agree due to rounding. We use long-term assumptions to produce our short-term budget impacts. Therefore, our short-term budget impacts will likely vary from estimates produced from other short-term budget models.

Important Note: The estimated impacts for the reinstatement of gain-sharing also include continuation of the replacement benefits for members of PERS and TRS Plans 1, 2, and 3 and SERS Plans 2/3 members. Should the Supreme Court uphold the lower court decision restoring gain-sharing, but repeal the replacement benefits for all members of PERS, TRS, and SERS, (including Plans 2) the early retirement benefits would not be available to anyone who had not yet retired and received his or her first monthly retirement allowance. Furthermore, the estimated impacts for the reinstatement of the UCOLA benefits assume reinstatement for all members in PERS 1 and TRS 1. Should the Supreme Court uphold the lower court decision on the UCOLA, the UCOLA would be reinstated for only certain Plan 1 members. As a result, the actual impacts of any reinstatement of benefits could be lower than estimated above.

Upcoming Reporting Changes Will Not Affect the Funded Status of the Pension Systems

There are multiple changes coming to how we will calculate and report pension liabilities due to recent announcements by the Governmental Accounting Standards Board (GASB) and certain credit rating agencies (Moody's). State and local governments will soon be required to distinguish several separate pension measurements, each for their own different purpose. The important thing to keep in mind is that none of these changes will actually change the financial condition of the pension systems unless they lead to changes in future funding policy.

GASB and Moody's measurements each have a specific purpose and neither is meant to be used in the calculation that determines the appropriate annual contribution that employers and members must make in order to maintain the soundness of the pension systems.

GASB changes are to take place in phases beginning in Fiscal Year 2014 and include new reporting requirements for local employers. New measurements from Moody's are aimed at creating more consistency between the states (and municipal plans) when calculating pension obligations for the purpose of government bond ratings. These upcoming reporting changes do not affect current funding policies or statutes for the state.

Summary

Since our *2011 Report on Financial Condition*, the financial status of the pension systems has continued to decline but that decline is expected to be short-term and followed by an improvement in the funded status. Recent investment returns and changes in benefits for new hires will improve the financial condition of the affected plans. The continued phase-in of lower assumed rates of investment return will reduce the long-term risks we expect for the retirement systems. Recent reporting changes adopted by GASB and Moody's will not affect the financial condition of the plans unless they lead to changes in future funding policy.

While the financial condition of the pension systems has declined in recent years and steps have been taken to improve the overall financial condition, we advise the Council to consider the following three outstanding issues when contemplating future pension action.

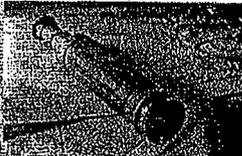
1. We expect contribution rates to increase, as remaining asset losses from 2008-2009 are recognized and lower rate of return assumptions are phased-in, before approaching expected long-term levels. While higher contribution rates result in additional prefunding and improved long-term financial condition of the plans, they put pressure on near-term budgets. If increasing contribution levels cannot be met, the financial condition of the plans will most likely decline.
2. A court reinstatement of recently repealed benefits would negatively impact the financial condition of the pension systems.
3. Volatility or swings in financial markets can weaken or improve the financial condition of a pension system over a short period of time. Continued full funding and the maintenance of affordable/sustainable plan designs will help the pension systems weather such volatility.

Data, Assumptions, and Methods Used

We performed this analysis consistent with the *June 30, 2012, Actuarial Valuation Report (AVR)*. We used asset information and participant data as of June 30, 2012. We have provided the June 30, 2013 asset returns for informational purposes only. Assets and liabilities measured at June 30, 2013, will be reflected in the 2013 Actuarial Valuation Report.

In estimating the cost of reinstating the UCOLA, we added back the liability (adjusted with interest) that was removed in 2011 when the UCOLA was removed prospectively. We compared the funded status and contribution rates with this additional liability to the funded status and contribution rates without this liability to determine the change in funded status and contribution rates. We applied the change in contribution rates to projected payroll to estimate the budget impacts for 2015-17. For purposes of this estimate, we assumed the UCOLA would be reinstated immediately. We did not include a liability for any back payments. Please see the actuarial fiscal note for SHB 2021 (2011) for a complete description of the data, assumptions and methods we used to determine the liability removed when the UCOLA was repealed.

In estimating the cost of reinstating gain-sharing benefits, we added back the liability (adjusted with interest) that was removed in 2007 when gain-sharing was removed prospectively. We compared the funded status and contribution rates with this additional liability to the funded status and contribution rates without this liability to determine the change in funded status and contribution rates. We applied the change in contribution rates to projected payroll to estimate the budget impacts for 2015-17. For purposes of this estimate, we assumed gain-sharing benefits would be reinstated only for members who were eligible to receive the 2008 gain-sharing event. The method for calculating the cost of gain sharing is consistent with the method used in our actuarial fiscal note for EHB 2391 from the 2007 Legislative session (the repeal of gain-sharing). For measuring the cost of reinstating gain-sharing benefits, we used a reduction in the assumed rate of investment return of 0.40 percent for PERS and TRS Plans 1, 0.04 percent for PERS 2/3, 0.33 percent for TRS 2/3, and 0.44 percent for SERS 2/3. Please see the actuarial fiscal note for EHB 2391 (2007) for a complete description of the data, assumptions and methods we used to determine the liability removed when gain-sharing was repealed.



Office of the State Actuary

Securing tomorrow's pensions today

Actuarial Certification Report on Financial Condition

August 30, 2013

This report documents the results of an actuarial assessment of the financial condition of the retirement plans defined under Chapters 41.26 (excluding Plan 2), 41.32, 41.35, 41.37, 41.40, and 43.43 of the Revised Code of Washington. The primary purpose of this assessment is to assist the Pension Funding Council in evaluating whether to adopt changes to the long-term economic assumptions identified in RCW 41.45.035. We understand the report may be used for other purposes, including an identification of risks facing the retirement plans documented above. However, this report does not represent a complete risk analysis of these retirement plans. Please replace this report in the future when the result of a more recent assessment becomes available.

Please see the 2012 Actuarial Valuation Report (AVR) for the data, assumptions, and methods used in determining the actuarial valuation results for this report. Please see the Actuarial Certification in the 2012 AVR for additional information concerning the development, purpose, and use of the 2012 actuarial valuation results. Participant data reflects retirement system census data through June 30, 2012. Asset data reflects returns through June 30, 2013.

The Department of Retirement Systems provided 2012 member and beneficiary data to us. We checked the data for reasonableness as appropriate based on the purpose of this report. The Washington State Investment Board provided asset information as of June 30, 2013. An audit of the financial and participant data was not performed. We relied on all the information provided as complete and accurate. In our opinion, this information is adequate and substantially complete for purposes of this assessment.

This report involves the interpretation of many factors and the application of professional judgment. We believe that the data, assumptions, and methods used in the underlying report are reasonable and appropriate for the primary purpose stated above. The use of another set of data, assumptions, and methods, however, could also be reasonable and could produce materially different results. Another actuary may review the results of this analysis and reach different conclusions or decide to use different assumptions and methods.

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015 111



In our opinion, all methods, assumptions, and calculations are reasonable and are in conformity with generally accepted actuarial principles and applicable standards of practice as of the date of this publication.

The undersigned, with actuarial credentials, meet the Qualification Standards of the American Academy of Actuaries to render the actuarial opinions contained herein.

Sincerely,

A handwritten signature in black ink, appearing to read "Matthew M. Smith".

Matthew M. Smith, FCA, EA, MAAA
State Actuary

A handwritten signature in black ink, appearing to read "Lisa Won".

Lisa Won, ASA, FCA, MAAA
Senior Actuary

OFFICE RECEPTIONIST, CLERK

To: Gorrell, Jeannie
Subject: RE: Corrected Amicus Brief #87424-7

Rec'd 9-26-13

Please note that any pleading filed as an attachment to e-mail will be treated as the original. Therefore, if a filing is by e-mail attachment, it is not necessary to mail to the court the original of the document.

From: Gorrell, Jeannie [<mailto:Jeannie.Gorrell@leg.wa.gov>]
Sent: Thursday, September 26, 2013 3:18 PM
To: OFFICE RECEPTIONIST, CLERK
Subject: Corrected Amicus Brief #87424-7

Dear Clerk,

Attached is an errata sheet and a corrected amicus curiae brief submitted by the Washington State Legislature in the following matter:

WEA v. Washington, Case No. 87424-7

The original motion and brief were filed on September 24, 2013.

My Bar Number is 25343, and my email address is gorrell.jeannie@leg.wa.gov

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