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SUPREME COURT No. 88546-0

SUPREME COURT
OF THE STATE OF WASHINGTON

WASHINGTON DEPARTMENT OF RETIREMENT SYSTEMS and
THE STATE OF WASHINGTON,

Petitioners,

vs.

WASHINGTON EDUCATION ASSOCIATION, *et al.*,

Respondents.

BRIEF OF PETITIONERS

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Table of Cases

Constitutional Provisions

Statutes

Regulations and Rules

I. INTRODUCTION

Plaintiffs seek an unprecedented ruling that would force taxpayers to give them billions in added pension benefits to which the Legislature expressly said they were not entitled. They ask this Court to override the Legislature's clear language and intent by holding that an enhancement to a pension plan instantly becomes a contract right of State employees that forever is constitutionally protected, even when the Legislature explicitly says it is creating no such right and that the enhancement can be revoked at any time. This Court never has so held, and should not do so here.

In 1995, the Legislature enacted a "uniform cost-of-living adjustment" ("UCOLA") for members of PERS Plan 1 and TRS Plan 1 ("Plan 1").[1] But the Legislature expressly limited this grant, stating:

> 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 postretirement adjustment not granted prior to that time.

Laws of 1995, ch. 345, §§ 2(6), 5(6); RCW 41.32.489(6); RCW 41.40.197(5).

In 2011, in the midst of a "perfect storm" of economic impacts that threatened the viability of Plan 1, the Legislature exercised its reserved

[1] PERS is the acronym for the Washington Public Employees' Retirement System. TRS is the acronym for the Washington Teachers' Retirement System.

right and canceled future UCOLA increases. With dramatically reduced revenues and increased obligations, the Legislature was forced to cut critical services such as healthcare and higher education, on top of substantial cuts the Legislature already had made in recent years. The repeal of UCOLA called upon public employees to share in the sacrifices required of the State's citizens to preserve crucial services, as well as the State's ability to pay core pension benefits.

The repeal of future UCOLA increases did not affect existing retirement allowances. Plan 1 members continue receiving "defined benefit" pensions and all cost-of-living adjustments previously provided, including UCOLA adjustments provided before the 2011 repeal.

Notwithstanding the Legislature's express reservation of the right to repeal and its disclaimer of any contractual rights to future UCOLA increases, Plaintiffs challenged the repeal, arguing that it violated the Contracts Clause of the Washington Constitution. The trial court agreed, holding that under *Bakenhus v. City of Seattle*, 48 Wn.2d 695, 296 P.2d 536 (1956), and its progeny, the Legislature could not reserve the right to terminate the UCOLA, and that as a matter of law, the State had not offered any off-setting, comparable benefit. This was error because the burden is on Plaintiffs to prove "beyond a reasonable doubt" that they had a contract right in the first place, and they failed to do so. *Retired Pub. Employees Council v. Charles*, 148 Wn.2d 602, 623, 62 P.3d 470 (2003).

To show an unconstitutional impairment of contract, Plaintiffs must prove (1) a contract right to future UCOLA increases; (2) that the UCOLA repeal substantially impaired this right; and (3) that the impairment was not reasonable and necessary to serve a legitimate public purpose. *Id.* at 624. Plaintiffs cannot satisfy any part of this test.

Plaintiffs had no contract right to future increases because of the clear statutory language expressly denying such a right. This Court never has found a contract right in the face of such statutory language, and doing so here would improperly restrict legislative authority. Next, Plaintiffs cannot plausibly claim substantial impairment of any right, given that the UCOLA statute stated from the outset that it could be repealed at any time. Finally, even if the Legislature impaired a contract right of the Plaintiffs, the UCOLA repeal was reasonable and necessary to protect basic pension benefits and to avoid even deeper cuts in other vital state services.

For these reasons, the State asks that the Court reject Plaintiffs' unprecedented claim with a narrow ruling: when the Legislature enacts a pension enhancement, stating in the same bill that it is non-contractual and can be repealed, plan members have no permanent right to that benefit.

II. ASSIGNMENTS OF ERROR

1. The trial court erred in ruling that the Legislature's repeal of future cost-of-living adjustments, pursuant to express language in the statute creating the UCOLA that allowed such a repeal, and an explicit statutory disclaimer of contract rights, was an unconstitutional impairment of contract. CP 1005.

2. The trial court erred in ruling that under binding Washington precedent, the State was prohibited from reserving the right to terminate the UCOLA.

3. The trial court erred in ruling as a matter of law that the State failed to "offer a comparable benefit in exchange for terminating the UCOLA." CP 1119.

III. ISSUES PERTAINING TO ASSIGNMENTS OF ERROR

1. Does the Legislature, with its plenary authority to alter and amend the State's retirement system, have the authority to enact statutes that both create and limit enhancements to public pensions? [Assignments of Error 1, 2]

2. Where the Legislature, after the closure of Plan 1 to new members, enacted a limited cost-of-living benefit expressly subject to repeal, and the enacting statute disclaimed any contractual entitlement to

the adjustment, may the Legislature constitutionally exercise the right to terminate future adjustments? [Assignments of Error 1, 2]

3. Should the Court reject Plaintiffs' position that pension rights can arise from alleged employee expectations when such expectations are contrary to the express terms of the UCOLA statute? [Assignments of Error 1, 2]

4. Did the trial court err in finding a contractual right under *Bakenhus v. City of Seattle*, 48 Wn.2d 695, 296 P.2d 536 (1956), where this case, unlike *Bakenhus*: (a) involves an express statutory reservation of the right to repeal and a disclaimer of contract rights; (b) involves repeal of a future pension enhancement, not elimination of a core pension right; (c) involves a benefit that did not become available until at least 18 years <u>after</u> Plan 1 members began public employment, and thus employees cannot claim that the benefit induced them to work for their public employers; (d) involves pension benefits expressly limited in order to provide flexibility in times of economic change; and (e) does not implicate the constitutional "gratuity" rationale on which *Bakenhus* was based, since the relevant provision of the Washington Constitution was amended after *Bakenhus*? [Assignments of Error 1, 2]

5. Did the trial court err in not recognizing that canceling future UCOLA increases was reasonable and necessary in light of the State's fiscal crisis, the need to preserve basic pension benefits, and the replacement benefits the Legislature provided? [Assignment of Error 3]

IV. STATEMENT OF THE CASE

A. History of the UCOLA and Prior Adjustments.

This appeal involves two retirement plans, PERS Plan 1 and TRS Plan 1 (together, "Plan 1"). Plan 1 members are public employees, school teachers, and administrators who were first employed in eligible positions before October 1, 1977, when Plan 1 closed to new members.

Eligible members of Plan 1 receive a retirement allowance calculated under a statutory formula based on their average final compensation and years of public employment.[2] Contributions by employees and employers, plus investment returns on those contributions, comprise the funding for Plan 1. Plan 1 members' contributions are set by statute at six percent of compensation.[3] Public employers contribute a

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[2] A member's retirement allowance is based on the average of his or her two consecutive highest years of salary (the "average final compensation" or "AFC"), multiplied by the member's years of creditable service ("YOS") and then by two percent (*i.e.*, AFC x YOS x 2%). CP 603-604.

[3] CP 604; RCW 41.32.350; RCW 41.40.330.

percentage of employees' salaries at rates fixed by the Legislature.[4] Investment returns fluctuate over time based on market conditions.[5] Thus, any shortfalls in pension funding must be addressed by increased employer contributions and ultimately paid by taxpayers.[6]

As created, Plan 1 made no provision for cost-of-living increases. However, inflation and greater retiree longevity reduced the purchasing power of pensions, and, in the 1970s, the Legislature came under political pressure to grant cost-of-living increases.[7] In response, between the 1970s and the early 1990s, the Legislature granted several one-time, ad hoc increases to pension benefits, subject to various eligibility requirements.[8]

In 1995, the Legislature ceased giving ad hoc increases and enacted the UCOLA for all Plan 1 members.[9] Like the prior ad hoc increases, the UCOLA was temporary in nature. The Legislature expressly reserved its discretion to repeal the UCOLA if necessary, and declared that the UCOLA was not a contract right:

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[4] CP 603. The Pension Funding Council sets the employers' contribution rate, subject to revision by the Legislature. *See* RCW 41.45.060.

[5] CP 607.

[6] CP 608.

[7] CP 605.

[8] *See* CP 560-597.

[9] CP 605.

> 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 postretirement adjustment not granted prior to that time.

Laws of 1995, ch. 345, §§ 2(6), 5(6); RCW 41.32.489(6); RCW 41.40.197(5).

The UCOLA was an enhancement to the basic retirement allowance, granted to those who had received a retirement allowance for at least one year and had attained age 66. The Legislature based the UCOLA on an "annual increase" amount defined as "fifty-nine cents per month per year of service which amount shall be increased each July 1st by three percent, rounded to the nearest cent."[10] Laws of 1995, ch. 345, § 9(45) (former RCW 41.32.010(4); former RCW 41.40.010(4)).

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[10] The UCOLA is not a 3% increase in a Plan 1 member's benefit, but rather a 3% increase in the "annual increase amount," which initially was set at 59 cents. For example, if a member had 30 years of service credit and met the eligibility requirements in July 1995 when the Legislature enacted the UCOLA, the monthly adjustment he or she would receive the first year would have been as follows: 30 years of service credit x .59 = $17.70 per month. The $17.70 would have been added to the member's monthly retirement allowance. *See* CP 605-606. Every year the "annual increase amount" increased by three percent. In 1996, the "annual increase amount" increased by two cents, to 61 cents, (or $18.31 per month for 30 years of service). Thus, in July 1996, the member in the foregoing example would have received a second adjustment in his monthly allowance. A newly eligible member would have received a first adjustment of $18.31 per month. At the time of the UCOLA repeal in 2011, the annual increase amount was $1.94; the maximum adjustment to any beneficiary's retirement allowance was $58.20 per month — $1.94 multiplied by 30 years of service, the maximum years of creditable service.

Eligible Plan 1 members received UCOLAs for 16 years, between 1995 and June 30, 2011. The Legislature repealed the UCOLA and ended future adjustments in 2011. Laws of 2011, ch. 362, §§ 3, 6; RCW 41.32.489(1); RCW 41.40.197(1). However, members continue to receive the benefit of adjustments made before the repeal, and they continue to receive any ad hoc increases they were granted prior to UCOLA's enactment. Those prior increases are permanently part of current monthly retirement allowances, and were unaffected by the UCOLA repeal.

B. Crisis in the State Budget and Funding of Public Employee Pensions.

The repeal of UCOLA was compelled by economic impacts that threatened Plan 1's viability. One indicator of the health of a pension plan is its funding, which may be evaluated by looking at (1) its funded status, *i.e.,* the ratio of the retirement plan's assets to the plan's liabilities at a particular point in time, expressed as a percentage, or (2) the dollar amount of its unfunded actuarial accrued liability ("UAAL").[11]

In the decade leading up to UCOLA repeal, the health of Plan 1 declined precipitously. As of 2009, the funded status of PERS Plan 1 was

[11] UAAL is the excess, if any, of the actuarial accrued liability over the actuarial value of assets. In other words, the UAAL is the present value of benefits earned to date that are not covered by plan assets.

70%, and that of TRS Plan 1 was 75%. The State Actuary's office projected both would drop below 60%.[12] When a plan's funded status drops below 60%, its continued viability is considered "at risk."[13] According to the State Actuary, the unfunded liability for PERS Plan 1 prior to UCOLA repeal was over $4.2 billion, and for TRS Plan 1 it was nearly $2.7 billion.[14] The State Actuary projected this unfunded liability to increase as the pension funds gradually accounted for extraordinary investment losses caused by the recession.[15]

The decline in the financial health of Plan 1 resulted not only from the recession, but also from plan design and demographic factors. Plan 1 as designed fixed the employee contribution rate at 6%.[16] While members have received increases in benefits for decades, their contribution rate has not increased since 1973 for PERS Plan 1 members, and 1974 for TRS Plan 1 members.[17] Further, lifespans have increased significantly over the

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[12] CP 703-704.

[13] CP 703-704.

[14] CP 608.

[15] CP 703-704. By statute, the State Actuary must apply an "asset-smoothing" approach in preparing an actuarial valuation of the plans. That approach requires incrementally allocating investment returns and/or losses over a period of years. RCW 41.45.035(4).

[16] CP 604.

[17] Laws of 1972, 1st Ex. Sess., ch. 151, § 13; RCW 41.40.330; Laws of 1973, 1st Ex. Sess., ch. 189, § 6; RCW 41.32.350.

70 years since the plans were created, leading to longer retirements, and the 6% capped employee contribution was designed to fund benefits for shorter lifespans.[18] Moreover, because Plan 1 closed in 1977 and members have subsequently continued to retire, there have been fewer and fewer employed Plan 1 members to make contributions to fund benefits for the growing beneficiary pool.[19]

The underfunded status of Plan 1 reached a crisis point as a result of the economic events of the 2000s.[20] Like other pension plans, Plan 1 was designed to be funded about 75% through returns on investments of employer and employee contributions.[21] The assumed rate of return after 2001 for purposes of funding Plan benefits was 8%.[22] But what followed was one of the worst decades of investment performance on record.[23] The actual compounded annual rate of return for the period 2000-2009 was

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[18] CP 604.

[19] As of June 30, 2009, only 15.54% of PERS Plan 1 members and 12.37% of TRS Plan 1 members were "active" employees. CP 701-702. With less in contributions and a larger number of beneficiaries, a greater proportion of the Plan 1 assets are used to pay benefits, and are unavailable for investment purposes.

[20] CP 702.

[21] CP 699-700.

[22] *See* RCW 41.45.035(1)(c).

[23] CP 702.

3.95%. Only the 1930s yielded a lower return over a decade.[24] In 2009 alone, the Plan 1 funds declined by 22.84%.[25]

The decline in the financial health of Plan 1 was accompanied by an unprecedented decline in the financial resources available to State and local governments. The recession caused significant reductions in property tax, sales tax, and B&O tax revenues. The State's General Fund experienced decreases not seen since the Great Depression.[26] At the same time, the State saw substantial increases in demand for services.

The decline in State and local government revenues greatly strained their ability to continue funding public pension plans, including Plan 1.[27] Because employee contributions to Plan 1 are at a fixed rate and declining over time as employees retire, and because investment returns have fallen sharply, all of the money to make up for the shortfalls in the plans has to come from increased employer contributions, at the expense of other public services.[28] One of the largest cost drivers in the State

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[24] CP 702.

[25] CP 702.

[26] CP 622.

[27] CP 629.

[28] CP 701. In 2012, the Legislature also reduced the assumed rate of investment return for Plans 1 from 8% to 7.7% over the next three years, adopting a more fiscally-conservative approach to projected future investment returns. RCW 41.45.035(3). This

budget, as well as the budgets of other public employers, is contributions to public employee pensions.[29] Every dollar that public employers must contribute to fund pensions is a dollar that is no longer available for other vital public programs.[30]

Despite increases in employer contributions, a significant risk remained that Plan 1 could run out of money before all the benefits were paid.[31] In that event, the State and other public employers would have to pay benefits from their annual operating budgets, if they could be paid at all. This status is referred to as "pay-as-you-go" or "pay-go." "Pay-go" status is universally recognized as the most expensive method of funding pension benefits because 100% of the benefits must be paid from annual employer and employee contributions, rather than largely from investment returns.[32]

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also will have the effect of requiring increased employer contributions to keep the Plans solvent. CP 706.

[29] CP 627. The State and virtually all local public employers pay not only monthly pension contributions into state pension funds for each member, but also an additional contribution to pay for the historic unfunded liability of Plans 1. CP 627; *see* RCW 41.45.070. The State Actuary estimates that the employer contribution to Plan 1, as a percentage of each employee's salary, will be 9.10% (2013-15) and 9.53% (2015-17) for PERS Plan 1, and 10.10% (2013-15) and 12.76% (2015-17) for TRS Plan 1. CP 628.

[30] CP 628.

[31] CP 704.

[32] CP 704-705.

The State Actuary calculated in 2010 that without some change, Plan 1 could fall to pay-go status as early as 2016, with the maximum pay-go risk by 2030. If the Plans reach "pay go" status, the State's annual pay-go costs would exceed $1.7 billion in today's dollars (if the State could make the payments at all, in light of mandatory fiscal demands).[33] If the State and other public employers were unable to contribute the necessary amounts, Plan 1 would be unable to pay basic benefits to Plan members, let alone the UCOLA.

C. The State's Efforts to Address the Pension Funding Crisis.

The Governor and the Legislature responded to the crisis besetting Plan 1 (and other public pension plans) by taking a series of steps to improve the Plans' health. In 2007, the Legislature repealed the pension enhancement referred to as "gain-sharing."[34] In 2009, the Legislature increased employer contribution rates to Plan 1 (but did not increase employee contributions).[35]

In the summer of 2010, the Governor created a special task force to examine the financial status of Plan 1 and provide recommendations to

[33] CP 705.

[34] Plaintiffs in this case also contested the repeal of gain-sharing in an action that is the subject of a companion case to this UCOLA case.

[35] CP 706.

reduce the risk that Plan 1 would run out of funding due to the State's other mandatory obligations and revenue limitations. Among the task force's recommendations was the repeal of the UCOLA. In December 2010, the Governor announced several proposals of shared sacrifice to save the pension plans, including elimination of the UCOLA.[36]

D. The Legislature's Repeal of Future UCOLAs.

In May 2011, the Legislature considered, debated, and eventually adopted the Governor's recommendations, enacting House Bill 2021 ("HB 2021"). *See* Laws of 2011, ch. 362. The law repealed future UCOLA adjustments based on the Legislature's original reservation of rights and disclaimer of contract rights.[37] The Legislature found:

> The legislature now finds that changing economic conditions have also made necessary the amendatory provisions contained in this act. Due to the current extraordinary economic recession and due to the financial demands of other core responsibilities of government, it is not feasible for public employers of this state to fund the annual increase amount and continue to ensure the fiscal integrity of these pension funds.

Laws of 2011, ch. 362, § 1. The repeal did not affect previously granted UCOLA adjustments (including all other previously granted COLAs),

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[36] CP 630; CP 610; CP 706-707.

[37] HB 2021 provided that, as of June 30, 2011, no future UCOLAs would occur for Plan 1 beneficiaries with the exception of beneficiaries receiving the "Basic Minimum Benefit." CP 545; RCW 41.32.489(1); RCW 41.40.197(1).

which are permanently included in Plan 1 pensions. *See* Laws of 2011, ch. 362, §§ 3, 6 ("This subsection shall not reduce retirement allowances below the amounts in effect on the effective date of this section."); RCW 41.32.489(1)(a); RCW 41.40.197(1)(a).

E. HB 2021 Improved the Plans' Financial Integrity and Increased the Alternative Minimum Benefit.

The repeal of the UCOLA reduced Plan 1's unfunded liability by approximately 50 percent, from $4.2 to $2.2 billion for PERS Plan 1, and from $2.6 billion to $958 million for TRS Plan 1.[38] The UCOLA repeal also substantially decreased the financial impacts of Plan 1 on the State, local governments, and school districts. For the 2011-13 biennium, the repeal of UCOLA reduced the expenses of the State and other government employers by $500 million and over $370 million, respectively, freeing up funds for other vital public services and programs.[39] Over the next 25 years, the repeal of UCOLA will reduce State expenses by $4.3 billion and those of other governmental employers by $3.3 billion — a total reduction of $7.6 billion.[40]

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[38] CP 611.

[39] CP 707-708.

[40] CP 707-708.

If the UCOLA were reinstated, it would have a crippling effect on the already-strained budgets of State and local governments. Without new taxes, any increase in pension costs resulting from restoration of the UCOLA would require the State to make equivalent funding reductions in areas such as healthcare, the courts, and/or higher education.[41] Because of the difficulty in making funding reductions to statutorily or constitutionally required programs, restoration of the UCOLA would potentially imperil the ability of Plan 1 to fund <u>any</u> retirement benefits, let alone the UCOLA.[42]

HB 2021 coupled the UCOLA repeal with an increase in the "Alternative Minimum Benefit" available to members of Plan 1. The Alternative Minimum Benefit is a pension "floor" for Plan 1 members who (a) have at least twenty years of service and have been retired at least twenty-five years or (b) have at least twenty-five years of service and have been retired at least twenty years.[43] RCW 41.32.4851(5); RCW 41.40.1984(6). An eligible beneficiary receives the Alternative Minimum

[41] CP 631.

[42] CP 608.

[43] CP 543-544.

Benefit if he or she has a calculated monthly pension that is less than the Alternative Minimum Benefit.

The Legislature originally established the Alternative Minimum Benefit at $1,000 a month. In 2006, the Legislature authorized an annual 3% increase in the Alternative Minimum Benefit; by 2011, the amount was $1,159 a month. HB 2021 increased the Alternative Minimum Benefit to $1,500 a month, and it will continue to increase annually by 3%.[44] *See* Laws of 2011 Ch. 362, §§ 4(5), 7(7); RCW 41.32.4851; RCW 41.40.1984. Because of the Legislature's action, many class members will become eligible for the Alternative Minimum Benefit years earlier than they otherwise would have.

F. Procedural History.

In 2011, three unions and several individuals filed class actions in Thurston County Superior Court challenging the repeal of the UCOLA.[45] The superior court consolidated the actions and certified a class.[46]

Plaintiffs filed a motion for summary judgment asking the trial court to find that elimination of the UCOLA was an impairment of

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[44] CP 631.

[45] CP 10; CP 1134; CP 1149.

[46] CP 1144-1146; CP 1172-1173; CP 454-459.

contract under Article 1, § 23 of the Washington Constitution and the *Bakenhus* line of authority.[47] Plaintiffs did not address the three requirements for assessing constitutionality of an alleged impairment of contract, including whether they could claim any contract right to a permanent UCOLA. They simply assumed, without support, that a perpetual UCOLA was a contract right and that its repeal was inconsistent with that right. Plaintiffs' motion relied primarily on the alleged absence of a "comparable, offsetting benefit" under *Bakenhus.*

On November 9, 2012, the trial court issued a letter opinion granting Plaintiffs' motion for summary judgment, holding that "the State is prohibited from reserving the right to unilaterally terminate the UCOLA."[48] The trial court, however, dismissed from the class (and from this action) those Plan 1 members who ceased working for a public employer before the UCOLA's enactment in 1995.[49]

On February 19, 2013, the superior court incorporated its letter opinion in an order "Granting Plaintiffs' Motion for Summary Judgment on Contract Impairment Claim."[50] The trial court, like Plaintiffs, largely

[47] CP 239.

[48] CP 1001.

[49] CP 1002.

[50] CP 1003.

ignored the threshold issues of whether the UCOLA statute gave rise to contract rights in the first place and whether "substantial impairment" of any such rights occurred by virtue of the UCOLA repeal. The trial court indicated some uncertainty about its ruling, stating:

> The high court may distinguish COLAs from the core retirement rights at issue in *Jacoby* and *Navlet.* COLAs are generally implemented to create flexibility during economic shifts, and this state has weathered a major economic shift that required such flexibility.[51]

The trial court's letter opinion incorrectly stated that the "parties agree[d] that the State did not offer any off-setting benefit when it terminated the UCOLA."[52] The State moved for reconsideration, citing the evidence it had submitted regarding the 2011 increase in the Alternative Minimum Benefit and the offsetting benefit of "a more secure, better-funded plan, on sounder footing for payment of benefits."[53] For example, Marty Brown, the State's Director of the Office of Financial Management, had testified that

> [a]lthough [the Legislature] repealed the UCOLA increases for the future, the Legislature nonetheless considered the effect of the change on retirees and provided the corresponding benefit of increasing the "alternate minimum

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[51] CP 1001.

[52] CP 999; CP 1001.

[53] CP 1017.

benefit" for Plan 1 members from $1,159/month to $1,545/month on June 30, 2011.[54]

The trial court granted in part the motion for reconsideration, amending its letter opinion to hold as a matter of law that "the State did not offer any comparable off-setting benefit when it terminated the UCOLA."[55]

On April 5, 2013, the superior court certified its summary judgment rulings under RAP 2.3(b)(4).[56] This Court granted discretionary and direct review, and ordered that this appeal would be a companion case to the "gain-sharing" appeal, Supreme Court Case No. 87424-7, which involves a nearly identical statutory reservation of rights and disclaimer of contract rights.

V. ARGUMENT

A. Standard of Review and Burden of Proof.

This Court reviews summary judgment rulings *de novo*. *TracFone Wireless, Inc. v. Dep't of Revenue*, 170 Wn.2d 273, 280-81, 242 P.3d 810 (2010). "A party challenging a statute's constitutionality bears the heavy

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[54] CP 631 (emphasis added).

[55] CP 1119. Because the trial court issued its Order on reconsideration after the State's Notice of Discretionary Review was filed, the Notice did not identify the Order as a subject of discretionary review. Under RAP 2.4, however, the Supreme Court may review the Order because it prejudicially affects the decision designated in the Notice, and it was issued on April 5, 2013, before this Court accepted review on June 5, 2013.

[56] CP 1121.

burden of establishing its unconstitutionality." *Pierce County v. State*, 159 Wn.2d 16, 27, 148 P.3d 1002 (2006) (citations omitted). Plaintiffs must establish that "there is no reasonable doubt that the statute violates the constitution." *Id.* (citation omitted).

B. Plaintiffs Have Failed to Prove a Contracts Clause Violation Under this Court's Three-Part Test.

Under this Court's longstanding precedent, a three-part test is applied to determine if there has been an impairment of a public contract:

> (1) does a contractual relationship exist; (2) does the legislation substantially impair the contractual relationship; and (3) if there is substantial impairment, is it reasonable and necessary to serve a legitimate public purpose?

Charles, 148 Wn.2d at 624. Plaintiffs have not satisfied any part of this test.

Plain statutory language forecloses Plaintiffs' claimed contractual right. Plaintiffs claim that *Bakenhus* establishes their contract right, but *Bakenhus* differs from this case in multiple ways as detailed below, and "there is no statutory analysis in *Bakenhus*." *Noah v. State of Wash.*, 112 Wn.2d 841, 844, 774 P.2d 516 (1989). Plaintiffs also claim that *Jacoby v. Grays Harbor Chair & Mfg. Co.*, 77 Wn.2d 911, 468 P.2d 666 (1970), and *Navlet v. Port of Seattle*, 164 Wn.2d 818, 194 P.3d 221 (2008), render the Legislature's reservation of the right to repeal UCOLA unenforceable.

But neither *Bakenhus, Navlet,* nor *Jacoby* involved the Legislature's contemporaneous reservation, by statute, of the right to repeal a pension enhancement, and an express disclaimer of contract rights. Moreover, as shown below, *Navlet* and *Jacoby* actually compel a ruling favorable to the State, not Plaintiffs.

Plaintiffs also cannot show substantial impairment of any contract right because the UCOLA statute said, from the beginning, that it could be repealed at any time.

Finally, even if Plaintiffs had a contractual right, the undisputed evidence before the trial court was that repealing the UCOLA was "reasonable and necessary to serve a legitimate public purpose," *Charles*, 148 Wn.2d at 624, namely, to protect basic pension benefits and prevent even deeper cuts to other vital services.

1. Plaintiffs had no contract right to perpetual UCOLA increases.

Under the first prong of the Contracts Clause analysis, "we must initially determine whether a contract exists." *Charles*, 148 Wn.2d at 624. The question "is not whether any contractual relationship whatsoever exists between the parties, but whether there was a 'contractual agreement regarding the specific . . . terms allegedly at issue.'" *Robertson v.*

Kulongoski, 466 F.3d 1114, 1117 (9th Cir. 2006) (quoting *General Motors Corp. v. Romein*, 503 U.S. 181, 187, 112 S. Ct. 1105, 117 L. Ed. 2d 328 (1992)). Plaintiffs cannot show a contract right here.

a. <u>The UCOLA statute's plain language forecloses any contract right to future UCOLA increases</u>.

The UCOLA statute could not have been clearer:

> 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 postretirement adjustment not granted prior to that time.

Laws of 1995, ch. 345, §§ 2(6), 5(6); RCW 41.32.489(6); RCW 41.40.197(5).

This language leaves no ambiguity. Instead, it explicitly prohibits any claim of an ongoing right to future UCOLA increases. The only way for Plaintiffs to prevail in this case is if this Court ignores or overrides the statutory language. But even in public pension cases, this Court "cannot delete language from an unambiguous statute." *McAllister v. City of Bellevue Firemen's Pension Bd.*, 166 Wn.2d 623, 630-31, 210 P.3d 1002 (2009) (quotation marks omitted). Rather, "[w]here 'a statute is clear on its face, its meaning [should] be derived from the language of the statute alone,'" even if the statute regulates public pensions. *Densley v. Department of Ret. Sys.*, 162 Wn.2d 210, 219, 173 P.3d 885 (2007) (quoting *Kilian v. Atkinson*, 147 Wn.2d 16, 20, 50 P.3d 638 (2002)). None of Plaintiffs' arguments for disregarding the clear statutory language have merit.

Moreover, accepting Plaintiffs' argument would inappropriately restrict the Legislature's authority to structure public pension plans, authority this Court has long recognized and respected. To rule for the Plaintiffs would effectively be to hold that the Legislature has no power to limit the scope of the pension enhancements it grants, even when that is its clear intent. But this Court has long held that the Legislature has the power to structure public pension plans.

> We believe the legislature has the authority under its police power to establish a retirement system for public employees because it serves a legitimate public purpose. . . . The role of this court does not encompass a duty on our part to review the wisdom of the legislative act. Indeed, <u>we must be cautious lest we substitute our judicial judgment for the legislative judgment</u>.

Washington State Pub. Employees Bd. v. Cook, 88 Wn.2d 200, 206, 599 P.2d 991 (1997) (emphasis added); *see also Charles,* 148 Wn.2d at 627 (recognizing the Legislature's authority to structure public pension plans); *Luders v. City of Spokane,* 57 Wn.2d 162, 165, 356 P.2d 331 (1960) (same); *Washington Fed'n of State Employees v. State of Wash.*, 107 Wn. App. 241, 247, 26 P.3d 1003

(2001) ("The courts have repeatedly said we will not substitute our judgment for the Legislature's with respect to the structure of public retirement plans.").

The Court should not reject its longstanding recognition of the Legislature's power "to place reasonable restrictions" on the pension benefits it grants, *Cook*, 88 Wn.2d at 206, particularly when those restrictions are clearly stated in the plain language of the statute creating the pension enhancement.

b. *Bakenhus* does not require ignoring the statute's plain language.

The trial court skipped over the first prong of the Contracts Clause analysis based on its view that under *Bakenhus,* "modifications to vested pension benefits after employment has started impair the employment contract,"[57] thus obviating any need to assess legislative language or intent. But "the employment contract" here did not include a right to perpetual UCOLAs, which is one of many crucial distinctions between this case and *Bakenhus.*

Since *Bakenhus*, this Court has made clear that only "some pension rights are contractual in nature," namely, those that "are in fact terms of

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[57] CP 1005-1006.

the employment contract." *Charles*, 148 Wn.2d at 624 (emphasis added). Here, the language of the UCOLA statute is the antithesis of any claimed contract right; it explicitly stated that it created no contract rights and that the UCOLA was subject to repeal. Plaintiffs cannot read those limitations out of the statute. *See, e.g.*, *McAllister*, 166 Wn.2d at 630-31 (party cannot delete language from an unambiguous statute). In *Bakenhus*, by contrast, the statutes contained no disclaimer of contractual rights and there was no dispute about the statutes' meaning. That is why "there is no statutory analysis in *Bakenhus*." *Noah*, 112 Wn.2d at 844.

Moreover, since *Bakenhus,* this Court has held that the state and federal Contracts Clauses "are coextensive and are given the same effect." *Pierce* County, 159 Wn.2d at 27 n.5. And both this Court and the United States Supreme Court repeatedly have held that only "[u]nder very limited circumstances a statute may be treated as a contract: when the statutory language and the circumstances establish a legislative intent to create rights contractual in nature." *Noah*, 112 Wn.2d at 843. The reason for this longstanding rule is that "to construe laws as contracts when the obligation is not clearly and unequivocally expressed would be to limit drastically the essential powers of a legislative body." *National R.R. Passenger Corp. v. Atchison, Topeka & Santa Fe Ry. Co.*, 470 U.S. 451, 466, 105 S. Ct. 1441, 84 L. Ed. 2d 432 (1985) (emphasis added). That is exactly what Plaintiffs seek to do here: drastically limit the Legislature's power to structure public pensions.

Bakenhus is distinguishable from this case in other fundamental respects as well. First, *Bakenhus* involved a reduction in a police officer's basic pension. Here, by contrast, no plan member's pension is being reduced; rather, plan members will no longer receive future cost-of-living increases. Second, in *Bakenhus,* the employee's basic pension was reduced below the amount to which he was entitled when he began working for the public employer.[58] The Court objected that "the employee who accepts a job to which a pension plan is applicable contracts for a substantial pension and is entitled to receive the same when he has fulfilled the prescribed conditions." 48 Wn.2d at 701 (emphasis added); *Noah,* 112 Wn.2d at 844 ("The public employee's services are rendered upon the promise made to him when he enters employment . . . "). Here, all class members began public employment no later than 1977, when Plan 1 closed, 18 years before the Legislature enacted the UCOLA. Moreover, as the trial court noted, unlike the basic pension plan at issue in *Bakenhus*,

[58] In *Bakenhus*, when a police officer retired in 1950, his retirement was capped at $125 a month under an amended statute. This was a reduction from $185 a month under the statute in effect when he began working. 48 Wn.2d at 697.

the cost-of-living adjustments at issue here were enacted precisely "to create flexibility during economic shifts, and this state has weathered a major economic shift that required such flexibility."[59] The trial court thus acknowledged that the UCOLA could be distinguished "from the core retirement rights at issue in *Jacoby* and *Navlet.*"[60] Finally, this Court based *Bakenhus* on a constitutional provision that was amended the year after the opinion was issued.[61]

Ultimately, neither *Bakenhus* nor any other Washington appellate opinion has found a contract right in the situation here, where the Legislature, in the same statute enacting a pension enhancement, expressly reserved the right to repeal and disclaimed any contract rights. *Bakenhus* simply provides no justification for ignoring clear legislative intent under these circumstances.

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[59] CP 1001.

[60] CP 1001.

[61] Plaintiffs argued in the trial court that the legislative grant of the UCOLA must have been contractual and irrevocable, because if it were not, then the UCOLA would have been invalid as "an illegal gratuity" under Article II, § 25 of the Washington Constitution. CP 252. Under that provision, when a public employee's compensation had been set by contract, the Legislature could not grant the employee "extra compensation" after services were provided. *Bakenhus,* 48 Wn.2d at 698. However, in 1958 – the year after the *Bakenhus* decision – Article II, § 25 was amended to exempt increases in pensions. The Court's "gratuity" rationale in *Bakenhus* no longer applies. *See, e.g., Luders v. City of Spokane*, 57 Wn.2d 162, 164-65, 356 P.2d 331 (1960) ("The legislative power in this respect is now unlimited.").

c. The Court must give effect to the reservation of rights.

In the trial court, Plaintiffs argued, and the court agreed, that the Legislature is powerless to reserve the right to repeal any future pension benefit. This Court has never so held. In fact, this Court has made clear that reservations of rights should be given effect when, as here, they are clearly expressed in the very document creating the pension benefit.

Besides *Bakenhus,* Plaintiffs and the trial court relied on *Navlet v. Port of Seattle*, 164 Wn.2d 818, 194 P.3d 221 (2008), and *Jacoby v. Grays Harbor Chair & Mfg. Co.*, 77 Wn.2d 911, 468 P.2d 666 (1970).[62] Plaintiffs also cited *Carlstrom v. State of Wash.*, 103 Wn.2d 391, 694 P.2d 1 (1985). These cases actually support the State here.

In *Navlet,* the Court held that a disclaimer contained in a "Summary Plan Description" and a "Welfare Trust Agreement" was ineffective to limit employees' rights to benefits, but indicated that the disclaimer would have been effective if the Port of Seattle had included the disclaimer in the Collective Bargaining Agreement ("CBA") that established the employees' rights. 164 Wn.2d at 849 ("If the Port wanted to limit its obligation to provide welfare benefits, then it could have

[62] CP 1000-1001.

insisted on limiting the right to retirement welfare benefits in the CBA itself."). Here, the Legislature did exactly that; it included the disclaimer and reservation of rights in the same statute that created the UCOLA.

In *Jacoby*, 77 Wn.2d 911, this Court reversed a decision in favor of the employees, enforcing the unambiguous language of the contract under which the employees claimed pension rights.

> Where a private pension plan creates a contractual obligation between employer and employee, the rights and obligations of the parties must be measured by the terms of the contract under the ordinary rules of contractual construction. The rights of the employee are limited by the terms of that contract.

Id. at 917 (citations omitted; emphasis added). The Court noted that while "[i]t may seem unfair to declare a pension plan to be compensation and then deny an employee who is not at fault the fruits of this compensation[,] . . . the extent of this compensation is limited by the terms of the contract." *Id.* at 920-21 (citation omitted; emphasis added). Even if this "may seem inequitable in a particular case, the alternative would be to hold that the adoption of a pension plan of any type creates an immediate enforceable monetary right in employees, irrespective of the terms of the contract," which would discourage employers from creating pension plans in the first place. *Id.* at 920-21 (citation omitted; emphasis added).

Finally, Plaintiffs cited *Carlstrom* to the trial court for the proposition that "deference to legislative judgment is reversible error."[63] But *Carlstrom* does not hold that a court should ignore the legislature's intent to limit a statutory right, including a pension right.[64] In fact, this Court indicated in *Carlstrom* that a properly drafted reservation of rights is enforceable:

> The Legislature knows how to use plain English to make existing contracts subject to future modification. It could have written [the statute at issue in that case] expressly to provide: These agreements shall be subject to subsequent modification by the Legislature.

Carlstrom, 103 Wn.2d at 398. That is what the Legislature did in the UCOLA statute.

During oral argument on the summary judgment motion here, the trial court recognized the problem with Plaintiffs' position, saying it "seems like a tough position, because you're telling the Legislature that they either have to provide nothing or they have to provide a defined

[63] *See* CP 251 ("The Court must conduct its own independent analysis as to whether a constitutional violation has occurred without any deference to the legislature.").

[64] At the trial court, Plaintiffs omitted the first part of the sentence in *Carlstrom*: "Reliance on the reasonably necessary standard with its resultant deference to legislative judgment is reversible error." 103 Wn.2d at 396. This Court in *Carlstrom* merely distinguished between the deferential "reasonably necessary" standard for the State's impairment of contracts between private parties, and the "reasonable and necessary" standard that a court must "independently" apply where a party alleges the State's impairment of its own contracts. *Id.* at 395-96.

[permanent] benefit."[65] That is exactly right. By seeking a ruling that the Legislature can never limit a pension benefit and that all pension enhancements automatically become contract rights in perpetuity, Plaintiffs would create a disincentive to the Legislature to offer <u>any</u> enhancements in the future.

d. <u>The termination of earlier COLAs did not create a contract right</u>.

Plaintiffs argued below that they had a contractual right to future UCOLA increases because UCOLA was a "replacement" for the termination of certain ad hoc cost-of-living increases enacted by the Legislature from the 1970s to the early 1990s. Plaintiffs asserted that employees who vested under the earlier COLAs received a perpetual entitlement to annual cost-of-living adjustments as a "corresponding benefit" for repeal of the earlier COLAs in HB 2021. This argument fails for several reasons.

First, the pre-UCOLA statutes were largely one-time increases in pension benefits for specific groups and were unaffected by the UCOLA repeal. For example, two of the statutes on which Plaintiffs relied below, former RCW 41.31.4871 and former RCW 41.40.1983 (*see* Laws of 1993,

[65] RP (9/7/12) at 59.

ch. 519, §§ 2-3), granted a one-time increase of $3 per year of service if a member was 70 years old as of July 1, 1993, and had been retired and receiving benefits as of July 1, 1988. The 1995 statute enacting the UCOLA made the adjustment permanent for all eligible beneficiaries. *See* Laws of 1995, ch. 345, §§ 4(1), 8(1). The repeal of the UCOLA did not affect that adjustment. That increase remains embedded in the retirement allowances of those class members who were eligible for the adjustment.

Plaintiffs also relied heavily on former RCW 41.32.499 and 41.40.195. *See* Laws of 1973, 1st Ex. Sess., ch. 189, § 9(6); Laws of 1973, 1st Ex. Sess., ch. 190, § 11(5). Any benefit increase under those statutes was subject to the following:

> *Provided* that the director [of DRS] finds, <u>at his or her sole discretion</u>, that the cost of such adjustments shall have been met by the excess of the growth in the assets of the system over that required for meeting the actuarial liabilities of the system at that time.

(emphasis added). No increase ever occurred under former RCW 41.32.499 for TRS Plan 1. For PERS Plan 1, the DRS Director never exercised "his or her discretion" under this statute after 1980.[66] *Retired Pub. Employee Council of Wash. v. State of Wash.*, 104 Wn. App. 147,

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[66] The Legislature also repealed the respective funding mechanisms for both statutes in 1982. *See* Laws of 1982, 1st Ex. Sess., ch. 52, §§ 11, 18.

149, 16 P.3d 65 (2001). Plaintiffs cannot claim a vested "contractual right" in a potential increase that was purely discretionary.

Indeed, one of the same plaintiff groups involved in this case (RPEC) already unsuccessfully challenged DRS's failure to grant pension increases under the PERS Plan 1 statute in *Retired Pub. Employee Council of Wash.*, 104 Wn. App. at 151-52,[67] and any claim relating to the repeal of the pre-1995 COLAs was time-barred long ago.

Plaintiffs also relied on former RCW 41.32.575 (TRS) and former RCW 41.40.325 (PERS), which provided an increase to Plan members who were at least 65 years old and retired, and whose benefit purchasing power had declined by 40% or more, as well as former RCW 41.32.487 (TRS) and former RCW 41.40.1981 (PERS), which authorized a CPI-based increase to the "minimum retirement allowance." Any Plan member who qualified for the "Age 65" increase before its repeal received it. The Legislature replaced the minimum retirement allowance with the "basic minimum benefit," which provided a greater retirement allowance to those who qualified for the minimum retirement allowance. Laws of 1995, ch. 345, §§ 3, 7. The Legislature did not change the basic minimum

[67] The Court of Appeals rejected a similar challenge based on the statute of limitations in *Retired Pub. Employees Council of Wash. v. State of Wash.*, 2003 Wash. App. LEXIS 1233 (Wash. Ct. App. June 24, 2003).

benefit when it repealed the UCOLA, and eligible beneficiaries continue to receive the benefit in an amount exceeding the minimum retirement allowance previously available. *See* RCW 41.32.489; RCW 41.40.197. The class expressly excludes recipients of the basic minimum benefit.

Finally, Plan members who did qualify under the earlier statutes received the increases called for by those statutes, and continue to receive any increase granted under the statutes before the UCOLA's enactment. Those prior increases are part of their existing pensions and were unaffected by the UCOLA repeal. Plan 1 members cannot claim any entitlement to the UCOLA as a "replacement" benefit when they already received everything to which they were entitled.

e. Plaintiffs have failed to prove a contract right to perpetual UCOLA increases.

In sum, Plaintiffs bear the burden of proving "beyond a reasonable doubt" that they had a contractual right to perpetual UCOLA increases. *Charles*, 148 Wn.2d at 623. They cannot meet this burden because the plain language of the statute forecloses any claimed contractual right, and there is no basis in justice, logic, or precedent for ignoring that plain language and awarding Plaintiffs billions in pension benefits they were never granted. If the Court agrees, it need go no further, but even if it does not, Plaintiffs' claim still fails because they cannot meet the remaining prongs of the Contracts Clause test.

2. Canceling future UCOLA increases did not substantially impair any contract right of Plaintiffs.

In canceling future UCOLA increases, the Legislature did not substantially impair any contract right of Plaintiffs because even if the UCOLA statute granted Plaintiffs contractual rights, those rights were expressly revocable and limited by the terms of the statute.

A statute "impairs" a contract if the statute "alters its terms, imposes new conditions, or lessens its value." *Charles,* 148 Wn.2d at 625 (citation omitted). That "impairment is substantial if the complaining party relied on the supplanted part of the contract." *Margola Assocs. v. City of Seattle*, 121 Wn.2d 625, 653, 854 P.2d 23 (1993). Here, because the UCOLA benefit was by statute a non-contractual benefit expressly subject to repeal, the repeal did not "alter" the terms of the statute, impose "new conditions," or "lessen its value." And any impairment could not have been substantial because it is plainly unreasonable to rely on the perpetual continuation of a benefit that is expressly non-contractual and subject to repeal. Plaintiffs received exactly what the original UCOLA called for – an annual increase in their pensions until repealed.

a. <u>The UCOLA repeal impaired no contract right</u>.

Even if the UCOLA statute created any contractual rights – which it did not – those rights can only be as broad as the language of the statutory grant. *See, e.g., Jacoby,* 77 Wn.2d at 920 ("the extent of [pension] compensation is limited by the terms of the contract"). Here, that language expressly reserved the right to repeal. Given that language, Plaintiffs cannot plausibly claim that the Legislature's cancellation of future UCOLA increases "alters [the] terms [of], imposes new conditions [on], or lessens [the] value" of any contractual right they had. *Charles,* 148 Wn.2d at 625. The terms and conditions of any alleged contract included the right to repeal.

Plaintiffs' contrary argument amounts to claiming that they should be able to pick and choose the parts of the UCOLA statute they like (the annual increases), while ignoring the parts they do not like (the right to repeal). But this Court has repeatedly held that Plaintiffs cannot "cherry pick" provisions of a pension plan. *McAllister*, 166 Wn.2d at 632; *see also Vallet v. City of Seattle*, 77 Wn.2d 12, 21, 459 P.2d 407 (1969) (party cannot rely only on the "best parts of several pension acts relating to him"). If the UCOLA granted contractual pension rights, those rights must include the limitations the Legislature expressly incorporated.

b. Any impairment could not have been substantial.

Even if Plaintiffs could establish both the existence and impairment of contract rights, they also must establish that such impairment is "substantial." Two factors bear upon the substantiality of impairment of a statutory contract: the degree to which the modified or repealed provisions induced Plaintiffs to enter into the contract in the first place, and the degree to which Plaintiffs reasonably expected the modified or repealed part of the contract to continue. As stated by this Court in *Tyrpak v. Daniels*, 124 Wn.2d 146, 155 n.1, 874 P.2d 1374 (1994):

> A contract with the government does not impose upon it a binding obligation to maintain with photographic precision the status quo at the time of the contract. What it does require is that policy changes and political evolutions not discard the legitimate expectations embodied in the contract, nor dramatically diminish the inducements which led to the initial formation of the contract.

(citation omitted; emphasis added). Where the purported contract itself states that the Legislature may amend or repeal the contract at any time, Plaintiffs cannot credibly argue that they were "induced" to work for their public employers by the promise of perpetual annual adjustments, particularly where, as here, the Legislature enacted the UCOLA 18 years after Plan 1 was closed to new members.

Everyone is presumed to know the law, and Plaintiffs cannot claim ignorance of the reservation of rights and contract disclaimer in the UCOLA statute, especially given that they supposedly relied on other parts of the statute. *Retired Pub. Employees Council,* 104 Wn. App. at 151-52 ("[A] reasonable person is deemed to know the law, or, as the old cliché puts it, 'ignorance of the law is no excuse.'").[68] At a minimum, factual disputes regarding the reasonable expectations of the class members should have precluded summary judgment.[69]

3. The UCOLA repeal was reasonable and necessary to serve a legitimate public purpose.

Plaintiffs' claim should fail because they had no contractual right to future UCOLA increases and UCOLA's repeal did not substantially impair any contractual rights. But even if Plaintiffs had such a right and it was substantially impaired, the Legislature complied with the Contracts Clause because the repeal was reasonable and necessary to serve

[68] The Court of Appeals decision in *Retired Pub. Employees Council* is particularly instructive. There, plaintiffs – including one of the Plaintiffs in this case – challenged part of the same 1995 statute at issue in this case, and its repeal of a different COLA. The court rejected plaintiffs' argument that they were ignorant of the prior statute that the UCOLA act repealed. Particularly in light of this prior challenge, Plaintiffs cannot credibly claim now that they had expectations contrary to the express limitations contained in the 1995 UCOLA statute.

[69] Plaintiffs offered no declarations from the named plaintiffs or any class members about their respective expectations of the UCOLA. The only evidence submitted reflects named Plaintiffs' lack of expectations; they were largely unaware of the UCOLA even after its grant. CP 940-996.

legitimate public purposes. *See, e.g.*, *Wash. Fed'n. of State Employees v. State of Wash.*, 127 Wn.2d 544, 564, 901 P.2d 1028 (1995) ("Even if a substantial impairment of contract occurs . . . it may nonetheless be constitutional if it was reasonable and necessary to achieve a legitimate public purpose.") (citation omitted); *Bakenhus*, 48 Wn.2d at 702 (holding that changes to contractual pension rights are acceptable "for the purpose of keeping a pension system flexible . . . and at the same time maintain[ing] the integrity of the system") (citation omitted). Specifically, the Legislature needed to repeal the UCOLA to preserve the integrity and flexibility of Plan 1 and to avoid even deeper cuts to other government programs that already were occurring at the time.

In the trial court, the State provided uncontroverted evidence that canceling future UCOLA increases was necessary to preserve the integrity and flexibility of Plan 1. The unrebutted record demonstrated that the State faced a significant risk that Plan 1 would fall to "pay-go" status unless the State took action.[70] Department of Retirement Systems Director Steve Hill testified specifically about the financial crisis and the need to

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[70] *See* CP 708.

repeal future UCOLAs: "Left unaddressed, the plans would simply run out of money to pay any beneficiary benefits, not just UCOLAs."[71]

When it terminated future UCOLAs, the Legislature expressly found that:

> Due to the current extraordinary economic recession and due to the financial demands of other core responsibilities of government, it is not feasible for public employers of this state to fund the annual increase amount and continue to ensure the fiscal integrity of these pension funds.

Laws of 2011, ch. 362, § 1. The UCOLA repeal reduced the unfunded liability of PERS Plan 1 by roughly $2 billion and of TRS Plan 1 by $1.6 billion.[72] Plaintiffs offered no contrary evidence.

Canceling future UCOLA increases also was necessary to prevent even deeper cuts to other government programs than already were required. It is difficult to overstate the magnitude of the budget challenges faced by Washington's state and local governments in the period immediately preceding UCOLA repeal. Revenues were plummeting, caseloads and demands for services were skyrocketing, and the budget outlook was extremely dim. The Legislature, forced to choose between eliminating future pension increases and further cutting vital services

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[71] CP 608.

[72] CP 611.

ranging from education to healthcare, reasonably chose the former. This was a legitimate public purpose. Under "severe economic difficulties," courts must show restraint; private rights should not be unwisely advanced at the expense of the public interest. *SEIU Healthcare 775NW v. Gregoire*, 168 Wn.2d 593, 601, 229 P.3d 774 (2010).

4. Plan 1 members received valuable replacement benefits in exchange for the UCOLA repeal.

The trial court based its ruling for Plaintiffs on the conclusion that the State did not provide "comparable benefits" for the repeal of the UCOLA. In this case, no "corresponding benefit" was due because Plaintiffs had no contract right to future UCOLA increases in the first place. But even if a "corresponding benefit" was required, the Legislature satisfied that requirement by substantially increasing the "Alternative Minimum Benefit" and improving the funding of Plan 1.

Washington courts assess legislative modifications to contractual pension rights to determine whether the over all result is "reasonable and equitable." *Dailey*, 54 Wn.2d at 738 (act of the Legislature "making a change in pension rights, will be weighed against pre-existing rights . . . to determine whether it is reasonable and equitable"); *Vallet*, 77 Wn.2d at 21 ("If the over all result is reasonable and equitable, the employees (prospective pensioners) will be presumed to have acquiesced in the modifications"). The trial court here failed to engage in that analysis.

In the law repealing the UCOLA, the Legislature substantially increased the Alternative Minimum Benefit available to many Plan 1 members. *See* Laws of 2011 Ch. 362, §§ 4(5), 7(7); RCW 41.32.4851; RCW 41.40.1984. Because of that increase, many Plan 1 members will become eligible for the Alternative Minimum Benefit years earlier than they otherwise would have been. The Alternative Minimum Benefit will exceed the value of the ordinary retirement allowances of those Plan 1 members even if the allowances had been increased by the UCOLA. The Legislature's increase in the Alternative Minimum Benefit substantially offsets the effect of the UCOLA repeal.

Further, Plan 1 members received a substantial benefit in exchange for the UCOLA repeal because the Legislature "ensure[d] that it would be able to continue to fund Plan 1 to pay for future <u>basic</u> benefits."[73] In *Vallet,* 77 Wn.2d 12, this Court held that a "corresponding benefit to counterbalance the loss of respondent's rights to a fixed pension" had been established where the fixed pension for police officers was replaced with a sliding scale that was "better suited to thwart the severity of inflation's

[73] CP 611; CP 631.

effect on fixed income . . . ." *Id.* at 22; *see also McAllister*, 166 Wn.2d at 628-30 (sufficient offsetting benefits accompanied the elimination of a salary cap that previously had limited the dollar amount of employees' contributions to their pensions).[74]

In sum, the trial court erred in failing to address the increase in the Alternative Minimum Benefit and the improvements in the funded status of Plan 1. At the very least, the State's evidence created a genuine issue of material fact regarding the existence of "corresponding benefits."

VI. CONCLUSION

While Plaintiffs ask this Court for an unprecedented decision overriding clear statutory language and legislative intent, the State seeks only a narrow ruling. To resolve this case, the Court need not say anything about pension plans offered by private employers; about whether basic pension benefits (in contrast to cost-of-living adjustments) can be subject to reservations of rights; or about whether reservations of rights enacted separately from a benefit are effective. Rather, the Court need only hold that when the Legislature enacts a law creating a pension enhancement, and says in that same law that there is no contractual right to

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[74] In *McAllister*, this Court recently found that "*Bakenhus* was not violated" where the Legislature, in enacting LEOFF Plan 1, retained a six-percent employee contribution rate but removed the limit on the salary to which the contribution rate was applied.

the enhancement and that it can be revoked at any time, members have no permanent constitutional right to receive that benefit. The State asks that the Court adopt that reasonable holding here and rule in the State's favor.

DATED this 26th day of July, 2013.

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Clerk of the Court:

Attached please find Brief of Petitioners Washington Department of Retirement Systems and the State of Washington in regard to the above-referenced action.

Thank you

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