

NO. 40861-9

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

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

Appellant,

v.

DEPARTMENT OF RETIREMENT SYSTEMS,

Respondent.

BRIEF OF RESPONDENT

ROBERT M. MCKENNA
Attorney General

SARAH E. BLOCKI
WSBA #25273
Assistant Attorney General
Government Operations
Division
P.O. Box 40108
Olympia, WA 98504-0108
(360) 586-3233

Attorneys for the Department
Of Retirement Systems

TIM J. FILER, WSBA #16285
SAMUEL T. BULL, WSBA #34387
Special Attorneys General
Foster Pepper PLLC
1111 Third Avenue, Suite 3400
Seattle, WA 98101
(206) 447-4400

Attorneys for the Department
Of Retirement Systems

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I. INTRODUCTION

The Department of Retirement Systems (“the Department”) respectfully asks this Court to affirm the dismissal of Appellants’ claims.

Appellants are members of the Teachers’ Retirement System (“TRS”) who transferred their membership from one plan within that system – the “defined benefit” TRS Plan 2 – to another plan in that system – the “hybrid” TRS Plan 3. The Legislature delegated to the Department the task of formulating procedures for effecting those transfers.

TRS does not hold its members’ retirement contributions “on deposit.” Retirement contributions become the property of the retirement system and are invested by the State to fund the payment of pension benefits to the system’s retired members. For certain limited accounting purposes, the Department tracks members’ contributions to Plan 2 as “accumulated contributions” in individual accounts and credits them with “regular interest.” “Regular interest” is a statutory term and embodies a statutory concept that has existed in TRS since 1937.

Between 1937 and 1976, while TRS was administered by a Board of Trustees, the statute required the Board to award “regular interest” to various TRS subfunds and individual accounts on an ex post facto basis, i.e., at the end of a fiscal year, depending on the market performance of the invested TRS assets over the year and based on the balance of the

assets as of the beginning of the fiscal year. As directed by the Legislature, the crediting of regular interest was (1) determined after the end of an accounting period and (2) based on a balance that existed as of the beginning of the period and (3) did not credit interest on contributions made during the accounting period. After the Legislature transferred authority to administer TRS to the Department in 1976, the director, under his discretionary authority to determine “regular interest”, adopted a method mirroring the one used by the Legislature for previous forty years.

The Legislature created the new “hybrid” TRS Plan 3, effective in 1996. Members of TRS Plan 2 had the option to transfer to TRS Plan 3. For any member who chose to transfer, the Department was required to develop procedures for transferring the member’s “accumulated contributions” from Plan 2 to Plan 3. Working within the existing logistical constraints of numerous stakeholders, the Department developed procedures to implement the transfer efficiently without disrupting existing computerized payroll processes. Plan 2 “accumulated contributions were transferred as expeditiously as possible after the Department received notification of the member’s transfer decision.

Leisa and Mickey Fowler were members of TRS Plan 2 and chose to transfer to TRS Plan 3. They claim that the “accumulated contributions” that were transferred to their Plan 3 accounts were

understated because “regular interest” was not calculated on a daily basis. Both the Presiding Officer in the administrative appeal and the trial court on judicial review determined that the transfer procedures adopted by the Department were within the discretionary authority granted by the Legislature and rejected Appellants’ argument that the Department incorrectly construed the statutory term “regular interest”. This Court should affirm that decision.

II. COUNTERSTATEMENT OF THE ISSUES

Among the duties delegated to the Department by the Legislature are (i) deciding how to credit “regular interest”, if any, to TRS Plan 2 members; and (ii) developing procedures for processing members’ requests to transfer their “accumulated contributions” from TRS Plan 2 to Plan 3. Appellants raise essentially three issues:

1. Were the Department’s procedures for transferring “accumulated contributions” (including “regular interest”) from TRS Plan 2 to TRS Plan 3 consistent with the retirement statutes?¹

2. Was the interest crediting methodology developed by the Department for effecting the transfers, under its statutory authority, well-reasoned and taken in full regard to all relevant facts and circumstances, making it not “arbitrary and capricious”?

¹ Appellants’ first three issues are sub-issues of this issue. Brief of Appellants (“Fowler Br.”), at 2-4.

3. Did the Legislature's remedial and retrospective clarification of the previously existing scope of the Department's authority to determine "regular interest" effect an unconstitutional "taking" of property?

III. PROCEDURAL HISTORY

Jeff Probst first challenged the Department's crediting of "regular interest" under the Public Employees' Retirement System (PERS) statutory scheme in an administrative proceeding in 2004. CAR 1126-29.² Mr. Probst transferred his retirement plan membership from PERS Plan 2 to PERS Plan 3 in 2002. CAR 12-13. Claiming his "accumulated contributions" (and "regular interest") were understated, Mr. Probst filed an administrative appeal in July 2004. CAR 1126-29. He also filed a class action in Thurston County Superior Court in January 2005. CP 6-11.

In September 2005, the Department's Presiding Officer denied Probst's administrative appeal, holding that the Department had properly exercised its statutory authority in calculating his "regular interest" and transferring his "accumulated contributions". CAR 1-33. In October 2005, Mr. Probst filed a Petition for Judicial Review of the Administrative Order. CP 687-92.

In March 2006, the *Probst* class action was consolidated with his judicial review petition. CP 696-700. Mr. Probst moved to be appointed

² CP means Clerk's Papers and CAR means the Certified Administrative Record.

as class representative of a class consisting of (i) all current members of PERS or TRS who transferred or will transfer from a Plan 2 to a Plan 3; and (ii) all former members of PERS or TRS who withdrew their retirement contributions within a specified period. CP 29-49. The court limited the class to members who had transferred from PERS Plan 2 to PERS Plan 3. CP 118-121.

In November 2007, the parties entered a Settlement Agreement, “fully and finally” resolving the claims of Mr. Probst and a settlement class. CP 261-86. The court-approved settlement is final. CP 247-60.³

The settlement did not resolve the claims of TRS members who transferred from TRS Plan 2 to TRS Plan 3 before January 20, 2002. CP 272. In February 2009, the Fowlers filed an Amended Supplemental Complaint to resolve these claims. CP 290-94. The court certified a class and appointed the Fowlers as class representatives. CP 321-24. The trial court dismissed the case on the merits applying the APA standards of review. CP 670-86.⁴ Fowlers seek review of that order.

³ The Fowlers argue their claims should be addressed “based on the agency record developed in the *Probst* administrative proceeding.” Fowler Br., at 7. Under the settlement agreement, the record from the *Probst* administrative appeal was deemed admitted as evidence in the unresolved portion of the class action. Because TRS has been, from its inception, the subject of a completely separate statutory framework and administration, the facts regarding Probst and PERS may or may not be relevant to the subsequent litigation involving the Fowlers and TRS. CP 275, ¶ 69.

⁴ The Department and Appellants also each moved for summary judgment. The Department’s motion on statute of limitations grounds and Appellants’ motion under a different statute were denied. CP 670-74. Neither of those rulings has been appealed.

IV. COUNTERSTATEMENT OF THE CASE

A. The Teachers' Retirement System Was Established To Provide Pension Benefits To Retired Washington Teachers.

TRS was established by the Legislature in 1937 to provide pension benefits to Washington teachers. Laws of 1937, ch. 221 (CP 513-27). The system is subdivided into three plans: TRS Plan 1, TRS Plan 2, and TRS Plan 3. At all times relevant here, plan membership has been determined by the date the teacher becomes enrolled in the system. RCW 41.32.010(31), (32), (33).⁵

1. TRS Plan 2 Is A Defined Benefit Plan Providing A Monthly Retirement Allowance To Retired Teachers.

The overarching purpose of governmental pension plans is to provide an income stream to members after they retire. TRS Plan 2 provides that a member may retire at age 65 and receive a monthly retirement allowance for life. RCW 41.32.765. The allowance is set by statute at two percent of the member's final salary for every year of service. RCW 41.32.760.

2. Employer And Employee Contributions And Earnings Provide Assets To Fund TRS Retirement Benefits.

So that TRS Plan 2 will have sufficient assets to meet its obligation to pay monthly retirement allowances, members of the plan and their

⁵ Teachers who first enrolled in TRS between October 1977 and June 1996 were required to participate in TRS Plan 2. The Fowlers and all members of the class became members of TRS Plan 2 during this period. CP 321-24.

employers are each required to make contributions to TRS. Every member “is conclusively presumed to consent [to making member contributions] as a condition of employment,” and these contributions are made as a monthly deduction from salary. RCW 41.32.042. TRS employers also make contributions based on the total monthly compensation of the employer’s members. RCW 41.32.035.

Member and employer contributions become assets of TRS Plan 2 held in the “combined plan 2 and 3 fund” *to pay retiree benefits*:

[a]ll assets of the Washington state teachers’ retirement system shall be credited according to the purposes for which they are held, to two funds to be maintained in the state treasury, namely,

- [i] the teachers’ retirement system plan 1 fund and*
- [ii] the teachers’ retirement system combined plan 2 and 3 fund. . . .*

[T]he combined plan 2 and 3 fund shall consist of all moneys paid to finance the benefits provided to members of the Washington state teachers’ retirement system plan 2 and 3.

RCW 41.50.075 (formatting and emphasis added).⁶ The Washington State Investment Board invests these funds “for the exclusive benefit of fund beneficiaries.”⁷ RCW 41.50.080; RCW 43.84.150; RCW 43.33A.140.

⁶ All TRS funds are held in the name of the Teachers’ Retirement System. RCW 41.32.020.

⁷ See WAC 415-02-756 ([n]o assets of the retirement system may be used for or diverted to a purpose other than the exclusive benefit of the members and their beneficiaries at any time prior to the satisfaction of all liabilities with respect to members and their beneficiaries).

The TRS funds' assets (member and employer contributions alike, and the market return thereon) are the property of the retirement system, held in trust by WSIB. RCW 43.33A.030. Although the funds are held for the "exclusive benefit" of members, members have no property interest in either their own contributions or those of their employer. At most, they have a "quasi-contractual" interest in receiving the benefits promised by the terms of the pension plan. *See Noah v. State*, 112 Wn.2d 841, 844-45, 774 P.2d 516 (1989).⁸

3. Though Commingled For Investment, TRS Plan 2 Assets Are Allocated To Subfunds And Individual Accounts For Internal Accounting Purposes.

Although both employee and employer contributions are deposited in a combined plan 2/3 fund for investment purposes, the statute provides various subfunds for internal accounting purposes: a "pension reserve" from which pension obligations are paid and a "member reserve" in which employee contributions are tracked prior to a member's retirement. RCW 41.32.010(27), (30) (member and pension reserves respectively).⁹ Further, "[a]ll contributions to the member reserve [i.e., all employee

⁸ The Washington Supreme Court has made clear that pension contributions paid into a "common benefit account fund" are not the property of pension plan members. Pension plan members "have no legal claim" upon funds contributed to their pension plans "until they qualify for benefits under [the statutory act governing the plan]." *Marysville v. State*, 101 Wn.2d 50, 56, 676 P.2d 989 (1984).

⁹ Similar accounting structures are utilized in other plans administered by the Department. For example, in TRS Plan 1, RCW 41.50.200 makes express provision for similar reserve funds (i.e., a member reserve and a pension reserve) "for the purpose of the internal accounting record."

contributions] shall be [and are] credited to the individual for whose account . . . deductions from salary were made.” RCW 41.32.042.

The statute provides for the periodic crediting of “regular interest” (out of the investment returns of the TRS combined plan 2/3 fund) to the *member and pension reserves* as follows:

From interest and other earnings on the moneys of the Washington state teachers’ retirement system . . . at the close of each fiscal year *the department shall make* an allowance of *regular interest* on the balance which was on hand *at the beginning of the fiscal year* in each of the teachers’ retirement system funds [the “member reserve” and the “pension reserve”] as they may deem advisable.

RCW 41.50.215 (emphasis added). “Regular interest” is defined by statute to be “such rate as the [Department’s] director may determine.”

RCW 41.32.010(38). “Regular interest shall be credited to each member’s *individual account* at least annually.” RCW 41.32.042 (emphasis

added).¹⁰ The sum of all contributions standing to the credit of a Plan 2 member in his individual account together with the “regular interest” thereon are defined to be the member’s “accumulated contributions.”

RCW 41.32.010(1)(b). This is the extent of the current statutory guidance as to how “regular interest” should be credited both to the TRS subfunds (i.e., the member and pension “reserves”) and to individual accounts.

¹⁰ Subsequently, the Legislature has provided that if “regular interest” in *all* the retirement systems administered by the Department, including TRS, is credited, it should be credited “at least quarterly.” RCW 41.50.033(1).

4. A TRS Plan 2 Member's "Accumulated Contributions" Have No Effect On A Standard Retirement Allowance.

Under TRS Plan 2, a member's monthly retirement allowance is based solely on years of service and final compensation, not the "accumulated contributions" in the member's individual account. If a Plan 2 member chooses to retire with a monthly allowance, the "accumulated contributions" credited to the individual account will ultimately have no relevance at all to the member's retirement benefit.

The statute does allow a Plan 2 member who separates from employment to request and receive a refund of his "accumulated contributions". RCW 41.32.820. The refund of "accumulated contributions" under this section terminates TRS Plan 2 membership and benefits, including any right to retire with a monthly allowance. *Id.*

5. TRS Plan 3 Is A "Hybrid Plan" Providing Two Distinct Income Streams To Teachers Upon Retirement.

TRS Plan 3 is the other pension plan involved in this proceeding. The Legislature established TRS Plan 3 in 1995, to become effective July 1, 1996. Laws of 1995, ch. 239. As in Plan 2, both Plan 3 members and their employers are required to contribute to the plan. RCW 41.32.035; RCW 41.34.040(1). However, unlike Plan 2, employee and employer contributions are used to fund two separate income streams at retirement. RCW 41.32.831; RCW 41.34.030.

Plan 3 employer contributions fund a one-percent retirement allowance (a “defined benefit”) based on final salary and years of service.¹¹ RCW 41.32.840. Plan 3 employee contributions are deposited into a member account (or “defined contribution” account), which provides a second income stream at retirement. RCW 41.34.020(6). The benefit that the member receives from this defined contribution account at retirement depends on the balance in the account at the time of the member’s retirement. RCW 41.34.070.

TRS Plan 3 members have the option to assume complete responsibility for investment decisions affecting their Plan 3 member accounts.¹² RCW 41.34.060. Thus, members have significant opportunities for market gain alongside significant opportunities for loss. Decl. of Wickman, ¶ 21, Apr. 27, 2005 (CAR 862). A third party record keeper keeps detailed records of the Plan 3 member accounts; receives and records their transaction requests; and directs the purchase and sale of investment units consistent with members’ aggregate requests. Decl. of Deem, May 20, 2005 (CAR 795). See RCW 41.34.130.

¹¹ Plan 3 employer contributions are deposited in the TRS combined Plan 2 and 3 fund. RCW 41.50.075.

¹² A Plan 3 member may chose either (i) to “self-direct” the investment of the funds in his/her member account; or (ii) to have the funds invested in the same investment portfolio as the combined plan 2 and 3 fund. In such case, the member’s contributions remain in the combined fund for investment purposes. The member’s authority to manage the investment of his/her member account does not imply legal ownership of the account. Legal ownership of the funds is in the retirement system until the funds are distributed. RCW 41.34.060.

6. Members Of TRS Plan 2 May Transfer To Plan 3.

When Plan 3 was created, the Legislature further provided that any person initially mandated into TRS Plan 2 could transfer into TRS Plan 3. RCW 41.32.817. If a member transfers, the amount that has previously been tracked in TRS Plan 2 as the member's "accumulated contributions" is transferred "to the member's account in [TRS Plan 3], pursuant to procedures developed by the department" RCW 41.32.817(5).

The Fowlers and the class they represent all transferred from TRS Plan 2 to TRS Plan 3 between July 1996 and January 2002. They claim that the "accumulated contributions" transferred into their Plan 3 member accounts should have been greater; i.e., that the Department did not transfer all the "regular interest" that should have been included in the "accumulated contributions" that were transferred.

7. Summary Of TRS Purpose.

In short, TRS is a *retirement system*: its objective is to provide pension benefits to TRS members, not "on deposit" savings accounts. All provisions for the internal operation of the system (from investment to accounting) and all provisions for retirement and other incidental benefits are defined in the retirement statute and associated regulations.

B. Since 1937, The Legislature Has Used The Term “Regular Interest” In The TRS Statutes Regarding Allowances To TRS Subfunds And Individual Accounts.

As indicated, the current TRS statute provides allowances of “regular interest” to subfunds and individual accounts, but gives little guidance to the Department regarding how these allowances should be made. In adopting its interest crediting methods, however, the Department drew on the Legislature’s use of the term “regular interest” while the system was administered by the TRS Board of Trustees.

1. Historically, “Regular Interest” On TRS Subfunds Was Not Credited Daily.

Since the inception of the Teachers’ Retirement System in 1937, the Legislature has required “regular interest,” i.e., allocations to the TRS subfunds and individual accounts from the market earnings of the invested funds. Since 1947, “regular interest” has been an amount credited to the various TRS subfunds and to individual accounts at the end of the fiscal year as the TRS Board of Trustees deemed advisable.¹³

With regard to the various subfunds, the requirement for “regular interest” has been stated in language substantially similar to the following:

From interest and other earnings on the moneys of the retirement system [all the TRS assets], *at the close of each fiscal year* the Board of Trustees shall make such allowance

¹³ Between 1937 and 1976, TRS had between four and nine statutory subfunds. Laws of 1937, ch. 221 (four subfunds); Laws of 1969, 1st Ex. Sess., ch. 150 (nine subfunds).

of regular interest on the balance which was on hand at the beginning of the fiscal year in each of the funds [i.e., the subfunds] as they may deem advisable . . .

Laws of 1947, ch. 80, § 19 (emphasis added) (CP 531). *Compare* RCW 41.50.215. Rather than being earned (and therefore accruing) throughout the year at a pre-established rate, the statute simply provided that the “regular interest” would be allocated to each subfund at the close of the fiscal year at the Board’s discretion, out of the interest and earnings on all TRS assets during the year. Amounts deposited into a subfund *during* the fiscal year, if any, did not receive a “year’s worth” of interest at the end of the year because they had not been in the subfund at the beginning of the fiscal year.

2. Historically, “Regular Interest” On Individual Accounts Was Not Credited Daily.

Since 1937, TRS has had a statutorily created subfund, i.e., the Annuity Fund, analogous to the present “member reserve.”¹⁴ Like the present “member reserve,” the “Annuity Fund” has been composed of the individual accounts of individual members. Whenever “regular interest” was credited to the Annuity Fund, that interest was “passed along” to individual accounts as a bookkeeping entry. Laws of 1947, ch. 80, §§ 35,

¹⁴ See Laws of 1937, ch. 221, § 6(3) (creation of Annuity Fund) (CP 519); Laws of 1992, ch. 212, § 1 (amending RCW 41.32.010(4) and changing name from Annuity Fund to Member Reserve).

46 (CP 532-34). In 1973, the Legislature clearly articulated the discretionary nature of this “passing along” as follows:

The moneys accumulated in the income fund¹⁵ shall be available for transfer, upon board authorization, . . . for regular interest allowance to the various [sub]funds . . . ; PROVIDED, That from such accumulated moneys ***the board shall have sole discretion*** to determine an amount thereof to be credited to the annuity [sub]fund which will thereupon be credited as regular interest to the individual members’ accounts

Laws of 1973, 1st ex. sess., ch. 189, § 8 (emphasis added) (CP 544).

Similar to the subfunds, “regular interest” on individual accounts, *as that term was defined and used by the Legislature*, was not earned (and did not accrue) throughout the year at a pre-established rate. It was not earned “de die in diem.” The statute provided that the “regular interest” may be allocated to each individual account at the end of the fiscal year at the Board’s discretion, out of the interest and earnings on all TRS assets.

Like the statutes governing “regular interest” to the subfunds, the statutes governing “regular interest” to individual accounts expressly provided (i) the date on which “regular interest” was to be granted, and (ii) the date for determining the balance on which “regular interest” would be based:

¹⁵ Between 1969 and 1992, amounts earned from the investment of the TRS assets were deposited into an Income Fund, pending distribution to the other subfunds. See Laws of 1969, ch. 150, § 12 (codified as RCW 41.32.405 creating TRS Income Fund); Laws of 1992, ch. 212, § 22 (repealing RCW 41.50.225 provision for TRS Income Fund).

[r]egular interest shall be credited to each member's account *at the end only of each fiscal year*, based upon the *balance in his account at the beginning of the year*.

Laws of 1947, ch. 80, § 46 (codified as former RCW 41.32.460) (emphasis added) (CP 534). Accordingly, amounts that had been credited to the individual accounts during the year (as employee contributions) *were not* granted an allowance of “regular interest” at the end of the fiscal year.

3. Historically, Amounts Paid Upon “Withdrawal” Of “Accumulated Contributions” Did Not Include Interest For Partial Periods.

As now, TRS members historically had the option (in the limited circumstances specified in statute) to withdraw the amount of the “accumulated contributions” standing to their credit *at the time of* such withdrawal. Laws of 1937, ch. 221, § 8(3) (CP 527). This was available only upon a separation from employment and only “regular interest” that had *previously been credited* could be withdrawn upon separation:

[s]hould a member cease to be employed as a teacher and request . . . a refund of his accumulated contributions with interest to the June thirtieth next preceding,¹⁶ this amount shall be paid to him

Laws of 1947, ch. 80, § 51 (CP 535).

¹⁶ “June thirtieth next preceding” was June 30 of the fiscal year that had ended immediately prior to the request for refund. For example, if a request for refund was made on April 30, 1950, the member could withdraw “accumulated contributions” including the “regular interest” that had been granted through June 30, 1949. (The TRS fiscal year ran from July 1 of one calendar year through June 30 of the next.)

In sum, the historical use of the term “regular interest” clearly shows that the Legislature did not understand the statutory concept of “regular interest” to include or require crediting of daily interest on amounts contributed during an accounting period. The Legislature did not understand “regular interest” either to be “earned” daily or to “accrue” daily prior to being credited. Rather, as the term was applied to subfunds, individual accounts, and withdrawals from individual accounts, “regular interest” was a statutory construct used by the Legislature to describe an allowance periodically granted to those TRS funds and accounts.

C. In 1976, The Legislature Delegated To The Department The Duty To Administer All Aspects Of TRS.

The Legislature created the Department of Retirement Systems in 1976, and transferred to the new agency “all powers, duties, and functions” relating to the administration of the various public retirement systems formerly vested in individual retirement boards. RCW 41.50.020, .090. Pursuant to this transfer of duties, the Department was delegated full authority to implement the provisions of the TRS statute. RCW 41.50.030. Indeed, the Department was “empowered . . . to decide on *all* questions of eligibility covering [TRS] membership, service, and benefits.” RCW 41.32.025 (emphasis added).

1. The Department’s Administration Powers Include The Authority To Determine How To Credit “Regular Interest” To TRS Subfunds and Individual Accounts.

As indicated, the current TRS statute requires “regular interest” but provides no express statutory guidance regarding its implementation. Instead, the Department’s general authority to administer the retirement systems includes “the authority and responsibility to establish the amount and all conditions for regular interest”:

The director shall determine when [regular] interest shall be credited to [TRS] accounts The amounts to be credited and the methods of doing so shall be at the director’s discretion.

RCW 41.50.033. Although these provisions were enacted in 2007, the Legislature plainly states that they articulate authority that had existed in the Department since its creation in 1976.¹⁷ This is clear because the provisions are “curative, remedial, and retrospectively applicable.” *Id.*¹⁸

¹⁷ Although statutory amendments generally apply prospectively, they will be applied retrospectively if the legislature so intended, or if they are curative or remedial. *1000 Virginia L.P. v. Vertecs Corp.*, 127 Wn. App. 899, 913, 112 P.3d 1276 (2005) (citing *McGee Guest Home, Inc. v. Dep’t of Social and Health Servs.*, 142 Wn.2d 316, 324-25, 12 P.3d 144 (2000)). In fact, “amendments are often applied retroactively if the legislature acted ‘during a controversy regarding the meaning of the law,’ because the legislature’s timing reflects its intent to cure or clarify a statute.” *Id.* Enacted mid-way through this controversy, RCW 41.50.033 was intended to clarify and ratify the Department’s authority to establish the methodology for “regular interest” for the remainder of the litigation. Indeed, the Legislature said as much: it intended the legislation to be “*curative, remedial, and retrospectively applicable.*”

¹⁸ The Fowlers make various assertions regarding what the Department told the Legislature and what the Legislature believed when it passed this legislation. *See, e.g., Fowler Br.*, at 33. Contrary to these assertions, the Department never told or implied to the Legislature that the entire case had settled. Not only are these assertions ungrounded in the record, they have no relevance in this proceeding.

In 1979, exercising this statutory authority to administer TRS, the Director determined that “regular interest” would be applied to TRS Plan 2 individual accounts quarterly, at the rate of 5.5% per annum based on the “accumulated contributions” in the member’s account on the final day of the prior quarter. Decl. of Wickman, ¶ 5, Apr. 27, 2005 (CAR 856-57). Rather than being removed from the TRS fund and distributed to the member, such “regular interest” would be added to the “accumulated contributions” already “standing to the member’s credit” in his individual account. See RCW 41.32.010(1)(b).¹⁹

The Director also determined that members would not be credited with “regular interest” for a period shorter than one quarter. Thus, in order to receive regular interest for any given quarter, funds must remain in the member’s individual account at the start of the quarter and be there for the entire quarter. Decl. of Wickman, ¶ 9, Apr. 27, 2005 (CAR 860). If “accumulated contributions” were withdrawn or refunded from an

¹⁹ For example, assume that a member has \$10,000 in a Plan 2 account on March 31, the last day of first quarter. Assume that the member’s required contributions during the second quarter are \$100 per month (April 15, May 15, and June 15). “Regular interest” is awarded on June 30, the last day of the second quarter as follows:

$$\frac{5.5\% \text{ of } \$10,000}{4} \quad \text{rather than} \quad \frac{5.5\% \text{ of } \$10,300}{4} .$$

NOTE. The amount is divided by four because 5.5% is a per annum rate. Thus, second quarter interest is \$137.50. The contribution amount (\$300) added to the account during second quarter is not used in the calculation of second quarter interest.

Thus, the member’s account balance at the end of second quarter is \$10,000 + \$300 + \$137.50 or \$10,437.50. Third quarter interest will be calculated on this new amount.

individual account during an interest period, “regular interest” would not be allowed for the partial period.

This methodology simply continued the Legislature’s historical use of the term “regular interest.” Indeed, when the Legislature delegated authority to the Department in 1976, nothing in the statute indicated that the Legislature intended the Department to change the terms upon which “regular interest” had previously been provided. “Regular interest” continued to be credited to subfunds and individual accounts only at the close of an interest period based on amounts that had been in the account for the entire interest period. When funds were withdrawn part way through an interest period, members did not receive a prorated amount of “regular interest” for the partial interest period, nor was “regular interest” credited on amounts contributed during that same period.

Just as the Legislature prior to 1976 did not define the statutory term “regular interest” to be pro rata daily interest, the Department, in the exercise of its delegated authority, did not. Rather, within its broad delegated authority to administer TRS, the Department has continued to apply “regular interest” to subfunds and individual TRS Plan 2 accounts consistent with the Legislature’s historical understanding of the term.

2. The Legislature Delegated Broad Authority To DRS To Develop Procedures For Transferring To TRS Plan 3.

The Legislature again delegated broad authority to administer TRS in TRS Plan 3. In establishing TRS Plan 3 and allowing members of TRS Plan 2 to transfer into Plan 3, the Department used the existing statutory concept of “accumulated contributions” (which by definition includes the statutory concept of “regular interest”) to describe the transfer of funds. RCW 41.32.010(1)(b). RCW 41.32.817(5) provided that, when a Plan 2 member requested to transfer to Plan 3, the member’s “*accumulated contributions* in plan 2 . . . shall be transferred to the member’s account in the defined contribution portion [of Plan 3], *pursuant to procedures developed by the department . . .*” (emphasis added).

The Legislature gave no other guidelines for this procedure. In particular, the Legislature did not set the timing of the transfer of Plan 2 “accumulated contributions” to a member’s Plan 3 account. The date of transfer affected (i) whether or not one more quarter of “regular interest” would be allowed on the individual’s Plan 2 account prior to transfer; (ii) when the transferred funds would be available for investment in Plan 3 units; and (therefore) (iii) the market price of Plan 3 units on the date transferred funds were invested.²⁰

²⁰ WSIB sets a monthly “unit price” for units of the combined plan 2 and 3 fund. RCW 41.34.060.

The Department formed a TRS Plan 3 Project Team to address all aspects of the Plan 3 implementation. Among the many questions before the Team was the determination of the date on which the account balance of a transferring member (i.e., the member's "accumulated contributions") would be transferred from Plan 2 to Plan 3. Because different Plan 2 members would have different priorities regarding timing, the Project Team decided that the Department would simply transfer a member's account balance from Plan 2 to Plan 3 immediately upon notification from the employer, i.e. "as expeditiously as possible." *See generally* Decl. of Wickman, Apr. 27, 2005, ¶¶ 28-40 (CAR 863-67).²¹

D. The Department Transferred The Fowlers From TRS Plan 2 To TRS Plan 3 According To Its Established Methodologies.²²

Leisa and Mickey Fowler represent the class of members of TRS Plan 2 who transferred to TRS Plan 3 prior to January 2002. CP 321-

²¹ The Department developed the procedures for the transfer of funds into TRS Plan 3 with careful regard for the other affected State agencies. Implementation and administration of TRS Plan 3 required the involvement and coordination of numerous entities, including, without limitation, the Office of the State Treasury, the Washington State Investment Board, custodial banks, the Department of Retirement Systems, a third party record keeper, individual school district employers, and individual members. In turn, the respective roles of each of these entities required the coordination of many complex computer systems. Electronic communications and transactions among these entities had to be completed on tight schedules, expeditiously and accurately, to allow Plan 3 members the ability to respond to daily market fluctuations. This required carefully defined procedures for each entity. *See generally* Decl. of Wickman, Apr. 27, 2005, ¶¶ 24-27 (CAR 862-63).

²² The Fowlers provided a detailed summary of the transfer process of PERS member Jeffrey Probst, rather than a summary of the Fowlers' transfer process. Fowler Br., at 11-12. The process relevant to the Fowlers (i.e., the TRS process) is different from the PERS process. Thus, the facts of Mr. Probst's transfer are not relevant.

24. The Fowlers each enrolled in TRS Plan 2 and requested to transfer to TRS Plan 3 in September 1996. Decl. of Wickman, ¶5, Nov. 13, 2009 (CP 600). They claim that insufficient Plan 2 “regular interest” was included in the transferred amount. The Fowlers do *not* claim that the Department failed to follow the procedures it adopted. To illustrate the effect of multiple tasks by various entities on the timing of the transfer, Ms. Fowler’s transfer process is explained below.

1. Leisa Fowler Requested A Transfer To Plan 3 At The Beginning Of The ’96-’97 School Year.²³

Ms. Fowler established membership in TRS Plan 2. When TRS Plan 3 became available, she decided to transfer. She completed her TRS Plan 3 enrollment form and submitted it to her employer, the Snoqualmie School District, on September 11, 1996, (the start of a new school year). The District retained the form, in anticipation of its first payroll transmittal of the school year (October 1996). Decl. of Wickman, Nov. 13, 2009, ¶¶ 3-5 (CP 599-600).

2. The Department Credited “Regular Interest” Before Receiving Ms. Fowler’s Transfer Request.

Ms. Fowler had a Plan 2 individual account, containing her employee contributions and “regular interest” that had been credited on those contributions. On the last day of third quarter 1996, the Department

²³ The facts related to Mickey Fowler are substantially similar.

had not been notified of Ms. Fowler's decision to transfer to Plan 3, so the Department credited her TRS Plan 2 individual account with \$640.42 in "regular interest." Decl. of Wickman, Nov. 13, 2009, ¶¶ 6-7 (CP 600).²⁴

3. The Department Effected Ms. Fowler's Transfer As Expeditiously As Possible After Notification.

As a TRS employer, the Snoqualmie School District works with the Department in administering TRS for its employees. RCW 41.50.140. On October 10, 1996, the District issued Ms. Fowler's first monthly paycheck of the '96-'97 school year, as compensation for September 1996 service. *See* Decl. of Wickman, Nov. 13, 2009, ¶ 8 (CP 600).

Consistent with long-established procedures for transmittal of relevant data to the Department on a payroll-by-payroll basis,²⁵ on the same day the District made an electronic transmittal to the Department, summarizing the relevant TRS Plan 3 data from its September payroll. The transmittal contained, without limitation, the names of District employees who had chosen to transfer to TRS Plan 3 (including Ms. Fowler); the chosen "transfer date" for each such District employee as

²⁴ The Fowlers refer to a flaw in the computer program used to calculate and credit "regular interest." *See, e.g., Fowler Br.*, at 10. There is no flaw in the Department's computer program. It was designed to credit "regular interest" exactly as the Department had decided it would be credited, while also meeting the logistical demands on available computer time to process such a large task. Decl. of Wickman, ¶¶ 10-11, Apr. 27, 2005 (CAR 860-61).

²⁵ Prior to the creation of Plan 3, procedures were in place for the electronic transmittal of relevant data from employers to the Department. The Department utilized the existing transmittal system to receive data regarding new TRS Plan 3 members.

shown on their transfer forms; and each employee's contributions to Plan 3 for September.²⁶ This was the first information the Department had received regarding Ms. Fowler's election to transfer (submitted to her employer a month earlier on September 11). *See generally* Decl. of Wickman, Nov. 13, 2009, ¶ 9 (CP 600).

Before the Department could make use of the electronic data received from the school district, it was required to "reconcile" the data to make sure it was internally consistent. The reconciliation was completed on the next business day, Friday, October 11. On the first business day following reconciliation (Monday, October 14), the Department incorporated the district's transmitted data into its own member database. Only then was the Department able to take any necessary actions based on the new data. Decl. of Wickman, Nov. 13, 2009, ¶¶ 10-12 (CP 601).

Having received information regarding Ms. Fowler's election to transfer to Plan 3, the Department was then required by statute to transfer her Plan 2 "accumulated contributions" into her Plan 3 member account. RCW 41.32.817. On October 14, the Department made certain accounting adjustments in its own database, reducing the balance in Ms. Fowler's Plan 2 individual account from \$47,690.55 to \$0, and increasing her

²⁶ In essence, Ms. Fowler was treated as if her transfer was effective on her requested transfer date (September 3), even though her transfer could not be fully processed until the Department subsequently received notification of her election. *See* Decl. of Wickman, Nov. 13, 2009, ¶¶ 11 (CP 601).

Plan 3 balance by the same amount.²⁷ In short, the Department's accounting records in its member database were revised to accurately reflect that, as of October 14, her TRS Plan 2 "accumulated contributions" would be *accounted for* as TRS Plan 3 funds. Decl. of Wickman, Nov. 13, 2009, ¶¶ 11-12 (CP 601).

Consistent with established transfer procedures developed by the Department, this change in the database triggered the Department to transmit this data to its contracted record keeper. The next business day (October 15), the record keeper added the transferred amount to Ms. Fowler's new TRS Plan 3 member account. On October 31, 1996 she was credited with approximately 29 units in the combined plan 2 and 3 fund (i.e., the Washington Total Allocation Portfolio) upon the completion of the SIB's monthly valuation. *See* RCW 41.34.060.

In short, Ms. Fowler was transferred from TRS Plan 2 to TRS Plan 3 consistent with all statutory requirements and reasonable procedures developed within the Department's authority. *As she requested*, her plan membership became effective on September 3. Her Plan 2 "accumulated contributions" were transferred to Plan 3 in the

²⁷ The Plan 2 amount had included all employee contributions made prior to September 1996, together with the final quarter of interest on the Plan 2 account, credited on September 30. (Consistent with her request to transfer on September 3, Ms. Fowler's employee contributions for September 1996 were made at the Plan 3 rate and deposited directly to her Plan 3 account.)

Department's database "as expeditiously as possible" after the Department received electronic notification from her employer. Likewise, her transferred contributions were invested at the market rate as "expeditiously as possible" upon the SIB's month-end calculation of the new unit price in the combined plan 2 and 3 fund. *See generally* Decl. of Wickman, Nov. 13, 2009, ¶¶ 8-15 (CP 600-02).

V. ARGUMENT

A. Standard Of Review.

The trial court considered the merits of this matter according to the judicial review standards in chapter 34.05 RCW, the Washington Administrative Procedure Act ("APA"). RCW 34.05.510.

On judicial review, the APA requires the reviewing court to affirm the agency's final order unless the petitioner can demonstrate its invalidity. RCW 34.05.570(1)(a) and (b); RCW 34.05.570(3). Judicial review invokes the appellate jurisdiction of the trial court, rather than its general or original jurisdiction. *Reeves v. Dep't of Gen. Admin.*, 35 Wn. App. 533, 537, 667 P.2d 1133 (1983). On appeal from the superior court, appellate courts "sit[] in the same position as the superior court applying the standards of the []APA...." *Heinmiller v. Dep't of Health*, 127 Wn.2d 595, 601, 903 P.2d 433 (1996).

In reviewing an agency order arising out of an adjudicative proceeding, the court shall grant relief *only if* it determines that one or more of the enumerated statutory bases for relief are established. *Heidgerken v. Dep't of Nat. Res.*, 99 Wn. App. 380, 384, 993 P.2d 934 (2000). Appellants rely on the “error of law” standard and the “arbitrary and capricious” standard. RCW 34.05.570(3)(d) and (i).

1. Under The Error-of-Law Standard, The Court Should Give “Substantial Weight” To The Department’s Interpretation Of The Statutes That It Implements.

When the petitioning party has challenged an agency’s conclusions of law or otherwise raised a question of law under RCW 34.05.570(3)(d), the error-of-law standard applies. Courts should accord substantial weight to an agency’s interpretation of a statute when an agency is interpreting the law it administers. *Renton Educ. Ass’n v. Public Empl. Relations Comm’n*, 101 Wn.2d 435, 441, 680 P.2d 40 (1984). This is especially true when the agency has expertise in a special field. *Chancellor v. Dep’t of Ret. Sys.*, 103 Wn. App. 336, 343, 12 P.3d 164 (2000). The Department has specialized expertise in pension administration. *Id.*

2. Discretionary Decisions Are Reviewed Under The “Very Narrow” Arbitrary And Capricious Standard.

The transaction being challenged here is the transfer of “accumulated contributions” from TRS Plan 2 to individual accounts in

TRS Plan 3. The Legislature directed that these transfers should be accomplished according to “procedures developed by the Department.” RCW 41.32.817. Developing and implementing those procedures unquestionably required the exercise of the Department’s discretion.

Discretionary acts by an administrative agency are reviewed under the “arbitrary and capricious” standard. “The arbitrary and capricious standard is very narrow, and the one asserting it carries a heavy burden.” *Wash. Indep. Tel. Assoc. v. Wash. Util. and Trans. Comm’n*, 110 Wn. App. 498, 516 (2002); (citing *Pierce County Sheriff v. Civil Serv. Comm’n*, 98 Wn.2d 690 (1983)). An action is only arbitrary and capricious if it “is willful and unreasoning action, without consideration and in disregard of facts and circumstances.” *Id.* When “there is room for two opinions, action is not arbitrary and capricious even though one may believe an erroneous conclusion has been reached.” *Heinmiller v. Dep’t of Health*, 127 Wn.2d 595, 609 (1996). A plaintiff is only “entitled to prevent [an agency] from exercising discretion arbitrarily and capriciously, it is not entitled to have the agency exercise discretion in [its] favor.” *Wash. Indep. Tel. Ass’n*, 110 Wn. App. at 516. In judicial review, “[the court] will not set aside a discretionary decision absent a clear showing of abuse.” *ARCO v. Utils. & Transp. Comm’n*, 125 Wn.2d 805, 812, 888 P.2d 728 (1995). For a court to reverse a discretionary

decision, “it must find that the decision was manifestly unreasonable,” “exercised on untenable grounds or for untenable reasons.” *Hadley v. Dep’t of Labor & Indus.*, 116 Wn.2d 897, 906, 810 P.2d 500 (1991).

B. The Department’s Method Of Crediting Interest Is Within Its Statutory Authority.

The power of the Legislature to grant discretionary authority to administrative agencies is well accepted. Administrative agencies have the implied authority to effect legislatively-mandated tasks. When “a power is granted to an agency, ‘everything lawful and necessary to the effectual execution of the power’ is also granted by implication of law.” *Tuerk v. Dep’t of Licensing*, 123 Wn.2d 120, 124-25, 864 P.2d 1382 (1994). In *Barry & Barry v. Dep’t of Motor Veh.*, 81 Wn.2d 155, 500 P.2d 540 (1972), the Supreme Court considered the Legislature’s authority to delegate powers to an agency without specific legislative standards and found that such delegation was not only permissible, but desirable to meet the demands of modern government.

[T]he legislature cannot delegate its power to make a law; but it can make a law to delegate a power to determine some fact or state of things upon which the law makes ... its own action depends [T]he strict requirement of exact legislative standards for the exercise of administrative authority has ceased to serve any valid purpose [B]y preventing the working out of certain administrative policies at the administrative level on a case-by-case basis, the doctrine [requiring strict legislative standards] frustrates the efficient operation of the appropriate governmental processes.

Barry, 81 Wn.2d at 159 (citations omitted). An administrative agency may “‘fill in the gaps’ via statutory construction as long as the agency does not purport to ‘amend’ the statute.” *Hama Hama Co. v. Shorelines Hearings Bd.*, 85 Wn.2d 441, 448, 536 P.2d 157 (1975).

Consistent with the “demands of modern government,” the Legislature delegated to the Department the duty and authority to develop procedures for the transfer of member accounts from TRS Plan 2 to TRS Plan 3. The TRS Plan 3 transfer statute provides that “*accumulated contributions in plan 2 . . . shall be transferred to the member's account in the defined contribution portion established in chapter 41.34 RCW, pursuant to procedures developed by the department. . . .* RCW 41.32.817 (emphasis added). The Legislature plainly left to the Department’s discretion how best to accomplish the transfers in light of the complex interactions among the employees, employers, the State Investment Board and the third party records manager for TRS Plan 3. As illustrated by Ms. Fowler’s transfer process, the Department needed latitude in deciding how to communicate with the various participants and coordinate each step of the process and in formulating a process that would accomplish the transfers in an expeditious manner.

The Legislature’s directive in RCW 41.31.817 also incorporated discretion previously granted to the director with regard to the

determination of “accumulated contributions.” That term is defined as the contributions in a member’s individual account and the “regular interest” on those contributions. RCW 41.32.010(1)(b). “Regular interest” is determined at the discretion of the director of the Department. RCW 41.32.010(23). The Legislature has recently confirmed and clarified that the discretion granted in the definition of the term “regular interest” and the statutes conveying general authority to administer the retirement systems have always provided the Department with discretionary authority to determine not only the rate, but all other aspects of whether, and in what fashion, “regular interest” should be credited. RCW 41.50.033.

The Legislature previously enacted legislation about how “regular interest” was to be credited to the TRS subfunds and member accounts. If the Legislature had wanted that process to be done in a particular way, this prior experience demonstrates that it knew how to give those directions. Instead, the Legislature incorporated the term “accumulated contributions” into the Plan 3 transfer statute without change, and coupled it with a grant of broad discretionary authority for the Department to “develop procedures” for the transfers. Thus, the Department’s interpretation of the term “accumulated contributions” in the context of Plan 2-3 transfers is entitled to great weight under the error of law standard. *Renton Educ.*

Ass'n, 101 Wn.2d at 441; *Dana's Housekeeping v. Dep't of Labor & Indus.*, 76 Wn. App. 600, 605, 886 P.2d 1147 (1995).

C. The Fowlers' Position Regarding Regular Interest Violates The Rule That Each Provision In A Statute Should Be Read In Relation To The Other Provisions In The Same Statute.

A fundamental canon of statutory construction is that “each provision of the statute should be read in relation to the other provisions, and the statute should be construed as a whole.” *Weyerhaeuser Co. v. Tri*, 117 Wn.2d 128, 133, 814 P.2d 629 (1991). Statutory terms should be given similar meanings in the same statute. *Northlake Marine Works, Inc. v. Dep't of Nat. Resources*, 134 Wn. App. 272, 281, 138 P.3d 626 (2006).

The Fowlers' position that “regular interest” must mean daily interest turns this canon on its head and requires the Court to ignore the manner in which “regular interest” is credited elsewhere in the TRS statute. When crediting “regular interest” to TRS subfunds, the applicable TRS provision states, “at the close of each fiscal year the department shall make such allowance of *regular interest* on the balance which was on hand at the beginning of the fiscal year in each of the teachers' retirement system funds as they may deem advisable.” RCW 41.50.215. This provision is plainly inconsistent with the Fowlers' regular-interest-must-mean-daily-interest argument. The Court should decline the Fowlers' requests to inject inconsistency into the TRS statutory scheme.

D. The Fowlers' Common Law Interest Arguments Fail.

The Fowlers' arguments that the common law somehow requires that the Department credit daily pro rata interest fail as: (1) the TRS' statutes have a long history of defining "regular interest" to mean something other than pro rata daily interest; and (2) the present case does not relate to "deposit accounts" but involves the calculation of statutorily defined benefits. *State v. Butler*, 126 Wn. App. 741, 750, 109 P.3d 492 (2005) ("if a statute is inconsistent with the common law, we deem the statute to abrogate the common law"); *see also Lutheran Day Care v. Snohomish County*, 119 Wn.2d 91, 102, 829 P.2d 746 (1992) (court noted that mere fact that statute modifies existing common law rule is no reason to interpret it otherwise) (citation omitted).

1. No Common Law Gloss Is Needed To Understand The Consistent Legislative Use Of The Statutory Term "Regular Interest".

The Fowlers' common law argument ignores the lengthy history of the Legislature's use in the TRS statutes of the statutory term "regular interest."²⁸ With over seven decades of the Legislature's using the term "regular interest" consistently to mean an allowance that (1) is determined

²⁸ Appellants' Brief, p. 38. In this regard, Appellants state that "[t]here is nothing in RCW 41.50.033 by which the Legislature 'clearly expressed' its intention the repeal the 250-year-old common law rule that interest accrues daily." This argument utterly misses the point that "regular interest" has had a long and consistent use as a statutory term of art in the TRS statutes. As explained above, RCW 41.50.033 merely confirms the wide latitude granted to the Department in implementing the crediting of regular interest as it administers the TRS statutes.

after the end of an accounting period and (2) is based on a balance that existed as of the beginning of that period and (3) does not credit interest on contributions made during the accounting period, there is no basis to graft an additional – and inconsistent – common law gloss onto this term.

In making the common law argument, the Fowlers’ rely on the PERS, not the TRS, statutory scheme, citing the administrative record. (*See, e.g.*, Brief of Appellants, pp. 17-19, n.5.) But this review involves the TRS statutory scheme and history, which is wholly distinct from that of PERS. There is no question that TRS statutes have long defined “regular interest” in a way that does not include daily interest on contributions or additions to a fund during an accounting period.

The term “regular interest” has been a part of the TRS statutes since 1937. Since that time, the Legislature has *never* indicated that the term implied or required daily pro rata interest. In fact, the statutes have historically *expressly required that interest not be credited daily*. From 1947 to 1982, the predecessor statute to the current TRS Plan 2 interest crediting statute expressly precluded the crediting of daily pro rata interest, instead mandating that, “Regular interest shall be credited to each member’s account at the end *only* of each fiscal year, based upon the balance in his account at the *beginning* of the year.” Former RCW 41.32.460 (recodified as RCW 41.32.042 in 1991). (Emphases

added.) So clearly as of 1947, the TRS statutory scheme was flatly inconsistent with any purported common law requirement that daily pro rata interest be provided on funds added to a member account during the most recent accounting period. Furthermore, when the statute was amended in 1982, the Department received *more* discretion (not less) with respect to the timing and manner in which interest could be credited (the legislature removed the language allowing the Department to only credit once per year based on the balance at the beginning of that year.)²⁹

The Fowlers' contention that the term "regular interest" means daily, pro rata interest is inconsistent with the Legislature's repeated and consistent use of the term "regular interest" as involving the crediting of interest at the end of the year based upon the account balance at the beginning of the year, and with the continued use of the term "regular interest" in the TRS statutes based upon a balance existing at the beginning of the reporting period.³⁰

²⁹ In addition, current portions of the statute require payment of regular interest on an annual and not daily calculation basis. RCW 41.50.215 provides for annual interest to be credited by the Department to certain teacher retirement funds. It provides that "at the *close of each fiscal year* the department shall make an allowance of *regular interest* on the balance which was on hand at the *beginning* of the fiscal year . . ." RCW 41.50.215 (emphasis added). This is completely consistent with the Department's practice of crediting *regular interest* on the balance present in the individual member accounts at the *beginning of the quarter*.

³⁰ This is particularly true because the Legislature knows how to require pro rata interest in pension statutes when it intends to require it. For example, in 1963, the Legislature amended the PERS retirement statutes to require a form of pro rata interest, stating that "when a member retires . . . he shall have pro rata interest credited on the

2. *Faulkenbury* Is Not Binding Precedent Or Analogous.

The Fowlers rely on a *North Carolina* decision arising out of a very different factual setting to argue that the *Washington* Legislature intended to require daily, pro rata interest. See *Faulkenbury v. Teachers' And State Employees' Ret. Sys. of North Carolina*, 133 N.C. App. 587, 515 S.E.2d 743 (1999). Specifically, the *Faulkenbury* decision was based on that court's review of North Carolina's *judgment interest* statutes and the common law, not its retirement and pension statutes. *Id.* at 589.

Faulkenbury involved a claim for interest on payments that were not made when due under the retirement statutes. The *Faulkenbury* court treated those unpaid amounts as sums certain owed to members. *Faulkenbury*, 113 N.C. App. at 589. It then looked to the North Carolina statutes governing judgment interest, as amplified by common law, to determine how to calculate interest on those amounts. *Id.* Thus, *Faulkenbury* provides no insight at all into the proper application of state retirement statutes to crediting interest for individual accounts maintained within a retirement system. *Faulkenbury* arose in a completely different context and does not purport to construe retirement system statutes at all.

accumulated contributions standing to his credit on the first day of the calendar year of his retirement." 1963 Session Law, ch. 174, § 7. When the Legislature omits from a statute a provision that it clearly "knew how to do," the inference that the omission was purposeful is strengthened." See, e.g., *Caritas Services v. Dep't. of Social and Health Services*, 123 Wn.2d 391, 407, 869 P.2d 28 (1994).

Faulkenbury is analogous to the situation addressed by the Washington Supreme Court in *Bowles v. Dep't of Ret. Sys.*, 121 Wn.2d 52, 78, 847 P.2d 440 (1991). In *Bowles*, the Washington Supreme Court addressed the question of whether interest must be paid on benefits wrongfully withheld from retirement system members. Unlike the *Faulkenbury* court, the Washington Supreme Court held that, under *Washington* law, the Department should not pay prejudgment or post judgment interest on such amounts at all. *Id.* That is still the rule today.

Moreover, the legislative intent in this case is clear that the Department's method of calculating interest *is* an appropriate manner of calculation. Indeed, the Washington Legislature has previously and repeatedly *required* the method that is now used by the Department. The Legislature has placed the authority for these decisions firmly in the hands of the Department and has never required any different type of interest calculation other than the one the Department has used since 1979.

E. The Fowlers' "Accrual" Arguments Fail.

1. There Is No Distinct Concept Of "Accrued" Interest Under The TRS statute.

The Fowlers try to side-step the Department's clear discretion with respect to crediting interest by attempting to insert a distinct concept of "accrued" interest into the TRS Plan 2 to TRS Plan 3 transfer statute.

Fowler Br. at 25-30. The problem with this approach is that there is *no* reference to “accrued” interest in the TRS transfer statute. Rather, the transfer statute uses the statutorily defined terms “accumulated contributions” and “regular interest”. RCW 41.32.817(5). As explained above, these terms expressly incorporate the concept of the Department’s “crediting” authority and make *no* reference to a distinct concept of accrued contributions or accrued interest.

2. RCW 41.04.445 (The “Pick-Up Statute”) Does Not Require Payment Or Crediting Of Daily Interest.

In making their argument regarding “accrued” interest, the Fowlers do not cite to the TRS transfer statute, but rather rely on a distinct section that has *no* relation to the present dispute. They rely on RCW 41.04.445, commonly known as the “Pick-Up Statute.” The Fowlers argue that RCW 41.04.445, enacted in 1984, changed the Department’s interest crediting practices. That section does no such thing:

All member contributions to the respective retirement systems picked up by the employer as provided by this section, plus the accrued interest earned thereon, shall be paid to the member upon the withdrawal of funds or lump-sum payment of accumulated contributions *as provided under the provisions of the retirement systems.*

RCW 41.04.445(4) (emphasis added).³¹

³¹ Enactment of the pick-up statutes allowed mandatory employee contributions to be made on a pre-tax basis. When contributions are “picked up” they are recharacterized as *employer* contributions. See Rev. Rul. 81-35, 1981-1 C.B. 255; Rev.

Without citation to authority, the Fowlers wrongly contend that the term “accrued interest earned thereon” requires the Department to award interest on accumulated contributions for each day funds are in a member’s Plan 2 individual account. First, the plain meaning of the statutory language “accrued interest earned thereon” does not require the Department to award pro rata interest for periods shorter than one quarter. Second, the Legislature’s purpose for adopting RCW 41.04.445 did not change the Department’s long-standing practice of interest crediting.

a. The term “accrued interest” does not specify how to calculate interest.

RCW 41.04.445 specifies that if a member seeks to withdraw the member’s contributions from one of the affected retirement systems, the member should receive both the actual contributions and interest. But the statute is plain that the amount to be paid is determined by the “provisions of the [various] retirement systems.” RCW 41.04.445.³²

Rul. 81-36, 1981-1 C.B. 255; and Rev. Rul. 87-10, 1987-1 C.B. 136. The cited provision in RCW 41.04.445(4) was necessary to make clear that even though mandatory “employee contributions” had been recharacterized as “employer contributions” in order to provide members with certain tax deferral benefits, these contributions were nonetheless included in the member’s accumulated contributions (i.e., employee contributions) for purposes of withdrawals or other lump-sum payments, as otherwise allowed by law. This statute has no application here because the Fowlers did not withdraw their funds from TRS, they merely transferred them from one TRS plan to another.

³²Under the method existing at the time of the enactment of RCW 41.04.445 in 1984, members of TRS Plan 2 received regular interest on their individual accounts at the rate of five and one-half percent (5.5%) per year, compounded quarterly. Each time that regular interest was compounded, it was added to the member’s individual account (or accumulated contributions) and became part of the principal for the next interest period.

Fowlers argue that the Legislature’s use of the term “accrued interest” in this 1984 statute allows a member to withdraw *not only* the contributions and interest that have been credited to his individual account prior to the date of withdrawal, *but also* additional interest for days that have elapsed *since* interest was last credited. Fowler Br. at 20, 28, 35.

To the contrary, the statute does not dictate that “additional interest” is to be earned in member accounts; it simply requires that such interest as *has* accrued at the time of a member’s withdrawal be paid. Thus, the statute simply requires that a member who withdraws the accumulated contributions in his individual account receives not only the amount of his member contributions but all the quarterly interest that has been credited to *and accrued in* his account during the “lifetime” of the account. That is, he receives the “accrued interest earned” on his account. In short, the language used in RCW 41.04.445 simply incorporates the existing methodology for the crediting of TRS interest and does not specify any different methodology.

b. The *Dean* prisoner account case is inapposite.

The present case is not analogous to *Dean v. Lehman*, 143 Wn.2d 12, 18 P.3d 532 (2001), the prisoner deposit accounts case cited by the

That is, the interest accrued (i.e., was added to and collected in the member’s account), rather than being paid out to the member at each quarter end. See Black’s Law Dictionary 812 (6th rev. ed. 1990).

Fowlers. The TRS transfer statute does *not* incorporate the term “accrued interest” and the “accounts” at issue in this case are not *deposit* accounts. TRS Plan 2 members do not make deposits into a savings account. Rather, they make *contributions* to the TRS asset base, in exchange for statutorily defined benefits. Under TRS Plan 2, these benefits have *no* relation to the contributions actually made – instead, the benefits are based upon salary and length of service. Because these are not *deposits*, TRS Plan 2 members cannot have any expectation or entitlement to have their contributions to be treated as such. Instead, transferring members are entitled to have their contributions treated exactly as required by the TRS transfer statute, i.e., transfer accumulated contributions standing to their credit to TRS Plan 3.

F. The Department’s Interest Crediting Methodology Is Not Arbitrary And Capricious.

The Fowlers claim that the Department’s quarterly interest methodology is arbitrary and capricious because (i) the Department calculates interest differently in different circumstances; (ii) the Department’s interest-transfer procedures did not allow the Fowlers to earn a return on their employee contributions for fifteen days; and (iii) recent computer technology makes a pro rata interest calculation possible. The Fowlers fail to meet their “heavy burden” on these theories.

1. The Department Calculates Interest Differently In Different Contexts According To Applicable Statutes.

The Fowlers argue that the Department's methodology for the crediting of "regular interest" is arbitrary because it is not identical to the Department's methodology for charging interest on its accounts receivable. The argument fails because the statutory provisions authorizing the Department to charge interest on accounts receivable are different from the statutory provisions for interest on individual member accounts. The Department collects funds in a variety of circumstances, including: (i) from employers, for both employer and employee retirement contributions; (ii) from employers, for the administrative costs of the retirement systems; and (iii) from employees, in the process of restoring withdrawn contributions. *See, e.g.*, RCW 41.50.110, .120, .125.

The retirement statutes contemplate that these payments may become overdue and authorize the Department to charge interest. The Department is authorized to "collect interest on any employer's overdue payments at the rate of one percent per month on the outstanding balance where necessary to secure adherence to timeliness requirements." RCW 41.50.120. Similarly, the Department is authorized to charge interest on amounts owed by members. RCW 41.50.125. Consistent with the legislative findings, by rule the Department has determined that

interest on member receivables “will be based on the long-term investment return assumption adopted under RCW 41.45.030 [currently 8%]” in order to “approximate amounts lost to the trust funds because the receivables have not been paid in a timely manner.” WAC 415-108-400.

This approach was adopted in full consideration of all the relevant circumstances. As to interest on outstanding employer amounts, the Legislature directed the imposition of interest at the rate of 1% per month (12% per year) to secure employer adherence to timeliness requirements. With regard to interest on outstanding employee amounts, the Legislature has indicated that the amount charged may be sufficient to compensate for any resulting loss to the trust funds. The statutory assumption is that money in the trust fund returns approximately 8% per year; accordingly the Department charges 8% to compensate for untimely contributions.

By contrast, the amount credited as “regular interest” to individual accounts has never been directed by statute; it has simply been an amount “deemed advisable” to be paid from the annual returns of the TRS assets. Accordingly, the Department has had complete authority to credit it at a rate set by the Department. The Department’s interest method is grounded in the relevant facts and circumstances. This means that the decision is not arbitrary or capricious. *Washington Indep. Tel. Ass’n v. Washington Util. and Trans. Comm’n*, 110 Wn. App. 498, 516, 41 P.3d 1212 (2002).

2. Having The Nominal Interest Rate Differ From The Effective Rate Is Not “Inaccurate” Or Arbitrary.

The Fowlers argue that the fact that the stated interest rate on member contributions differs from the effective rate renders the Department’s interest methodology “inaccurate” or arbitrary. (Fowler Br. at 16.) This argument ignores basic concepts of compound interest.

Interest is commonly expressed at its stated annual rate, i.e., the rate that will be used in the formula to calculate interest for a given period. However, depending on other aspects of an interest methodology, the interest earned may be more or less than the nominal rate. For example, under the Department’s regular interest methodology (5.5% per year, compounded quarterly), money invested on the first day of the year will have an effective yield of 5.61% at the end of one year. If the money were compounded monthly, rather than quarterly, money invested on the first day of the year will have an effective yield of 5.64% at the end of one year. If the money were compounded daily, it will have an effective yield of 7.3% at the end of one year. The fact that the nominal rate and the effective rate differ does not render the methodology inaccurate.

Nor is a methodology that establishes a minimum period for the crediting of interest “inaccurate.” For example, assume that money is on deposit at a bank that provides for simple interest at the rate of 5.5% per

year, to be paid on every full day that the amount is on deposit. The account holder withdraws the amount after 365 days and 6 hours. Consistent with the original agreement, the bank pays interest for 365 days (1 year); no interest is paid for the additional 6 hours.

The Fowlers argue that the Department acted arbitrarily in failing to change its interest policy. (Fowler Br. at 42-47.) This argument is based on the false premise that the system must be changed because it results in “inaccurate” interest calculations that improved computer systems could now fix. There is nothing inaccurate about the system. The Fowlers claim that although the Department is free to select any interest rate, the only system that can be “accurate” enough to be used is one in which an actual 5.5% annual yield is paid and calculated on a daily basis.

The Legislature included no such requirement. The total interest payment is affected by several factors including the time period for which interest is earned, timing, and whether it is compounded. For example, compounding interest in any manner increases the effective return above 5.5%, just like requiring contributions to be on deposit at the beginning of the quarter can reduce the effective return. The fact that the effective rate is changed does not make the policy arbitrary.

The Fowler’s argument about the “accuracy” of the approach further illustrates the discretionary nature of the Department’s decision in

adopting it. The Department is not required to use the most “accurate” method. *Larson v. Seattle Popular Monorail Auth.*, 156 Wn.2d 752, 131 P.3d 892 (2006); *Good Samaritan Hosp. v. Shalala*, 508 U.S. 402, 418-19 (1993) (upholding calculation method under arbitrary and capricious standard even though the agency “could use a more exact mode of calculating depreciation”).

The Fowlers’ misplaced reliance on *Trustees of Cal. State Univ. v. Riley*, 74 F.3d 960 (9th Cir. 1996), does not alter this conclusion. In *Riley*, the agency was seeking to recover for any improper “financial windfall from the Pell Grant Program.” *Id.* at 965. To do so, a determination had to be made about “whether CSU earned any interest on Pell Grant funds pending disbursements to students.” *Id.* at 966. In the context of an audit, the agency determined that it would estimate interest by ignoring any periods of time in which it owed money to the Universities, and assuming that all money present at the end of a month was held by the University for the entire month. The Ninth Circuit found this approach to be arbitrary and capricious because it inflated the amount the Secretary could recover.

Thus, the *Riley* case involved the question of how to approximate interest *actually collected* from a third-party on funds wrongfully kept. Here, the question is how interest must be credited in the context of a retirement system plan in which the Department is free to use 5.5%

interest or any other amount of interest. This payment is not based in any manner on actual investment returns or losses or actual interest payments made on moneys wrongfully withheld. Rather, it is a contract under which members contribute to retirement accounts and those contributions are kept in their name. If they retire in the system, members are paid based on a statutory formula. If they leave the system or transfer, their contributions are returned and they are provided with interest that was credited using the rate determined by the director.

G. RCW 41.50.033 Does Not Effect An Unconstitutional Taking Of Property Belonging To Appellants.

RCW 41.50.033 does not effect any “taking” of property. The Washington Supreme Court has made it clear that pension contributions paid into a “common benefit account fund,” as is the case with TRS Plan 2 member contributions, are not the property of the pension plan members. Indeed, pension plan members “have no legal claim” upon funds contributed to their pension plans “until they qualify for benefits under [the statutory act governing the plan].” *Marysville v. State*, 101 Wn.2d 50, 56, 676 P.2d 989 (1984). In reaching this conclusion, the Supreme Court expressly distinguished state employee pension plans from common law trusts, noting that unlike common law trusts, “benefits paid” under state

pension plans “are controlled by statutory formulas, not by the amount of or investment return on money in the fund.” *Id.*

The Fowlers’ takings claim argument relies entirely on *Phillips v. Washington Legal Foundation*, 524 U.S. 156 (1998), an IOLTA *trust* case. No useful analogy can be formed between state employee pension plans, such as TRS Plan 2, and IOLTA trust accounts. The benefits received by TRS Plan 2 members, unlike distributions from deposit trust accounts, are not simply a return upon an individual investment account. Rather, contributions are pooled and employees receive pension benefits that are controlled by *statutory* formulas rather than return on investments. Indeed, one of the primary attributes of defined benefit plans such as TRS Plan 2 is that they shield members from the risk of market losses.

The fact that the *Marysville* case only specifically refers to employer contributions does not change this analysis. The salient point is that with pension plans, unlike IOLTA trusts, contributions are made in exchange for a statutory benefit and controlled by statutory, not common, law. It is the Legislature’s role to define the benefit to be received – in this case, the Legislature has provided that in certain circumstances that a TRS member can forego the retirement benefits of TRS Plan 2 (namely, 2% of average compensation for every year of service) in exchange for an interest credit on contributions using a method set by the Department.

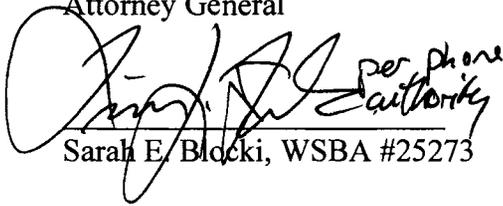
Moreover, the nature of the interest credit provided with respect to transfers from TRS Plan 2 to TRS Plan 3 is fundamentally dissimilar to the type of interest at issue in *Phillips*. Interest, as such term is used with respect to such TRS transfers, is a term of art describing a credit applied to certain amounts under certain circumstances. It does not represent the actual interest or other earnings gained by TRS with respect to assets of TRS allocated to a specific member.

VI. CONCLUSION

For the reasons stated above, the Court should affirm the dismissal of Appellants' claims with prejudice.

Respectfully submitted this 24th day of March, 2011.

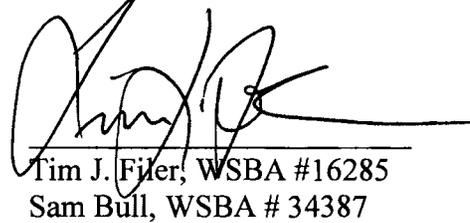
ROBERT M. MCKENNA
Attorney General



Sarah E. Blocki, WSBA #25273

Attorneys for the Department Of
Retirement Systems

FOSTER PEPPER PLLC



Tim J. Filer, WSBA #16285
Sam Bull, WSBA # 34387

Attorneys for the Department Of
Retirement Systems

NO. 40861-9

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

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

Appellant,

v.

DEPARTMENT OF RETIREMENT SYSTEMS,

Respondent.

CERTIFICATE OF SERVICE

ROBERT M. MCKENNA
Attorney General

SARAH E. BLOCKI
WSBA #25273
Assistant Attorney General
Government Operations
Division
P.O. Box 40108
Olympia, WA 98504-0108
(360) 586-3233

Attorneys for the Department
Of Retirement Systems

TIM J. FILER, WSBA #16285
SAMUEL T. BULL, WSBA #34387
Special Attorneys General
Foster Pepper PLLC
1111 Third Avenue, Suite 3400
Seattle, WA 98101
(206) 447-4400

Attorneys for the Department
Of Retirement Systems

ORIGINAL

I, the undersigned, declare that I am employed by the firm of Foster Pepper PLLC, I am over the age of 18 years, am not a party to the above entitled litigation, and I am competent to be a witness herein.

On March 24, 2011, I served a true and correct copy of the following document(s) in the above captioned case:

1. Brief of Respondent

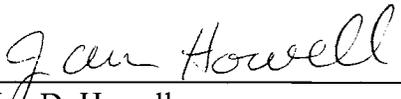
together with a true and correct copy of this Certificate of Service upon the following counsel for the parties of record in this action by sending same properly addressed and as follows:

Via Hand Delivery to Counsel for Plaintiffs:

Stephen K. Strong
Stephen K. Festor
Bendich, Stobaugh & Strong, P.C.
701 5th Ave Ste 6550
Seattle, WA 98104-7097

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

Executed at Seattle, Washington on March 24, 2011.



Jan D. Howell