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SUPREME COURT OF THE STATE OF WASHINGTON

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

Respondents/Cross-Appellants,

v.

WASHINGTON STATE DEPARTMENT OF RETIREMENT SYSTEMS
and the STATE OF WASHINGTON,

Appellants/Cross-Respondents,

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

Respondents,

v.

WASHINGTON STATE DEPARTMENT OF RETIREMENT SYSTEMS
and the STATE OF WASHINGTON,

Appellants,

v.

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

Respondents/Cross-Appellants,

v.

WASHINGTON STATE DEPARTMENT OF RETIREMENT SYSTEMS
and the STATE OF WASHINGTON,

Appellants/Cross-Respondents.

 ORIGINAL

RESPONDENTS' BRIEF

and

CROSS APPELLANTS' BRIEF

Earl Younglove III, WSBA #5873
Younglove & Coker, P.L.L.C.
Westhills II Office Park
1800 Cooper Point Rd SW, Bldg. 16
PO Box 7846
Olympia, WA 98507-7846
(360) 357-7791

Counsel for Respondents and Cross Appellants WFSE, et al

Harriet Strasberg, WSBA #15890
Law Office of Harriet Strasberg
203 – 4th Avenue E, Suite 520
Olympia, WA 98501

Counsel for Respondents and Cross Appellants WEA, et al

Don Clocksin, WSBA #4370
Law Office of Don Clocksin
203 – 4th Avenue E, Suite 405
Olympia, WA 98501

Counsel for Respondents and Cross Appellants WEA, et al

James D. Oswald, WSBA #11720
Schwerin Campbell Barnard Iglitzin & Lavitt
18 W. Mercer Street, Suite 400
Seattle, WA 98119

Counsel for Respondents Costello, et al

Steven B. Frank, WSBA #4944
Frank Freed Subit & Thomas
705 Second Avenue, Suite 1200
Seattle, WA 98104

Counsel for Respondents Costello, et al

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I. RESPONDENTS' INTRODUCTION¹

The Appellants' Brief distorts the undisputed facts of this case. Gain-sharing was not repealed in response to an economic crisis. It was repealed in April 2007, long before the economic crisis of 2008 began. It also was not repealed to preserve the fiscal integrity of Washington State retirement plans, which were then, and remain, among the best-funded in the country.

Contrary to the State's suggestion, the legislature did not repeal gain-sharing because it became aware, for the first time, of its cost. Before gain-sharing was enacted, the State Actuary had provided detailed explanations of the impact of gain-sharing on investment returns, plan assets, and employer contribution rates.

The Legislature repealed gain-sharing in response to the current State Actuary's recommendation about *when* contribution rates should be adjusted to reflect gain-sharing. The former State Actuary's 1998 design was that employer contribution rates would be adjusted in response to each gain-sharing event, when rates would otherwise be trending lower in response to extraordinary investment gains. When the new State Actuary recommended that contribution rates be increased *in advance* to reflect his estimated value of all future gain-sharing distributions, the Legislature decided to repeal gain-sharing by passing EHB 2391 instead – even

¹ PART 1 of this brief is submitted by all Respondents in response to the State's appeal of the trial court's decision in Phase One (gain-sharing). Costello et al. did not participate in Phase 2 of the litigation. PART 2 is the Cross Appeal of the other Respondents from the trial court's decision in Phase Two (the ERRFs).

though it was not legally required to adopt the new Actuary's recommendation, and the contribution rates he had proposed were below the long term rates projected when gain-sharing was enacted.

Because the trial court's decision invalidating the repeal of gain-sharing correctly applied well-established principals protecting the retirement benefits of employees in Washington,² it should be affirmed.

II. ISSUES PRESENTED

1. Does the constitutional prohibition on impairment of contracts prevent the Legislature from reducing retirement benefits of current and former employees?
2. Does the reservation of rights ("ROR") language in the gain-sharing statutes protect the gain-sharing rights of employees who were granted a contractual right to gain-sharing before the 2007 repeal?
3. Is the ROR language in the gain-sharing statutes, if otherwise effective, insufficiently clear and explicit to be enforced by the courts?
4. If the ROR language in the gain-sharing statutes is interpreted as unambiguously reserving the right to eliminate gain-sharing for current and former employees, should the Court nonetheless give no effect to purported reservation of rights?
5. Where DRS communications inviting employees to irrevocably choose or transfer to Plan 3, and Handbooks distributed to Plan 1 and Plan

² The State derisively asserts that respondents seek gain-sharing "in perpetuity." Respondents simply seek to have gain-sharing treated like other retirement benefits. This means protecting employees' right to receive future gain-sharing based on their service prior to the 2007 law, and protecting their right to accrue additional gain-sharing rights by their future service. Both of these rights were eliminated by EHB 2391.

3 members, uniformly stated that retirement benefits would include gain-sharing, but failed to state that gain-sharing could be terminated, was a unilateral contract formed that included gain-sharing, but did not include the ROR, when employees chose or transferred to Plan 3, or continued to work under Plan 1 or Plan 3, after receiving the communications?

6. Did the 2007 repeal of gain-sharing constitute an unconstitutional impairment of contract because either a) it was not necessary to preserve the flexibility and financial integrity of the retirement system, or b) employees who were denied gain-sharing did not receive comparable replacement benefits?

7. Do principles of equitable estoppel and/or promissory estoppel bar the Legislature from repealing gain-sharing after DRS affirmatively represented to members that they would receive future gain-sharing if they were members of Plan 1 or Plan 3, and members continued working, transferred to Plan 3, or chose Plan 3?

8. If the Court gives effect to the purported ROR, will the Court also permit the Legislature to retroactively eliminate the right to gain-sharing distributions that are to be paid in the future, but were already earned by service before the effective date of the 2007 law?

9. Did the trial court properly award attorneys' fees against the State under RCW 49.48.030, where the State employs over 10,000 class members in its agencies and departments, and acts of the State eliminated employees' deferred compensation?

10. Did the trial court properly order that the State pay interest on the

attorneys' fee award?

III. STATEMENT OF THE CASE

This case arises from the 2007 repeal, in EHB 2391,³ of the retirement benefit known as “gain-sharing” for members of PERS Plan 1 and TRS Plan 1 (“Plan 1”)⁴ and PERS Plan 3, TRS Plan 3, and SERS⁵ Plan 3 (“Plan 3”).⁶

1. Gain-sharing proposed to permit Plan 1 members to share extraordinary investment gains.

The pension benefit provided by Plan 1⁷ is funded by the combination of the accumulated principal in the Washington State Investment Board's (WSIB) pension account, investment earnings on the WSIB account, employee contributions, and employer contributions. Employee contribution rates to Plan 1 are fixed by statute. Employer contribution rates are established based on actuarial projections of the amount needed to supplement employee contributions and investment earnings. When investment earnings consistently exceed actuarial projections, employer

³ Hereafter “EHB 2391” or “the 2007 law.”

⁴ Collectively referred to as Plan 1 and Plan 3, respectively.

⁵ “PERS” is the Public Employee Retirement System, composed of state, county and city employees. RCW 41.40. “TRS” is the Teacher Retirement System, composed of certificated teachers in public schools. RCW 41.32. “SERS” is the School Employee Retirement System, composed of classified public school employees. RCW 41.35.

⁶ Respondents make all claims on behalf of all members (App. Br. at 38 incorrectly indicates that the estoppel claims were made only for TRS Plan 1 members).

⁷ Plan 1 is a defined benefit plan. The benefit is two percent times the employee's years of service (up to sixty percent) times the employee's final average compensation (“AFC”) (two consecutive years of highest compensation). *See e.g.* RCW 41.40.185(2) and RCW 41.40.010(6)(a) (PERS 1).

contribution rates are reduced.⁸

In the four years, 1993 through 1997, the Washington State Investment Board (WSIB) was experiencing annual investment gains of 13.7 percent on its pension accounts, far above the projected return on which employee benefits and employer contributions were based.⁹ If no plan changes were adopted, all extraordinary investment gains would have been used to reduce employer contribution rates.¹⁰

In 1997, the Office of the State Actuary proposed establishing gain-sharing as a “new mechanism” “for funding retirement benefits”¹¹ so that “[w]hen employer contribution rates are coming down, members with fixed contribution rates may receive benefit improvements in order to share in the reduced costs [to employers].”¹² As discussed below, the Legislature enacted gain-sharing for Plans 1 in 1998.

2. Gain-sharing offered as incentive to transfer to Plans 3.

PERS 3, TRS 3 and SERS 3 are hybrid defined benefit/defined contribution plans created between 1995 and 2000.¹³ The defined benefit in Plan 3 is funded exclusively by employer contributions. Plan 3 members also place between 5 percent and 15 percent of their pay into a

⁸ See App. Br. at pp. 4-7; Plans 2 have a benefit structure comparable to Plans 1 using a five year AFC instead of two years.

⁹ CP 964-65.

¹⁰ *Id.*, CP 1045.

¹¹ CP 1785.

¹² CP 1045. The State describes the gain-sharing mechanism, whereby Extraordinary Investment Gains (i.e., gains of over ten percent per year compounded annually over four years ending on June 30 of an even-numbered year) are distributed to Plan 1 and Plan 3 members. App. Br. at 7.

¹³ The defined benefit for Plan 3 is computed at one percent, rather than two percent, of years of service, times average final compensation. *E.g.*, RCW 41.40.790(1).

defined contribution account.¹⁴

In 1995, the Legislature enacted TRS Plan 3, which was the first Plan 3. All teachers hired after June 30, 1996 were placed into TRS Plan 3.¹⁵ In 1996, the Legislature created an 18 month “transfer window” from July 1996 through December 1997, when current TRS Plan 2 members could make an irrevocable transfer to TRS Plan 3.¹⁶

Plan 3 is significantly less costly to employers than Plan 2.¹⁷ Therefore, the Legislature offered cash bonuses as inducements¹⁸ for Plan 2 members to transfer. During the first 16 ½ months of the transfer window, approximately 4,365 Plan 2 members transferred.¹⁹ By a letter of November 20, 1997, the chair of the JCPP²⁰ notified all Plan 2 members²¹ of a pending proposal to add a gain-sharing feature to Plan 3, which would add an estimated \$150 per year of service to Plan 3 members’ defined contribution accounts.²² During the remaining 40 days of the transfer window, an additional 17,135 Plan 2 members – 80 percent of total 21,500

¹⁴ Member accounts are invested in one or more options provided under the Plan. *See* Laws 1995, c 239 § 105. *See also* notes following RCW 41.32.005.

¹⁵ RCW 41.32.010(33).

¹⁶ RCW 41.32.817, RCW 41.32.818.

¹⁷ CP 2638 (Cost to employer from permitting employees to choose Plan 2 or Plan 3, rather than mandating all new SERS and TRS employees into Plan 3 is \$301.7 million).

¹⁸ Bonuses were in the form of additional funds placed in the defined contribution accounts of employees who accepted the offer to transfer from Plan 2 to Plan 3. *See e.g.* RCW 41.32.8401.

¹⁹ 4,365 is the difference between 21,500 total transfers during transfer window (CP 974) and 17,135 transfers from November 21, 1997 through December 31, 1997 (CP 904¶6).

²⁰ The Washington State Legislature Joint Committee on Pension Policy, which consists of eight Senators and eight Representatives (CP 4994). *See former* RCW 44.44.050 and RCW 44.44.060, repealed by Laws 2003, Ch. 295, §15.

²¹ CP 904 ¶6.

²² CP 4994.

transfers²³ – transferred to Plan 3.

3. Gain-sharing enacted after actuarial analysis of costs.

During the 1998 session, the Legislature enacted gain-sharing for Plan 1, for TRS Plan 3, and for the newly-created SERS Plan 3.²⁴ PERS Plan 3, which includes gain-sharing,²⁵ was created in 2000.²⁶

For each of the gain-sharing statutes, Fiscal Notes prepared by State Actuary Gerald Allard quantified the impact of gain-sharing on long-term investment returns,²⁷ reduction in Plan assets,²⁸ and employer contribution rates.²⁹

4. Present value payment method for funding gain-sharing established.

The Office of the State Actuary provided the Legislature with detailed analyses of gain-sharing. Actuary Allard explained that by using the “present value payment” method of funding,³⁰ when gain-sharing

²³ CP 640¶12, 974.

²⁴ Ch. 340, Laws of 1998, §3, codified at RCW 41.31.030, Ch. 341, Laws of 1998, §§312, 313, codified at RCW 41.31.020(4) and RCW 41.31A.030(5).

²⁵ The formula to determine whether extraordinary investment gains trigger gain-sharing is outlined in the Appellants’ Brief at p. 7. For summary of gain-sharing mechanism, see *Retired Public Employees Council v. Charles*, 148 Wn.2d 602, 609 n. 1, 62 P.3d 470 (2003).

²⁶ Ch. 247, Laws of 2000, §§408, 409; RCW 41.31A.020(4) and RCW 41.31A.040(5).

²⁷ CP 1797 (PERS and TRS Plan 1), 1806 (SERS Plan 3), 4563 (PERS and TRS Plan 3). Allard’s estimate that gain-sharing reduced long-term investment returns by no less than .4 percent was later confirmed by Actuary Smith (CP 1766).

²⁸ CP 982 (PERS and TRS Plan 1), 1805 (SERS Plan 3), 4566 (PERS and TRS Plan 3). See generally CP 4537-42, ¶¶6-16.

²⁹ CP 983-84 (PERS and TRS Plan 1), 1805-06 (SERS Plan 3); 4563 (PERS and TRS Plan 3).

³⁰ CP 1779. A present value payment is one of “two primary methods for funding retirement benefits. . . . A present-value payment is a one-time payment to cover all the estimated future costs of the benefit.” The other funding method is a “contribution rate increase . . . [which] pays off the cost of the new benefit over time.”

distributions occurred, employer contribution rates would be adjusted based on the plan assets remaining after the gain-sharing distribution. Because gain-sharing only occurred when investment earnings had far exceeded actuarial projections, and only one half of earnings in excess of 10 percent were distributed as gain-sharing, gain-sharing acted to flatten the steep reduction in employer contributions that otherwise would have resulted from the extraordinary gains.³¹

In 1998,³² and again in 2002, the international actuarial firm Milliman confirmed that the methods used by Allard were proper.³³

5. Inclusion of ROR language in statutes.

The legislative history of gain-sharing contains no discussion of whether the costs would be unsustainable.³⁴ In his oral testimony before the JCPP, Research Analyst Steve Nelson explained, “this is a new process, so the legislature is going to reserve the right *to amend this process* in the future.”³⁵ The written summary prepared for the JCPP stated: “the Legislature will reserve the right to *amend the gain-sharing*

³¹ CP 966, 4557.

³² CP 1792-93 (re: Fiscal Note for 1998 gain-sharing statutes).

³³ CP 1189, 1846, 1735 (Smith Dep. 38:11-40:14).

³⁴ When gain-sharing was proposed, State Actuary Gerald Allard was not concerned that the cost of the benefit might be excessive. He was aware that the gain-sharing was relatively new and the mechanism used to implement gain-sharing might need to be “tweaked” in the future. Allard recommended the ROR language to permit the Legislature to amend or repeal the statute as written and “enact a replacement statute” providing “a similar benefit, with a somewhat modified computation procedure.” Neither Allard, nor anyone with whom he interacted when gain-sharing was enacted, anticipated that the ROR language was intended to permit gain-sharing to be completely eliminated in the future. CP 4536-37¶4, 4542¶18.

³⁵ CP 1697.

process in the future.”³⁶ The gain-sharing statutes ultimately included language that permits amendment or repeal, subject to members’ “contractual rights . . . granted prior to . . . amendment or repeal”:

The legislature reserves the right to amend or repeal this chapter in the future and *no member* or beneficiary *has a contractual right* to receive this postretirement adjustment *not granted prior to that amendment or repeal*.³⁷

The Plan 3 gain-sharing statutes have comparable language, but replace the words “this postretirement adjustment” with “this distribution.”³⁸

6. DRS communications to members regarding gain-sharing.

No DRS communication to members during the eight years after enactment of gain-sharing advised employees that they could lose their contractual right to gain-sharing. The State entered into the following Stipulation that DRS never informed members that gain-sharing could be reduced or eliminated:

*[Prior to passage of HB 2391] none of the General Communications [by DRS to members of the retirement system] contains the text, or a paraphrase, or a summary of the 1998 or the 2000 statutory reservation of rights.*³⁹

³⁶ CP 1661 (emphasis added).

³⁷ RCW 41.31.030, Ch. 340, §3, 1998.

³⁸ RCW 41.31A.020(4), Laws of 1998, Ch. 341, §312; RCW 41.31A.030(5), Laws of 1998, Ch. 341, §313. PERS 3 gain-sharing was established by RCW 41.31A.040(5), Laws of 2000, Ch. 247, §409.

³⁹ CP 898-99, 901-02 (emphasis added). The Stipulation notes that a June 2006 edition of the document entitled “Plan 3 Investment Guide” is the sole document issued before April 2007 that mentions the reservation of rights language, and lists over 70 general communications from DRS that failed to mention the reservation. “General Communications includes written materials or video or audio materials” and the DRS website CP 902-04, CP 903-04, 2678-79 (list of general communications); 2680-4371 (text of documents listed).

“Plan Choice” and “Transfer Decision” Materials from DRS

Beginning in 1998, DRS provided materials to current Plan 2 members who could choose to transfer from Plan 2, with its guaranteed benefit, to Plan 3, where the guaranteed benefit was 50 percent smaller, with the employee’s defined contribution account replacing the other half of the defined benefit. In the DRS materials, “[g]ain-sharing was highlighted as a major incentive to entice employees to join Plan [3].”⁴⁰

DRS provided the 20 page booklet entitled “PERS Plan 2 or Plan 3 Transfer Decision, Journey to Retirement,”⁴¹ and a very similar booklet to newly hired employees who were permitted to choose between Plan 2 and Plan 3.⁴² Each booklet was offered “as a road map to guide you through the decision-making process [and] to provide key information”⁴³ to “make the choice between Plans that is best for you.”⁴⁴ The booklets described “ongoing gain sharing”⁴⁵ and stated that during periods of strong investment performance, “the gain sharing feature . . . will provide extra savings for the Defined Contribution component.”⁴⁶ Under “Irrevocable

⁴⁰ CP 1228-29 (letter from six legislators to Governor Gregoire regarding proposals to eliminate gain-sharing).

⁴¹ CP 4375-95. Similar materials were provided to classified employees of public schools, who had previously been members of PERS Plan 2, but could transfer to the newly-created SERS Plan 3.

⁴² “PERS Plan 2 or Plan 3 New Member Plan Choice, Journey to Retirement,” (CP 4405-23).

⁴³ CP 4377-78, 4407.

⁴⁴ *Id.*

⁴⁵ CP 3866, 3890, 4048, 4152.

⁴⁶ CP 3834, 4022, 4086, 4116. The statement at CP 3834 continues: “Consider whether the gain-sharing feature will add significantly to your Defined Contribution account savings. You can include this calculation in the financial modeling software.” *See also* CP 3838, 3844, 4047, 4058, 4081, 4093, 4111, 4123 (“half of [extraordinary investment

decision,” the booklets urged members to “be sure to have weighed all of your options carefully” because members could not transfer back to Plan 2.⁴⁷

The Plan Choice and Plan Transfer booklets included a note, in small print, under the copyright, which stated:

This publication is not a substitute for reading the full plan materials. . . . The operations of the Plan are governed by the Plan documents.⁴⁸

There are no Plan documents for the retirement plans administered by DRS. The booklets do not refer to the retirement laws.⁴⁹

DRS Handbooks Issued to Plan 1 and Plan 3 Members

DRS regularly issued Member Handbooks to members of Plans 1 and 3. The Handbooks uniformly stated that gain-sharing would be paid if there were extraordinary investment gains. For example, a September 2000 SERS Plan 3 Member Handbook, under the heading “What is *ongoing gain sharing*,”⁵⁰ stated:

If [asset earnings] average more than 10 percent annually over a four-year period, half of the amount over 10 percent *will be passed on* to Plan 3 members’ defined contribution accounts based on

gains] “will be passed on” to qualifying members). Several documents stated: “Gain sharing is not guaranteed; it depends on market conditions.” *E.g.*, CP 4163.

⁴⁷ CP 4378, 4408.

⁴⁸ CP 4376, 4406. The complete paragraph is:

This publication is not a substitute for reading the full plan materials. It is a brief outline intended to give you an overview of some of the features of PERS Plans 2 and 3. It is not a legal document. The operations of the Plan are governed by the Plan documents, which contain all of the technical provisions that govern the Plan. If there is any conflict between this document and the provisions of the Plan documents, the Plan documents will prevail.

⁴⁹ CP 4375-4423.

⁵⁰ CP 2785, 3826 (emphasis added).

each member's number of service credit years.⁵¹

The Handbooks typically contained a statement that the Handbook was a summary and the actual rules governing the benefits are “contained in state retirement laws.”⁵² No Handbook explained how to locate state retirement laws, or identified which statutes within “state retirement laws” applied to the benefits described.⁵³ The gain-sharing statutes were not on the DRS website.⁵⁴

7. New State Actuary proposes increased contribution rates to prefund; consulting actuary and Assistant Attorney General say prefunding not required.

On November 6, 2002, Matthew Smith became the State Actuary.⁵⁵ Mr. Smith disagreed with Actuary Allard regarding when contribution rates should be adjusted to reflect gain-sharing. Whereas Mr. Allard had funded gain-sharing by a “present value payment” (and adjustment to contribution rates) each time a gain-sharing distribution occurred,⁵⁶ Smith's position was that contribution rates should be adjusted in advance

⁵¹ CP 2723, 3637, 3930, 3952, 3974 (SERS 3 and PERS 3: describing “ongoing gain sharing”) (emphasis added); CP 2765, 2785, 2896, 2806, 2827, 2846, 2866, 2886, 2905, 2924, 2944 (SERS Plan 3: gain sharing “will be passed on”); CP 2967, 2989 (TRS Plan 1: if extraordinary gains, gain sharing “will be paid”); 3049, 3072, 3098, 3122, 3146, 3170, 3195 (TRS Plan 3: part of extraordinary gains “are paid. . .in even-numbered years”); CP 3272, 3284, 3316, 3336, 3347, 3399, 3437, 3347, 3385 (TRS Plan 3 Investment Guide: gain sharing “will be passed on”).

⁵² The full text of passage in the 2000 SERS Handbook states:

Summary Description

The actual rules governing your benefits are contained in state retirement laws. This handbook is written in less legalistic terms. It is not a complete description of the law. If there are any conflicts between what is in this handbook and what is contained in the law, the current law will govern. (CP 2702).

⁵³ CP 2681-4371.

⁵⁴ CP 902¶4.

⁵⁵ CP 654 (Smith Dep. 38:11-13).

⁵⁶ CP 1779.

to reflect his estimate of the cost of all future gain-sharing.⁵⁷ Smith called his approach “pre-funding.”⁵⁸

In Smith’s opinion, the “long term cost of gain-sharing” was a .4 percent reduction in the long-term rate of return on investments.⁵⁹ This was the same long-term reduction in investment returns identified by Allard when gain-sharing was enacted.⁶⁰

After being advised of Mr. Smith’s opinion, the consulting actuary for the Office of Financial Management (OFM)⁶¹ and the Assistant Attorney General for OFM⁶² concluded that the Legislature could properly direct that gain-sharing be funded by present value payments, as originally proposed by Mr. Allard.⁶³ If the Legislature had done so, Smith’s Actuarial Valuations would have reflected that gain-sharing was funded differently than other pension obligations.⁶⁴

8. Legislature responds by studying repeal of gain-sharing.

Smith’s 2003 Actuarial Valuation⁶⁵ recommended that gain-sharing be

⁵⁷ CP 659 (Smith Dep. 75:19-77:13).

⁵⁸ CP 1741 (Smith Dep. 63:1-7).

⁵⁹ CP 1766 (Smith Dep. 162:14-18).

⁶⁰ CP 4537-40¶¶6, 7, 11, 14; 1160.

⁶¹ CP 1746 (Smith Dep. 82:13-20).

⁶² CP 1206, 1745 (Smith Dep. 78:13-18).

⁶³ CP 1943. Smith acknowledged that the consulting actuary’s opinion was that pre-funding was not legally required. CP 1746 (Smith Dep. 82:16-83:15).

⁶⁴ CP 1766 (Smith Dep. 164:16-165:22). In a later declaration, Smith stated that his valuation would have disclosed this as an omission of a material liability and disclosed the amount and impact of that omission. Smith acknowledged that the outside actuarial consultant to the OFM did not share his opinion. CP 1709:23-1710:6. Actuarial Standard of Practice No. 4, issued in September 2007, provides that if a benefit is funded on a “pay-as-you-go” basis, the actuary may follow the law and indicate that the benefit is funded differently than others in the plan. CP 2187, 2194, 2205§4(i).

⁶⁵ CP 1906-14, 1738 (Smith Dep. 53:24-55:3).

pre-funded and that employer contribution rates be increased to reflect the change.⁶⁶ The contribution rates Smith recommended were below the highest rate previously required for plans that had pre-dated gain-sharing, and below the long term rates projected by Actuary Allard in Fiscal Notes to the gain-sharing statutes.⁶⁷ The Legislature did not approve the contribution rates Smith recommended.⁶⁸

Rather than adopting the rates suggested by Smith, the Legislature authorized repeated gain-sharing studies by the SCPP.⁶⁹ The 2004 SCPP Gain Sharing Study recommended replacing gain-sharing with benefits worth approximately one-half the value of gain-sharing.⁷⁰ The 2005 SCPP Gain-Sharing Study acknowledged that: “[r]epealing gain-sharing would eliminate a material benefit to a large number of active, retired, and term-vested members [who] may have come to rely on those benefits.”⁷¹ It also noted that “members transferred into Plan 3 from Plan 2 because of the availability of the benefit.”⁷² The SCPP Study discussed the 2005 AGO⁷³ stating that repeal of gain-sharing would not constitute an unconstitutional impairment of contracts. It questioned the AGO’s presumption that members read the statutes, and acknowledged that members reviewed the

⁶⁶ CP 1908 (2003 Valuation Report rate table), 1740-41 (Smith Dep. 58:24– 61:25).

⁶⁷ CP 1741-42 (Smith Dep. 64:11-65:23). The exception is SERS, which was created in the early 2000’s, after gain-sharing was introduced; CP 984.

⁶⁸ CP 1741 (Smith Dep. 61:11-21).

⁶⁹ CP 1966. The Select Committee on Pension Policy was the successor to the JCPP. CP 1747 (Smith Dep. 87:13-19); Laws 2003, Ch. 295, §15.

⁷⁰ CP 1218.

⁷¹ CP 1987.

⁷² *Id.*

⁷³ CP 2555-60 (AGO 2005 No. 16).

DRS materials, which did not tell employees that gain-sharing could be repealed:

The AGO may presume that members read the pension statutes, but the great majority of members peruse the plan information available through the Department of Retirement Systems. It has been alleged this information did not discuss the non-contractual nature of gain-sharing.⁷⁴

The 2005 Study noted that the Legislature could legally continue to use the present value payment funding method, as was expressly authorized in the first gain-sharing statute.⁷⁵ But after noting that pre-funding would result in increases in employer contribution rates of between .71 percent and 2.55 percent,⁷⁶ the Study recommended instead that gain-sharing be repealed and replaced with benefits with projected costs of about 50 percent less than gain-sharing.⁷⁷

9. Funding status of retirement plans when EHB 2391 enacted.

The DRS/OFM “May 15, 2006 Briefing on Pension Issues” noted that on an actuarial basis,⁷⁸ PERS, TRS and SERS Plans 2/3 were funded at 134 percent, 153 percent and 137 percent.⁷⁹ These funding ratios

⁷⁴ CP 1990. DRS publications after the “2005 Gain-Sharing Study” continued to omit information regarding possible repeal of the benefit. CP 2678-79 (dates of publications submitted with Declaration).

⁷⁵ CP 1965-66, 1981, 1990-93.

⁷⁶ CP 1990.

⁷⁷ CP 1956, 1221.

⁷⁸ Most public funds, including Washington, use the actuarial basis to measure funding. CP 1355.

⁷⁹ CP 1354.

evidently included the cost of gain-sharing.⁸⁰ The funding ratios placed “the funding status of all [plans other than TRS Plan 1 and PERS Plan 1] at or near the top of the nation.”⁸¹

When EHB 2391 was being considered, Actuary Smith “did not raise [gain-sharing] as a fiscal integrity issue.” He testified that he was not aware of any materials related to gain-sharing legislation that indicated repeal of gain-sharing was necessary to preserve the fiscal integrity of the pension plans.⁸²

Mr. Smith understood that the two reasons for repealing gain-sharing were “to save money” and that “people preferred as a policy matter a different way of delivering pension benefits.”⁸³

10. Costs and absence of savings in EHB 2391.

EHB 2391 repealed gain-sharing for employees hired after July 2007.⁸⁴ It also repealed gain-sharing for current members, effective January 2, 2008, which was the day after the 2008 gain-sharing event.⁸⁵ EHB 2391 provided a small one-time COLA supplement for Plan 1 members⁸⁶ and created improved early retirement benefits for Plan 2 and 3

⁸⁰ CP 1035 (Cost gain-sharing to be reflected in Actuarial Valuations, beginning in 2003); CP 1872 (Actuarial audit by Milliman, confirming that cost of gain-sharing was reflected in 2003 Actuarial Valuation).

⁸¹ CP 1360.

⁸² CP 1767 (Smith Dep. 166:16-167:14).

⁸³ CP 1767 (Smith Dep. 167:10-20).

⁸⁴ EHB 2391§1(2) (CP 238).

⁸⁵ *Id.* §13 (CP 257-58).

⁸⁶ *Id.* §5 (TRS Plan 1), §11(PERS Plan 1 (CP 246, 255)).

members with 30 years of service.⁸⁷

Preserving gain-sharing for current members, while eliminating it for new entrants, would have reduced employer contribution costs by \$3,220.1 million.⁸⁸ The total net reduction in employer costs from all provisions of EHB 2391, after considering savings by the repeal of gain-sharing for both new entrants, the new benefits provided to existing members of all Plans and to new entrants to Plans 2 and 3, was \$2,265.5 million.⁸⁹ Actuary Smith acknowledged that the Legislature would have saved an additional \$954.6 million if it had added no new benefits, but “simply eliminated gain-sharing for future new members” and left gain-sharing in place for existing members.⁹⁰

11. Value of new benefits to members losing gain-sharing.

The new benefit provided to Plan 1 members in lieu of all future gain-sharing was a one-time COLA adjustment of \$.05 per year of service.⁹¹ The 2008 gain-sharing event alone yielded a COLA adjustment of \$.35 per year of service.⁹²

⁸⁷ *Id.* §§2(3)(b), 4(3)(b), 6(3)(b), 8(3)(b), 9(3)(b) and 10(3)(b) (CP 241-55). These benefits, called “ERRFs” or “Early Retirement Reduction Factors,” are more fully detailed in Cross Appellants’ brief below. These ERRFs have the effect of eliminating the penalty on early retirement for those between ages 62 and 65 who have 30 years of service and reducing the penalty for those between ages 55 and 62 who have 30 years of service.

⁸⁸ CP 2636.

⁸⁹ CP 2641. Because the Fiscal Note treats elimination of the 2008 gain-sharing distribution as a savings from enactment of the bill, and treats permitting the distribution as a benefit of the bill, the \$2,265.5 million figure is the effect of all bill provisions, other than those related to the 2008 gain-sharing event.

⁹⁰ CP 1771 (Smith Dep. 181:7-22).

⁹¹ CP 1710:11.

⁹² CP 1710:8-9.

The new benefit provided for Plan 3 members was the reduction in penalties for early retirement if they retired before age 65 with 30 years of service.⁹³ Over 46 percent of Plan 3 members were hired after age 35, and so could never qualify for this benefit.⁹⁴

12. Procedural History.

Three lawsuits challenging the repeal of gain-sharing were consolidated.⁹⁵ Costello filed a class action challenging only the repeal of gain-sharing.⁹⁶ The Union Plaintiffs also challenged provisions eliminating replacement benefits if gain-sharing was restored.⁹⁷

The trial court bifurcated the case.⁹⁸ Phase 1 addressed repeal of gain-sharing.⁹⁹ Phase 2 addressed the claim regarding elimination of replacement benefits. The court entered summary judgment for Plaintiffs in Phase 1 on September 10, 2010.¹⁰⁰ The trial court entered an award for attorneys' fees on November 5, 2012.¹⁰¹

The trial court entered summary judgment in favor of the State in

⁹³ See *supra* note 87.

⁹⁴ CP 585:18-CP 586:12.

⁹⁵ A fourth lawsuit, by WPEA, was voluntarily dismissed.

⁹⁶ CP 6433.

⁹⁷ In Phase Two, WEA and WFSE and several of their members were certified as class representatives for the purpose of asserting the claims of the members of all three plans to the new benefits. Costello et. al. did not assert claims to the new benefits, did not participate in Phase Two, and are not Cross Appellants.

⁹⁸ CP 461.

⁹⁹ CP 548. The parties stipulated to class certification, which included several subclasses, based on Plan, dates of service, and whether the employee affirmatively chose Plan 3.

¹⁰⁰ CP 5105.

¹⁰¹ CP 7155.

Phase 2 on January 30, 2012.¹⁰²

Pages 1 to 58 of this Brief constitute the Respondents' brief on behalf of all consolidated Plaintiffs in Phase 1. Pages 58 to 74 constitute the Cross-Appeal by the Union Plaintiffs from the trial court's ruling in Phase 2.

IV. ARGUMENT

SUMMARY OF ARGUMENT

The *Bakenhus/Navlet* line of cases forbids the Legislature from repealing retirement benefits, even if the Legislature intended to reserve such a right. Under *Bakenhus*,¹⁰³ the Legislature could not reduce retirement benefits after employees¹⁰⁴ began work. Under *Navlet*,¹⁰⁵ the Court may not give effect to the ROR language in EHB 2391, even if it clearly indicated the Legislature's intention that gain-sharing benefits could be repealed.

The language relied upon as a reservation of rights is reasonably interpreted to preserve the right of current and former employees to receive continued gain-sharing. Even if it is not, the ROR's are unenforceable because they are insufficiently explicit. Regardless of how the disputed language is interpreted, communications by DRS created constitutionally-protected expectations of continued gain-sharing. The

¹⁰² CP 6468-71.

¹⁰³ *Bakenhus v. City of Seattle*, 48 Wn.2d 695, 296 P.2d 536 (1956).

¹⁰⁴ The term "employees" is used throughout this brief to refer to current and former employees who acquired gain-sharing rights between 1998 and 2007, unless the context clearly indicates otherwise. "Employees" is co-extensive with "current members" unless the context clearly indicates otherwise.

¹⁰⁵ *Navlet v. Port of Seattle*, 164 Wn.2d 818, 848-49, 194 P.3d 221 (2008).

same DRS communications established the terms of a unilateral contract with employees. Repeal of gain-sharing was unconstitutional because it was not justified by a need to maintain either the flexibility or the fiscal integrity of the retirement system, and because employees who lost gain-sharing did not receive comparable replacement benefits.

Employees are also entitled to continued gain-sharing benefits under estoppel principles.

The trial court correctly granted attorneys' fees under RCW 49.48.030, and properly ordered the State to pay interest until the fee awards are paid.

A. THE STATE CANNOT SATISFY THE *BAKENHUS* REQUIREMENTS FOR REDUCING RETIREMENT BENEFITS OF EMPLOYEES.

Under the *Bakenhus* line of cases, public employers are obligated to continue to provide the retirement benefits that were in effect when employees began employment, or that became effective during their tenure.¹⁰⁶ The employees' right to a benefit is established as soon as it becomes a recognized pension benefit, and continues throughout their employment and retirement.¹⁰⁷ Preventing employees from continuing to accrue benefits offered during their tenure, such as the gain-sharing rights at issue here, violates *Bakenhus*, which is grounded in Article 1, Section

¹⁰⁶ *Bakenhus v. City of Seattle*, 48 Wn.2d 695, 700, 296 P.2d 536 (1956); *Bowles v. Wash. DRS*, 121 Wn.2d 52, 65, 847 P.2d 440 (1993); *Crabtree v. State, DRS*, 101 Wn.2d 552, 556, 681 P.2d 245 (1984); *WFSE v. State*, 98 Wn.2d 677, 686, 608 P.2d 634 (1983); *Eagan v. Spellman*, 90 Wn.2d 248, 258, 581 P.2d 1038 (1978); *Wa. Ass'n of Cy. Officials v. Washington Public Employees' Ret. Sys. Bd.*, 89 Wn.2d 729, 733, 575 P.2d 230 (1978); *Tembruell v Seattle*, 64 Wn.2d 503, 506, 392 P.2d 453 (1964).

¹⁰⁷ *WFSE v. State*, 98 Wn.2d at 688-89.

23 of the State Constitution.¹⁰⁸

Bakenhus supplements the general test for determining whether the Legislature unconstitutionally impaired a contract with additional standards that apply when retirement benefits have been changed. The three elements of the standard test are:

1. Did a contractual relationship exist?
2. Did the legislation substantially impair the contractual relationship? and
3. Was the impairment both reasonable and necessary to serve a legitimate purpose?¹⁰⁹

Under *Bakenhus*, a change in pension benefits is “reasonable and necessary” only if the State can prove three elements:

1. The modifications were necessary to keep the system flexible;
2. The modifications were necessary to maintain the integrity of the pension system; and
3. Any disadvantageous changes were offset by comparable new advantages.¹¹⁰

Application of this standard establishes that the repeal of gain-sharing was unconstitutional.

1. Employees Have a Constitutionally-Protected Right to Continued Gain-Sharing.

The focus of *Bakenhus* and its progeny is on protecting the reasonable expectations of employees, rather than on the “intent” of the Legislature or

¹⁰⁸ *Eagan v. Spellman*, 90 Wn.2d at 258, *Bowles v. Wash. DRS*, 121 Wn.2d at 447, Article 1, Section 23 provides: “[N]o . . . law impairing the obligations of contracts shall ever be passed.” Plaintiffs did not rely on Art. 1, Sec. 10 of the U.S. Constitution.

¹⁰⁹ *Caritas v. Department of Social and Health Services*, 123 Wn.2d 391, 403, 869 P.2d 28 (1994). See also *Retired Public Employees Council v. Charles*, 148 Wn.2d 602, 624, 62 P.3d 470 (2003); *Pierce County v. State*, 159 Wn.2d 16, 28, 148 P.3d 1002 (2006).

¹¹⁰ *Id.*, 48 Wn.2d at 702.

the express terms of the contract.

- a. *Bakenhus* protects the expectations of employees, and is not based on the intent of the Legislature.

The *Bakenhus* court “focused its analysis on *the expectations of the employee* at the time benefits were conferred, rather than on the express language of the contract, to determine whether the employer was free to eliminate benefits.”¹¹¹ Washington law protects employees’ expectations that they will receive deferred compensation, even if the express intention of the entity creating the benefits is to the contrary.¹¹²

The State incorrectly relies on *RPEC v. Charles*¹¹³ to contend that employees have no contractual right to gain-sharing. The *Charles* court began its discussion by acknowledging that, under *Bakenhus*, “[p]ension provisions are part of the compensation for services and therefore become part of the employment contract.”¹¹⁴ Because gain-sharing was plainly a pension provision that was part of the compensation for services by employees, it became a part of their employment contract.

Decisions cited by the State in support of its argument that no contract is formed unless the Legislature intended to undertake a contractual commitment are inapposite.¹¹⁵ The federal cases cited either arise in the

¹¹¹ *Navlet v. Port of Seattle*, 164 Wn.2d 818, 849, 194 P.3d 221 (2008), citing *Bakenhus*, 48 Wn.2d at 700-01 (emphasis added).

¹¹² 164 Wn.2d at 835.

¹¹³ 148 Wn.2d 602, 623, 62 P.3d 470 (2003). App. Br. at 20-21, 35.

¹¹⁴ 148 Wn.2d at 624.

¹¹⁵ App. Br. at 24-31.

non-pension context,¹¹⁶ or apply the general federal law impairment standard,¹¹⁷ rather than the more specific Washington standard for pensions set out in *Bakenhus. Strunk v. Public Employees Retirement Board*,¹¹⁸ provides no guidance because, under Oregon law, the retirement statute “was intended to be and is a contract between the state and its employees,”¹¹⁹ and is the sole source of pension terms.¹²⁰

By contrast, *Noah v. State*¹²¹ clearly states that in Washington, pension statutes are not a “complete contract” with respect to pension rights, which rights may arise based on employee expectations¹²² or administrative interpretation.¹²³

¹¹⁶ *Nat'l 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) (challenge to Amtrak decision to cut back pass-rider privileges for railroad employees).

¹¹⁷ *Robertson v. Kulongoski*, 466 F.3d 1114, 1117 (9th Cir. 2006).

¹¹⁸ 338 Or. 145, 108 P.3d 1058, 1075, 1078 (2005) (emphasis added).

¹¹⁹ *Strunk v. PERB*, 108 P.3d at 1075.

¹²⁰ Amy B. Monahan, “Statutes as Contracts? The ‘California Rule’ and Its Impact on Public Pension Reform,” 97 Iowa L. Rev. 1029, 1051-66 (2011-2012), cited by the State, assumes that statutes are the sole source of employees’ retirement rights, whereas Washington law protects employee expectations. See, Pettit, *Modern Unilateral Contracts*, 63 B.U.L. Rev. 551, 577-584 (1983) (discussing unilateral contract and promissory estoppel frameworks to protect employee benefit expectations). Monahan incorrectly states that Washington has not explicitly protected employees’ right to accrue future benefits. *Id.* at 1083. See, *Eagan v. Spellman*, 90 Wn.2d at 258 (mandatory retirement age law violated *Bakenhus* by preventing employee from accruing additional retirement benefits). The Monahan analysis exports the employment-at-will doctrine to pensions, and ignores the distinctive character of deferred compensation. Madiar, *Public Pension Benefits Under Siege: Does State Law Facilitate or Block Recent Efforts to Cut the Pension Benefits of Public Servants?*, 27 ABA J. Lab. & Emp. L. 179, 191-194 (2012). It permits employers to frustrate employees’ expectations of retirement income by terminating pensions, potentially leaving mature, long-term, employees no opportunity to achieve retirement savings sufficient to replace their expected pensions.

¹²¹ *Noah v. State by Gardner*, 112 Wn.2d 841, 844-46, 774 P.2d 516 (1989).

¹²² See, e.g., *Eagan v. Spellman*, 90 Wn.2d 248, 257-58, 581 P.2d 1038 (1978)

¹²³ *Bowles v. DRS*, 121 Wn.2d at 67-68, *Washington Ass'n of County Officials v. PERS*, 89 Wn.2d 729, 733, 575 P.2d 230 (1978).

- b. Under *Navlet*, even if the Legislature clearly intended to reserve the right to repeal gain-sharing, courts cannot give effect to that intention.

Navlet holds that the courts “cannot give effect” to language purporting to permit the employer to eliminate a retirement benefit previously offered to employees.¹²⁴ The State’s argument that *Navlet* permits repeal of gain-sharing is based on a misreading of the decision.

- i. *Because employees provide work in response to promise of retirement benefits, courts cannot give effect to language reserving the right to eliminate the benefits.*

Employees’ reasonable expectations that pension benefits conferred in an employment relationship will remain in place are protected, even if the employer has clearly stated its intention to reserve the right to eliminate pension benefits in the future. As the court stated in *Navlet*:

The obligation [to provide a retirement benefit] arises *independent of any required showing of the employer's express intent* to provide retirement benefits....¹²⁵

The employer’s expression of intent is disregarded because the expectation of deferred compensation has induced the employees’ service. The employer cannot accept the service that was induced by the promise of deferred compensation, while reserving the right to withhold the compensation:

Therefore, *the expectation of the employee at the beginning of the relationship determines the compensatory nature of the benefit because the promise of a pension induces the employee to complete his or her required services before he or she receives the benefit.*

¹²⁴ 164 Wn.2d at 848.

¹²⁵ *Id.* at 834-35(emphasis added).

...
*An employer cannot expect to accept the benefit of continued service from its employees while reserving the right not to compensate those employees once it has received the full benefit of their service.*¹²⁶

For these reasons, *Navlet* clearly holds that the courts cannot give effect to a reservation of the right to eliminate a retirement benefit, even if there is no doubt as to the employer's intention:

Even assuming that the reservation of rights language in the Trust Agreement and the [Summary Plan Description] indicated the Port's intent to not provide a vested right to retirement welfare benefits in the [collective bargaining agreement], *we cannot give effect to such an attempted reservation of rights by an employer.*¹²⁷

Thus, under *Navlet*, the ROR language relied upon by the State – even if it reflected the Legislature's clear intention to reserve the right to repeal gain-sharing – is ineffective because it is inconsistent with the nature of deferred compensation and the reasonable expectations of employees.

ii. The ROR language in the retirement statutes is not comparable to an ROR in a negotiated collective bargaining agreement.

The State fails in its attempt to distinguish *Navlet* as a case where the ROR was contained in "peripheral documents."¹²⁸ The ROR in *Navlet* was included in the Trust Agreement and Summary Plan Description.¹²⁹ Those documents, like the statute in this case, created the retirement benefits, and included language the employer claimed was an ROR. The *Navlet* court refused to give effect to an ROR included only in these source documents.

¹²⁶ *Id.* at 836, 848-49 (emphasis added).

¹²⁷ *Id.* at 848 (emphasis added)

¹²⁸ App. Br. at 28-30.

¹²⁹ 164 Wn.2d at 825-26, 847-48.

The *Navlet* court implied that if the parties had negotiated language in the Collective Bargaining Agreement (CBA) limiting the duration of retiree medical benefits, the limitation might have been effective. There was no negotiation in the present case. The employees did not negotiate the terms of the RORs with the Legislature. The *Navlet* court's statement about the potential effectiveness of an ROR in a CBA does not authorize unilateral promulgation of an ROR.

The State's reliance on an analogy between the statutory ROR and an ROR in a CBA is undermined by a major factual difference between this case and *Navlet*. CBAs are generally distributed to employees who are covered by their terms. In *Navlet*, the employees received CBAs that did not include the ROR, as well as Summary Plan Descriptions that did. In this case, no communications advised employees that the Legislature had asserted an ROR.¹³⁰

- c. Even if RORs were not universally invalid regarding retirement benefits, the language in the gain-sharing statutes does not effectively reserve a right to repeal gain-sharing for employees already granted a contractual right to the benefit.

The "ROR" language relied upon by the State does not empower the Legislature to deny employees the right to receive future gain-sharing benefits based on their past work or the right to earn additional benefits based on their continued work.

¹³⁰ CP 898-99, 901-06.

- i. *The gain-sharing statutes are reasonably interpreted to protect the rights of employees who worked before passage of EHB 2391.*

The Plan 1 ROR provision states:

The legislature reserves the right to amend or repeal this chapter in the future and no member or beneficiary *has a contractual right* to receive this postretirement adjustment *not granted prior to* that amendment or repeal.¹³¹

The Plan 3 ROR provision states:

The legislature reserves the right to amend or repeal this section in the future and no member or beneficiary *has a contractual right* to receive this distribution *not granted prior to that time*.¹³²

Fairly read, this language permits the Legislature to amend or repeal gain-sharing as to any member *unless* the member had already been granted a contractual right to gain-sharing.

Bakenhus and its progeny establish that each member's contractual right to gain-sharing was "granted" when he first worked while gain-sharing was offered.¹³³ The Legislature is presumed to know existing case law.¹³⁴ When the Legislature enacted gain-sharing in 1998 and 2000, it was presumed to know about the rule of *Bakenhus* and its progeny, that pension rights vest from the day an employee is hired or works. Therefore, retirement system members who worked after the 1998 or 2000 enactment of gain-sharing were "granted" a contractual right to gain-

¹³¹ Former RCW 41.31.030 (2006) (Plan 1) (emphasis added).

¹³² Former RCW 41.31A.020(4), .030(5) (Plan 3) (emphasis added).

¹³³ *Bakenhus v. City of Seattle*, 48 Wn.2d at 701. Cases cited *supra*, at note 106.

¹³⁴ *WFSE v. Joint Center for Higher Educ.*, 86 Wn. App. 1, 7, 933 P.2d 1080 (1997) ("Legislature is presumed to know the existing case law in areas in which it is legislating, and thus common law may be considered in ascertaining the proper scope of a statute.").

sharing on their first day of work after the benefit became effective as to them. Therefore, as to those members, the RORs did not authorize the 2007 repeal of gain-sharing. Under *Bakenhus*, the repeal was unconstitutional because there was no ROR in effect as to them.

The State may argue that the word “granted”¹³⁵ modifies “this post-retirement adjustment” and “this distribution,” so that the State could eliminate gain-sharing rights as to any gain-sharing event that has not yet occurred. But that argument is not consistent with the language of the RORs. If the Legislature had intended the phrase “not granted prior to that time” to modify any future gain-sharing events, the statute would have been phrased “a” post-retirement adjustment not granted. Use of “this” reflects that the word “granted” modifies the contractual right, not a specific gain-sharing event. Therefore, all employees who worked after enactment of gain-sharing were “granted” a contractual right which could not be eliminated by EHB 2391.

ii. Because the disputed language does not clearly reserve the right to repeal gain-sharing for employees, even if a clear and explicit ROR could be effective as to retirement benefits, repeal of gain-sharing would not be permitted.

Even if the Court were to conclude that the RORs can be read as permitting the repeal of gain-sharing as to current employees, the Court

¹³⁵ The retirement statutes do not define the word “granted.” Black’s Law Dictionary, 4th Ed. 1968, defines “grant” as “to bestow; to confer,” and notes: “as distinguished from mere license, a grant passes some estate or interest.” See also *Blood v Sielert*, 38 Wash. 643, 646, 80 P.799 (1905) (defining “grant” as “[i]n modern law, a general term including all sorts of conveyances.”)

should decline to enforce the RORs because they are insufficiently explicit, and therefore ambiguous. At a minimum, the ROR language is ambiguous regarding when gain-sharing is “granted,” and when members acquire a contractual right to gain-sharing. Where a statute is subject to two interpretations, one rendering it constitutional and the other unconstitutional, the legislature is presumed to have intended a meaning consistent with the constitutionality of its enactment.¹³⁶ In this case, the constitutional interpretation is that repeal of gain sharing is only effective as to employees not yet hired.

These ambiguities also prevent the ROR’s from satisfying the requirement that, even in the non-pension area, ROR’s are enforceable only if they are clear and explicit.¹³⁷

- d. Employees have a constitutionally-protected right to continued gain-sharing based on DRS communications.

Significantly, DRS did not interpret the ROR to permit elimination of gain-sharing.

- i. *Actions by DRS created constitutionally-protected rights to gain-sharing, even if those rights exceed what is required by statute.*

Because the *Bakenhus* rule is focused on the expectations of employees, rather than on the intent of the Legislature, it protects the

¹³⁶ *Martin v. Aleinikoff*, 63 Wn.2d 842, 850, 389 P.2d 422 (1964).

¹³⁷ *Caritas Services, Inc. v. DSHS et al.*, 123 Wn.2d 391, 406, 869 P. 2d 28 (1994) (reservation of powers clause ambiguous and not sufficiently explicit); *Carlstrom et al., v. State of Washington et al.*, 103 Wn.2d 391, 398, 694 P. 2d 1 (1985) (the reservation of powers language in the collective bargaining agreement held not sufficiently explicit).

expectations of Plan members that arise as a result of DRS practices, even if the practices are not required by statute.¹³⁸ The standard is whether the duration and nature of the DRS practice were such as to create vested rights in their future continuation.¹³⁹

For more than eight years, in countless documents it characterized as “roadmaps” and “guides,” and in annual Handbooks, DRS advised employees that gain-sharing was part of the deferred compensation that they would receive for their work.¹⁴⁰ Under *Bowles*,¹⁴¹ *WFSE v. State*,¹⁴² and *Washington Ass’n. of County Officials*,¹⁴³ the duration and nature of this long-standing DRS practice created constitutionally-protected expectations in the continuation of gain-sharing, regardless of the Legislature’s intention.

ii. A unilateral contract that included gain-sharing was formed based on Transfer/Choice booklets and Pension Handbooks issued by DRS.

Under Washington employment law, the terms of handbooks distributed to employees become a binding unilateral contract with

¹³⁸ *Wash. Ass’n. of County Officials*, 89 Wn.2d at 733 (DRS practice of including termination payments in retirement benefit calculations created constitutionally-protected employee expectations).

¹³⁹ *Bowles*, 121 Wn.2d at 68 (change in long-standing DRS practice of including all leave cash outs in Average Final Compensation violated *Bakenhus*); *WFSE v. State*, 98 Wn.2d at 689 (statute that prevented employees from receiving lump sum payments for unused vacation at retirement violated *Bakenhus* in light of long-standing DRS practice of including such lump sum payments in Average Final Compensation).

¹⁴⁰ See *supra* notes 39-51 and accompanying text.

¹⁴¹ 121 Wn.2d at 68.

¹⁴² 98 Wn.2d at 689.

¹⁴³ 89 Wn.2d at 733.

employees.¹⁴⁴ The terms of a unilateral contract are determined by the “plain language of the agreement,”¹⁴⁵ without regard to the unexpressed subjective intent of one party.¹⁴⁶

Here, the “agreement” consists of the offers that were conveyed by DRS in booklets and Handbooks, which employees accepted by their continued work. The “plain language” of those booklets and Handbooks told employees they would receive gain-sharing on the same basis as any other retirement benefit.

The employer can avoid formation of a unilateral contract only by including an effective disclaimer, which must:

at a minimum . . . state in a conspicuous manner that nothing contained in the handbook, manual or similar document is intended to be a part of the employment relationship and that such statements are simply general statements of company policy.¹⁴⁷

The “disclaimer . . . must be reasonable notice to the employee that the employer is disclaiming intent to be bound by what otherwise appear to be promises of employment conditions.”¹⁴⁸

The State erroneously implies that all DRS communications stated that

¹⁴⁴ *Swanson v. Liquid Air Corp.*, 118 Wn.2d 512, 522, 826 P.2d 664 (1992), discussing *Gagliardi v. Denny's Restaurants, Inc.*, 117 Wn.2d 426, 433-35, 815 P.2d 1362 (1991) (when an employer issued a handbook, and employee worked thereafter, “all the requisites of unilateral contract formation existed as a matter of law.”). If employees must show that they relied on the offers embodied in DRS communications, under *Dorward v. ILWU-PMA Pension Plan*, 75 Wn.2d 478, 488, 452 P.2d 258 (1969) (“reliance is shown where plaintiff knew of a pension plan covering [his job] and continued working.”).

¹⁴⁵ *Vehicle/Vessel LLC v. Whitman County*, 122 Wn. App. 770, 777, 95 P.3d 394 (2004).

¹⁴⁶ *Multicare Medical Center v. DSHS*, 114 Wn.2d 572, 587, 790 P.2d 124 (1990).

¹⁴⁷ *Swanson v. Liquid Air Corp.*, 118 Wn.2d at 527, citing *Thompson v. St. Regis Paper Co.* 102 Wn.2d 219, 230, 685 P.2d 1081 (1984).

¹⁴⁸ *Swanson*, 118 Wn.2d at 529.

a more complete description was contained in the retirement laws.¹⁴⁹ The Transfer/Choice booklets, which invited employees to rely on them to choose whether to join Plan 3, contained no reference to retirement laws.¹⁵⁰ In obscure print, inserted under the copyright, the booklets advised: “the operations of the Plan are governed by the Plan documents, which contain all the technical provisions that govern the Plan.”¹⁵¹ But there are no “plan documents” for PERS, SERS and TRS.

The language in the Handbooks does not satisfy the standard for an effective disclaimer. The “Summary Description Statement” recites that it is a “summary, written in less legalistic terms,” and “[t]he actual rules governing the plans are contained in State retirement laws.”¹⁵² This Statement fails to advise employees that “nothing contained in the handbook . . . is intended to be part of the employment relationship,” as required by *Swanson*.¹⁵³

Most importantly, any language alleged to constitute a disclaimer “*must be read by reference to the parties’ norms of conduct and expectations founded upon them.*”¹⁵⁴ In light of the well-established *Bakenhus* rule, the “norms of conduct and expectations” for public employees are that their retirement benefits cannot be reduced during their careers. Generally stating that the actual rules are found in the “retirement

¹⁴⁹ App. Br. at 42.

¹⁵⁰ See, e.g., CP 3815-3837.

¹⁵¹ E.g., CP 3818.

¹⁵² See *supra* note 52.

¹⁵³ 118 Wn.2d at 529.

¹⁵⁴ *Swanson*, 118 Wn.2d at 535, citing *Zaccardi v. Zale Corp.*, 856 F.2d 1473, 1476-7 (10th Cir 1988) (emphasis added).

laws” falls far short of effectively notifying employees that this bedrock principle did not apply to gain-sharing.¹⁵⁵

iii. The State cannot rely on the maxim that employees are “presumed to know the law” to avoid obligations created by DRS’s assurances of ongoing gain-sharing.

The State has asserted that employees had no “legitimate expectation” of continued gain-sharing because the statutes, as interpreted by the State, include an ROR. The State’s brief,¹⁵⁶ like AGO 2005 No. 16,¹⁵⁷ assumes that expectations were not formed because employees are “presumed to know” that the gain-sharing statutes contain language that may permit its repeal.¹⁵⁸

The SCPP’s 2005 Gain-sharing Study noted the conflict between this

¹⁵⁵Other states bind public employers to the description of benefits in its employee handbooks. See, e.g., *Lauderdale v. Eugene Water and Electric Board*, 217 Or.App. 551, 177 P.3d 13 (2008) (employee fact sheets promising retiree medical benefits enforceable, notwithstanding alleged reservation of rights and argument that the fact sheets were not approved by governing board; reservation of right to eliminate retiree medical benefits ineffective as a matter of law); *LeMaitre v. Massachusetts Turnpike Authority*, 70 Mass. App. Ct. 634, 638-41, 876 N.E.2d 888 (2007), *aff’d*, 452 Mass. 753, 897 N.E.2d 1218 (2008) (contents of employee handbook created contract right to payout of sick leave at retirement. To make no legally binding promises, employer must include in employee manual a “in a very prominent position . . . an appropriate statement . . . that, regardless of what the manual says or provides, the employer promises nothing.” “What is sought here is “*basic honesty*.”) (internal citations omitted) (emphasis added).

Under federal pension law, employees are entitled to the benefits described in a plan summary, despite language of the type included in DRS Handbooks. *Toohy v. Wyndham Corp. Health & Welfare Plan*, 727 F.Supp.2d 978, 990 (D.Or. 2010), (“[Summary Plan Description] is the participants’ primary source of information regarding employment benefits. . . . [a]ny burden of uncertainty created by careless or inaccurate drafting must be placed on those who do the drafting . . . not on the individual employee.”) (citing *Bergt v. Ret. Plan for Pilots Employed by Mark Air, Inc.*, 293 F.3d 1139, 1143 (9th Cir. 2002)).

¹⁵⁶ App. Br. at 27.

¹⁵⁷ CP 2555-60.

¹⁵⁸ The AGO does not bind the Court, and it may disregard it. *City of Pasco v. Dept. of Retirement Systems*, 110 Wn. App. 582, 592, 42 P.3d 992 (2002), citing *Davis v. King County*, 77 Wn.2d 930, 934, 468 P.2d 679 (1970).

presumption in the AGO and the reality that employees learned of their retirement benefits from DRS communications.¹⁵⁹ As the SCPP implies, employees may reasonably rely on employer communications outlining retirement benefits, without researching the underlying law.¹⁶⁰

2. EHB 2391 Substantially Impaired the Retirement Benefits of Employees Because Gain-Sharing Was of Significant Value to Employees as a Whole, and to Individual Employees.

“A contract is impaired by a statute which alters its terms, imposes new conditions, or lessens its value.”¹⁶¹ The State incorrectly asserts that gain-sharing is not entitled to protection because it was “not substantial.”¹⁶²

EHB 2391 eliminated the value of all future gain-sharing for over 230,000 employees.¹⁶³ In 2008, \$8,120 was deposited into the investment account of every Plan 3 member with 30 years of service.¹⁶⁴ Retired Plan 1 members with 30 years of service had their annual retirement benefit permanently increased by \$126.00.¹⁶⁵

Gain-sharing distributions in 1998 and 2000 totaled \$1.101 billion.¹⁶⁶

¹⁵⁹ CP 1990.

¹⁶⁰ *Samuelson v. Grays Harbor Community College*, 75 Wn. App. 340, 347, 877 P.2d 734 (1994), rev. den. 125 Wn.2d 1023 (1995) (declining to hold that a community college professor should have “learned of his eligibility for [a particular retirement plan] by reading the [WAC],” and noting “it is common for employees to rely on their employers for information regarding their benefits.”).

¹⁶¹ *WFSE v. State*, 127 Wn.2d 544, 562, 901 P.3d 1028 (1995) citing *Caritas*, 123 Wn.2d at 404.

¹⁶² App. Br. at 31-34.

¹⁶³ CP 2504.

¹⁶⁴ CP 641¶15.

¹⁶⁵ CP 641¶14.

¹⁶⁶ CP 1033.

The State asserts that the future value of the benefit¹⁶⁷ is nearly \$2.5 billion over the next 25 years. In short, the State’s repeated assertion that gain-sharing was not a substantial benefit¹⁶⁸ is not supported by the record.

- a. Repeal of gain-sharing was not necessary to maintain the flexibility of the retirement system.

Because employees had a contractual right to continued gain-sharing based on the statute, or on communications by DRS, repeal of gain-sharing was unconstitutional unless the State can satisfy both that repeal was necessary to preserve the flexibility and financial integrity of the pension system, and that employees who lost benefits received comparable replacement benefits.¹⁶⁹

The State faces a heavy burden of proof. When the State’s own contracts are at issue, “[t]o exempt a contract from constitutional protection demands significant justification.”¹⁷⁰ The Court must conduct its own independent analysis – rather than deferring to the Legislature’s opinion – to decide whether the change was necessary.¹⁷¹

Repeal of gain-sharing was not justified under the limited exception for flexibility in *Bakenhus*:

[T]he pension system may be modified . . . to keep the system

¹⁶⁷ CP 1718 (value of benefits as measured by funding cost).

¹⁶⁸ App. Br. at 22, 31.

¹⁶⁹ *Bakenhus*, 48 Wn.2d at 702.

¹⁷⁰ *Pierce County v. State*, 159 Wn.2d at 28. See also *Retired Public Employees Council*, 148 Wn.2d at 623-24; *Caritas Services, Inc. v. DSHS*, 123 Wn.2d 391, at 403, n.6, 869 P.2d 28 (1994), citing *Allied Structural Steel Co. v. Spannaus*, 438 U. S. 234, 244, n.15, 57 L. Ed. 2d 727, 98 S. Ct. 2716 (1978).

¹⁷¹ *Carlstrom v. State*, 103 Wn.2d 391, 394, 694 P.2d 1 (1985), citing *United States Trust Co. v. New Jersey*, 431 U. S. 1, 52 L. Ed. 92, 97 S. Ct. 1505 (1977).

flexible enough to permit adjustments in accord with changing conditions and at the same time maintain the integrity of the system.¹⁷²

The trial court correctly concluded that gain-sharing enhanced, rather than reduced, the system's flexibility.¹⁷³ Gain-sharing is payable only when there are extraordinarily high investment returns, whereas permanent benefit increases saddle a plan with increased benefit obligations, regardless of whether recent investment performance is positive.¹⁷⁴ To the extent the State's brief conflates "flexibility" with the cost of pre-funding, those arguments are addressed below.

b. Repeal of gain-sharing was not necessary to preserve the fiscal integrity of the retirement system.

Repeal of gain-sharing was not necessary to protect the fiscal integrity of the retirement system. In April 2007, when gain-sharing was repealed, the Washington state retirement system in the aggregate was among the nation's most well-funded public retirement plans.¹⁷⁵ Funding of Plan 3 far exceeded 100 percent of future liabilities, even though Actuarial Valuations included the impact of all future gain-sharing on investment earnings.¹⁷⁶

Actuary Smith testified that fiscal integrity was not among the issues considered in 2007, when the Legislature decided to repeal gain-sharing

¹⁷² *McAllister v. City of Bellevue Firemen's Pension Bd.*, 166 Wn.2d 623, 628, 201 P.3d 1002 (2009), citing *Bakenhus*, 48 Wn.2d at 701.

¹⁷³ CP 5109.

¹⁷⁴ CP 4543 (Allard Dec. ¶19), 1737 (Smith Dep. 47:12-24).

¹⁷⁵ CP 1742 (Smith Dep. 68:3-69:14).

¹⁷⁶ *Id.*; CP 1271, 1269, 1354, 1872.

A: I did not raise this issue - - I did not raise this as a financial integrity issue. . . . I did not raise it as an issue of its necessary to maintain the integrity of the plans.

Q: And you're not aware of any place in the fiscal notes or the materials related to this legislation where anyone said repeal was necessary to preserve the fiscal integrity of the pension plans, are you?

A: I don't recall reading that.¹⁷⁷

In light of this clear statement, the State's after-the-fact arguments regarding fiscal integrity must be rejected. The State attempts to argue that the unanticipated economic downturn in 2008 can retroactively validate its actions. The relevant inquiry is whether repeal was necessary to preserve fiscal integrity when the Legislature acted in 2007. Both the robust funding status of the Plans in 2007, and the Actuary's deposition testimony, establish that it was not.¹⁷⁸

i. The State's argument that repeal of gain-sharing is constitutional because it saved money is legally invalid and factually unsupported.

The State's argument that repeal of gain-sharing is constitutional because it saved money for other uses is invalid as a matter of law, and unsupported by the record.

a) Saving money is not a legally valid reason to impair contract rights.

¹⁷⁷ CP 1767 (Smith Dep. 167:10-14).

¹⁷⁸ The State relies on invalid evidence regarding legislative intent. The sole basis for State's argument that the ROR was inserted in 1998 and 2000 because of concern about future expense is the 2010 declaration of Steven Nelson. Legislative intent cannot be shown by depositions of individual legislators. *Woodson v. State*, 95 Wn.2d 257, 264, 623 P.2d 683 (1980). The previously unexpressed opinions of a staff member are likewise invalid. Respondents acknowledge that the Declaration of former State Actuary Gerald Allard, which directly contradicts Nelson, stands on the same footing. The Court properly relies only on the contemporaneous record, which contains no reference to concerns regarding the future expense of gain-sharing.

The State's argument that the money necessary to pre-fund gain-sharing could be used for other purposes misses the point.¹⁷⁹ If simply preferring to spend the money elsewhere were an acceptable justification for impairing state contracts, the constitutional protection would be meaningless.¹⁸⁰

- b) EHB 2391 did not save money when compared to the constitutional alternative of retaining gain-sharing for current members and eliminating it for future entrants.

Actuary Smith explained that there were two reasons for the repeal of gain-sharing: "one was to save money and the second was that people preferred as a matter of policy a different way of delivering pension benefits."¹⁸¹

However, Smith's testimony confirmed that EHB 2391, which not only eliminated gain-sharing, but provided a variety of new benefits, *did not save money*, when compared to the constitutional alternative of simply retaining gain-sharing only for current employees:

- A: [T]he Legislature would have saved more money had they simply eliminated gain-sharing for future new members . . . than by passing . . . EHB 2391].¹⁸²

EHB 2391 as a whole did not save money because the legislation added valuable benefits for current employees who never had a right to

¹⁷⁹ App. Br. at 37.

¹⁸⁰ *Caritas*, 123 Wn.2d at 408. *Continental Ill. Nat. Bank & Trust Co. of Chicago v. State of Washington*, 696 F.2d 692, 702 (9th Cir. 1983), citing *United States Trust Co. v. New Jersey*, 431 U.S. 1, 28, 97 S. Ct. 1505, 1519, 52 L.Ed.2d 92 (1977).

¹⁸¹ CP 1767 (Smith Dep. 167:15-20).

¹⁸² CP 1771 (Smith Dep. 181:7-15).

gain-sharing, and for future employees.¹⁸³

Where, as in this case, the State can achieve its financial goal without violating constitutional rights, financial necessity cannot justify impairment of its own contract.¹⁸⁴

- c) The costs of gain-sharing were not unanticipated; contribution rates required to fund gain-sharing were lower than the rates projected when gain-sharing was enacted.

Before gain-sharing was enacted, the State Actuary advised the Legislature of its impact on investment gains, plan assets, and contribution rates.¹⁸⁵ When Actuary Smith recommended pre-funding in 2003, the adjustment to investment returns he proposed to reflect the cost conformed exactly to information the Legislature had received before enacting gain-sharing.¹⁸⁶ The contribution rates Smith proposed in December 2004 to pre-fund gain-sharing¹⁸⁷ were lower than the long-term contribution rates Actuary Allard had projected.¹⁸⁸ They were also far below the contribution rates that had been paid in the 1980's and 1990's.¹⁸⁹

¹⁸³ CP 1770-71 (Smith Dep. 177:24-181:15).

¹⁸⁴ *United States Trust Co.*, 97 S. Ct. at 1522 (“[A] State is not free to consider impairing its obligations on a par with other policy alternatives.”).

¹⁸⁵ See *supra* notes 27-29.

¹⁸⁶ CP 1797 (PERS and TRS Plan 1), 1806 (SERS Plan 3), 4563 (PERS and TRS Plan 3). Allard's estimate that gain-sharing reduced long-term investment returns by no less than .4 percent was later confirmed by Actuary Smith. CP 1766 (Smith Dep. 162:9-20).

¹⁸⁷ CP 1906, 1911.

¹⁸⁸ Compare CP 1911 (rates from 5.73 percent to 7.56 percent) to CP 984 (rates from 8.5 percent to 13.73 percent).

¹⁸⁹ <http://www.drs.wa.gov/employer/employerhandbook/pdf/combinedList.pdf> percentage rates to 9.27 for PERS 1-State Agencies, 13.28 for TRS 1, 8.43 for PERS 2/3-State Agencies, and 13.00 for TRS 2/3); See also, *Charles*, 148 Wn.2d at 476 (referencing contribution rates of 7.32 percent for PERS and 11.75 percent for TRS before dramatic rate reductions in 1999 and 2000).

Nonetheless, the Legislature refused to authorize the recommended contribution rates.¹⁹⁰ This delay meant that higher contribution rates would be required when the Legislature implemented pre-funding.¹⁹¹

As of December 2004, contribution rates were at historic lows,¹⁹² in part because the Legislature had prioritized reducing rates over other policy goals. In 2001, the Legislature had repealed the portion of the 1998 gain-sharing statute that committed one-half of extraordinary investment gains to paying down the historic underfunding of Plan 1,¹⁹³ so those gains could be used to reduce current contributions.¹⁹⁴ In 2003, when the auditing actuary (and later, Smith) recommended use of an updated mortality table, the Legislature refused, because contribution rates would have increased.¹⁹⁵

The Legislature also refused to adopt Smith's recommendation that rates be adjusted to pre-fund gain-sharing. In 2004 and 2005, the SCPP directed Smith to develop a proposal to end gain-sharing, and replace it with a benefit with one half the cost.¹⁹⁶ In August 2006, Smith outlined contribution rates, with gain-sharing pre-funded, that were still well below the long-term rates originally identified by Allard.¹⁹⁷ Nonetheless, the

¹⁹⁰ CP 1740-41 (Smith Dep. 57:23-62:4).

¹⁹¹ CP 1732-33, 1741, 1754 (Smith Dep. 27:23-29:17, 63:1-7; 115:18-21).

¹⁹² Rates for the various plans ranged from 1.28 to 1.38 percent. <http://www.drs.wa.gov/employer/employerhandbook/pdf/combinedList.pdf> (percentage rates to 9.27 for PERS 1-State Agencies, 13.28 for TRS 1, 8.43 for PERS).

¹⁹³ Laws of 2001, 2nd sp. s. ch. 11 §10; Laws of 2001 ch. 329 §10.

¹⁹⁴ CP 1732-33 (Smith Dep. 27:5-29:6).

¹⁹⁵ CP 1735-1736 (Smith Dep.: 40:15-44:6).

¹⁹⁶ CP 1211, 1250.

¹⁹⁷ Compare CP 2004 (rates between 6.91 percent and 9.52 percent) and CP 984 (rates from 8.5 percent to 13.73 percent).

Legislature chose to repeal gain-sharing in April 2007.

As this history reflects, “unanticipated and unsustainable costs” of gain-sharing cannot justify EHB 2391.¹⁹⁸

d). The Legislature’s actions in 2007 cannot be justified based on conditions in 2011.

The State argues, in effect, that the cost to restore gain-sharing in 2013 is unsustainable. There are at least four reasons this argument is unavailing. First, the constitutional violation occurred in 2007. Second, lack of funds is not a defense to a claim that constitutional rights have been violated.¹⁹⁹ Third, as discussed above, the Legislature can adjust the financial impact by deciding whether to prefund gain-sharing, or restore present value payment funding.²⁰⁰

Finally, any cost associated with restoring gain-sharing is caused by the Legislature’s 10 year delay in prefunding the benefit.²⁰¹ In 2007, the 25 year cost²⁰² of future gain-sharing for current members was \$2,389.8 million.²⁰³ The cost of the replacement benefits eliminated under the trial

¹⁹⁸ The State relies on *SEIU Healthcare 775NW v. Gregoire*, 168 Wn.2d 593, 601, 229 P.3d 774 (2010). App. Br. at 38. That case did not include an impairment of contract claim, as to which the Court must conduct its own independent review, and may not defer to the Legislature’s judgment. *Carlstrom v. State*, 103 Wn.2d at 396.

¹⁹⁹ *Braam ex rel. Braam v. State*, 150 Wn.2d 689, 710, 81 P.3d 851 (2003) (due process rights of children in foster care system violated; cost to correct no defense).

²⁰⁰ See *supra* notes 61-64 and accompanying text.

²⁰¹ CP 1732-33, 1741, 1754 (Smith Dep. 27:23-29:17, 63:1-7; 115:18-21).

²⁰² “Cost” refers to decrease in funding expenditures over 25 years, as reflected in Fiscal Note accompanying EHB 2391.

²⁰³ CP 2631-2635 ((\$2,000.7M minus \$1,097.7M) plus \$1,486.8M = \$2,389.3M). This cost is more than offset by the cost of the replacement benefits that would be eliminated if the trial court’s decisions were affirmed. CP 1718.

court's order is \$2,499 million,²⁰⁴ which would mean the State saves \$110 million if all trial court rulings are affirmed. The State asserts that, as of April 2010, the cost to restore gain-sharing had increased to \$3,364 million.²⁰⁵ No current members were added after July 2007, and gain-sharing benefits are based on years of service, rather than salary. Therefore, the increased cost must reflect investment earnings lost because gain-sharing was not funded in 2007.²⁰⁶ Having caused this additional cost by its own delay, the State should not be permitted to interpose cost as a defense to correcting its constitutional violation.²⁰⁷

- e) Repeal of gain-sharing for all Plans cannot be justified based on funding level of specific Plans, particularly when funding levels result from the Legislature's prior decisions.

Bakenhus requires that the State prove that the repeal of gain-sharing was necessary to preserve the fiscal integrity of the "pension system."²⁰⁸ Because integrity is measured by the pension system as a whole, that the entire system was funded at over the 99 percent level resolves the financial integrity question.

The State implies that underfunding of Plan 1 justifies repeal of gain-sharing for all Plans. This is inconsistent with *Bakenhus*. But if Plans

²⁰⁴ CP 1718.

²⁰⁵ *Id.*; App. Br. at 15.

²⁰⁶ CP 1732-33, 1741, 1754 (Smith Dep. 27:23-29:17, 63:1-7; 115:18-21) (delaying the start of pre-funding means higher contributions will be required later).

²⁰⁷ The 25 year cost of future gain-sharing is less than 2 percent of current value of plan assets. Actuary Alan Stonewall concluded that the cost of gain-sharing, whether or not it is pre-funded, does not significantly impact the financial health of Plans 1 and 3. (CP 4577-78[9]).

²⁰⁸ 48 Wn.2d at 701.

were analyzed separately, the Legislature cannot rely on its own systematic underfunding of Plan 1 to justify repeal of Plan 1 gain-sharing. Even under a Plan-by-Plan analysis, because there was no threat to the fiscal integrity of any Plan 3, repeal of gain-sharing provisions in the PERS, TRS, and SERS Plan 3 statutes was improper.

- c. New benefits EHB 2391 provided for Plan 1 and Plan 3 are not comparable to the gain-sharing benefits repealed.

On both an individual and aggregate basis, the benefits provided by EHB 2391 were not comparable to the gain-sharing benefits repealed.

- i. New benefits provided by EHB 2391 were of little value to Plan 1 members and were of no value to nearly half of Plan 3 members.*

The 2008 gain-sharing adjustment for Plan 1 members was \$.35 per year of service.²⁰⁹ In lieu of all future gain-sharing, EHB 2391 provided Plan 1 members with a one-time COLA adjustment of \$.05 per year of service.²¹⁰ The actuarial value of the five-cent COLA adjustment was less than 22 percent of the value of future gain-sharing.²¹¹

EHB 2391 affected Plan 3 members differently, depending on their circumstances.²¹² EHB 2391 permitted Plan 3 members who achieved 30

²⁰⁹ CP 1710:7-10.

²¹⁰ EHB 2391 provided that the 2009 special COLA adjustment would be the difference between \$.40 per year of service and the 2008 gain-sharing adjustment. Because the 2008 gain-sharing adjustment was \$.35, the 2009 adjustment was \$.05, rather than the \$.13 that was originally estimated, and which was the basis for the Plan 1 replacement ratios included in the Fiscal Note to EHB 2391. CP 1710:7-15; 5336.

²¹¹ CP 4580.

²¹² The aggregate value of the ERRFs relative to future gain-sharing was also different for each Plan. The aggregate replacement percentages were: SERS-13.76, TRS 69.48, PERS 52.47. CP 583. The average is slightly less than the 50 percent requested by the SCPP. CP 1211. The replacement percentages in the Fiscal Note (CP 5291) were inflated

years of service before reaching age 65 to retire with increased benefits. The 46 percent of Plan 3 members who began work after age 35,²¹³ could never qualify for the ERRFs, so they received no advantage to offset the repeal of gain-sharing. Providing a replacement benefit for roughly half the members is insufficient because, under *Bakenhus*, advantages for one individual do not offset disadvantages for another.²¹⁴

The State's reliance on "increased actuarial soundness" as an offsetting advantage²¹⁵ is unreasonable. This reasoning would validate any action that reduced employer contributions.

ii. The actuarial value of gain-sharing reflects that it is extraordinary; an additional reduction in value relative to new benefits is unwarranted.

The State's argument that the relative value of new benefits is greater because they are predictable, whereas gain-sharing is sporadic, is specious. Smith assigned an actuarial value to gain-sharing that already reflected that it was sporadic.²¹⁶ By inflating the relative value of new benefits because they are predictable, the State is counting the same factor twice.

The sporadic nature of gain-sharing was not unanticipated. By definition, it is only paid when investment gains are "extraordinary."

because the Legislature improperly directed Smith to include 2008 gain-sharing as a "replacement benefit." The Fiscal Note Instructions direct that "the starting point for the fiscal note should be . . . current law." CP 644. The 2008 gain-sharing would have occurred with no action by the legislature. CP 2538. Smith had never prepared a Fiscal Note that included an event that would have occurred without legislation as an effect of the legislation. CP 1761 (Smith Dep. 146:25-147:9).

²¹³ CP 5290, 585-86¶25, 1765-66 (Smith Dep. 157:10-159:3, 160:1-161:12).

²¹⁴ *Bakenhus*, 48 Wn.2d at 702-3.

²¹⁵ App. Br. at 32-34.

²¹⁶ CP 1748 (Smith Dep. 92:15-21).

Gain-sharing was actually less sporadic than anticipated. Historical data provided in 1998 showed that gain-sharing would have occurred 12 times in the prior 34 biennia.²¹⁷ It occurred during half the biennia from 1998 through 2008. The Legislature simply preferred, as a matter of policy, to repeal gain-sharing and provide a different mix of benefits. The rule against impairment of contracts exists to address this very situation – where “policy changes and political evolutions . . . discard the legitimate expectations embodied in the contract.”²¹⁸

B. THE STATE’S FRAMEWORK WOULD PERMIT ELIMINATION OF ALL PENSION PROTECTIONS.

There is no logical limit to the rule proposed by the State.

1. The State’s Proposed Rule Would Permit RORs in All Future Retirement Plans, Making All Pension Promises Illusory.

The State’s analysis would permit the Legislature to eliminate all pension protections by creating a new pension plan, in which it reserved the right to later decide not to pay any of the benefits offered. What the State requests is a license to make pension promises illusory.

2. EHB 2391 Retroactively Eliminated Gain-Sharing Benefits Employees Had Already Earned by Their Past Service.

The State’s assertion that employees received all the gain-sharing benefits that they “earned” with work before the repeal²¹⁹ is false. EHB 2391 retroactively eliminated deferred compensation owed for work

²¹⁷ CP 1661.

²¹⁸ *Tyrpak v. Daniels*, 124 Wn.2d 146, 155, 974 P.2d 1374 (1994).

²¹⁹ App. Br. at 27.

already performed. To illustrate, if the 2007 law had not been passed, a Plan 3 member who resigned the day before EHB 2391 became effective would have been entitled, based on her past work, to receive gain-sharing distributions for the rest of her life. EHB 2391 prevents her from receiving this deferred compensation for her past work.

None of the authorities cited by the State permit this harsh result.²²⁰ This Court has acknowledged that, even in the non-pension context, permitting retroactive reduction in compensation for services already provided is an absurdity.²²¹

C. EVEN IF THE ROR WERE VALID, THE STATE IS ESTOPPED FROM REPEALING GAIN-SHARING.

1. Introduction and Summary of Estoppel Claims.

The doctrines of equitable and promissory estoppel are designed to redress injustices that occur in situations of unequal knowledge or bargaining power. The doctrines may, in appropriate circumstances, be applied against government agencies.²²²

²²⁰ *E.g.*, *Strunk v. PERB*, 108 P.3d at 1094, held that a reduction in the earnings rate to be credited to accounts accumulated prior to repeal constituted an impermissible retroactive reduction in retirement benefits. By the same reasoning, eliminating the portion of gain-sharing attributable to service before the date of repeal reduces the future earnings rate of the defined contribution account of Plan 3 members because future gain-sharing amounts will not be credited to the accounts.

²²¹ *Caritas*, 123 Wn.2d at 407.

²²² Contrary to the State's attempt to invoke the maxim that estoppel cannot be used as a sword, retirement benefits may be granted under estoppel principles. *Dorward v. ILWU-PMA Pension Plan*, 75 Wn.2d at , *Hitchcock*, 39 Wn. App. 67, 74-75, 692 P.2d 834 (1984); *See also Greaves vs. Medical Imaging Systems*, 124 Wn.2d 389, 397-98, 879 P.2d 276 (1994).

2. Employees Satisfy the Elements of Equitable Estoppel.

The record contains clear and convincing evidence supporting each element of equitable estoppel:

- (a) a statement, admission, or act by the government, which is inconsistent with its later claims;
- (b) the asserting party acted in reliance upon the statement, admission or act;
- (c) injury would result to the asserting party if the government were allowed to repudiate its prior statement or action;
- (d) estoppel is necessary to prevent a manifest injustice; and
- (e) estoppel will not impair governmental functions.²²³

- a. DRS' statements were inconsistent with the State's later actions.

Incorrect representations regarding future pension benefits establish the first element of equitable estoppel.²²⁴ DRS' repeated communications to members that gain-sharing distributions "will" be made when there are extraordinary gains²²⁵ satisfies this element.

The State's argument that the word "will" is equivocal is untenable. The State relies on *Harberd v. City of Kettle Falls*,²²⁶ which rejected estoppel because, in context, the phrase "shall be provided by one municipal entity" meant "water service, if provided, will be by one municipal entity." No similar limited reading is possible here.

DRS' statements were not "ultra vires," as the State asserts. RCW 41.50.030(1) grants all "powers, duties, and functions" of the retirement

²²³ *Silverstreak, Inc. v. Dept. of L&I*, 159 Wn.2d 868, 887, 154 P.3d 891 (2007).

²²⁴ *Dorward*, 75 Wn.2d 488.

²²⁵ *See, e.g.*, CP 2785. (emphasis added).

²²⁶ 120 Wn. App. 498, 518, 84 P.3d 1241, *rev. den.* 152 Wn.2d 1025 (2004).

plans to DRS.²²⁷ DRS's own regulations confirm that it "has the authority to . . . administer" the plans.²²⁸ Moreover, *Bowles* confirms that actions by DRS bind the State.²²⁹

The limitation that estoppel does not apply to "statements of law" is inapplicable.²³⁰ Misrepresentations about pensions can support estoppel claims although the benefits are defined in plan documents or statutes.²³¹

b. Employees relied on DRS statements.

In a claim for retirement benefits, sufficient reliance is shown where the plaintiff knew of the benefits offered and continued working."²³² Thus, reliance is established for all Plan 1 and Plan 3 members who worked after gain-sharing was offered.²³³

²²⁷ DRS is also "empowered...to decide on all questions of eligibility covering membership, service credit, and benefits." RCW 41.32.025.

²²⁸ WAC 415-02-020; *see also* WAC 415-02-130 requiring the agency to provide members with "retirement and account information" on at least an annual basis.

²²⁹ 121 Wn.2d at 65. *See also Shafer v State*, 83 Wn.2d 618, 623, 521 P.2d 736 (1974) (state may not assert that failure to file timely claim bars tort action after Assistant Attorney General advised claimant that a written claim was not necessary; "[t]he conduct of government should always be scrupulously just in dealing with its citizens; and where a public official, acting within his authority and with knowledge of the pertinent facts, has made a commitment and the party to whom it was made has acted to his detriment in reliance on that commitment, the official should not be permitted to revoke that commitment.").

²³⁰ *Dorward*, 75 Wn.2d at 486, *Hitchcock v. Wash. St. DRS*, 39 Wn. App. 67, 692 P.2d 834, (1984), *rev. den.*, 103 Wn.2d 1025 (1985); *Samuelson, supra* (duty to permit employee to elect retirement plan includes duty to inform employee of options).

²³¹ *Cf. West v. DSHS*, 21 Wn. App. 577, 579, 586 P.2d 516 (1978), *rev. den.*, 92 Wn.2d 1032 (1979) (failure to advise client of costs imposed by statute or regulation supports estoppel claim); *Silverstreak*, 159 Wn.2d at 887 (applying estoppel based on L&I memo regarding requirements of prevailing wage law).

²³² *Dorward*, 75 Wn.2d at 488; *see also Crabtree v. State of Washington*, 101 Wn.2d 552, 557, 681 P.2d 245 (1984) (The purpose of pension benefits is "to induce long continued and faithful service").

²³³ The State fails to acknowledge that estoppel claims are brought only on behalf of all Plan 1 and Plan 3 members, including PERS Plan 1 members. App. Br. at 38.

Additional reliance is established by members who transferred to or chose Plan 3.²³⁴ There is no requirement each employee read the communications from DRS.²³⁵

c. Injury would result from permitting the State to repudiate.

Gain-sharing significantly increased the long-term value of employees' retirement benefits. Its elimination constitutes injury. Plan 2 members, who had guaranteed retirement income, assumed investment risk when they chose to transfer to Plan 3.²³⁶ Gain-sharing mitigated that risk because employees shared in investment gains without being exposed to investment losses.²³⁷ Plan 3 members cannot return to Plan 2. They have lost both the economic security of Plan 2 and the protection against investment loss provided by gain-sharing.²³⁸

d. Estoppel is necessary to prevent manifest injustice.

Denying an employee access to a retirement benefit constitutes a manifest injustice that warrants application of equitable estoppel. *Beggs v City of Pasco*.²³⁹ While the denial of benefits here is not complete, as it was in *Beggs*, in the aggregate it involves billions of dollars.²⁴⁰

²³⁴ See *supra* notes 46, 51 and accompanying text, e.g., gain-sharing "will be paid," "will be distributed," "will be passed on," "is credited," "will occur," etc.

²³⁵ *Silverstreak*, 159 Wn.2d at 888-89 (plaintiffs not required to show they read memo from L&I regarding minimum wage requirements).

²³⁶ CP 584-85¶¶19-23.

²³⁷ *Id.*

²³⁸ *Id.*

²³⁹ 93 Wn.2d 682, 689, 611 P.2d 1252 (1980).

²⁴⁰ CP 580-81¶11. See also *Silverstreak*, 159 Wn.2d at 887 (imposing financial conditions not contemplated when sub-contractors submitted bids for work); *West v. DSHS*, 21 Wn. App. 577, 579, 586 P.2d 516, (1978), rev. den. 92 Wn.2d 1032 (1979) (requiring payment when DSHS failed to advise mother that support could be required in connection with placement for foster care).

- e. Requested declaratory and injunctive relief will not impair governmental functions.

The trial court granted an injunction and declaratory judgment protecting employees' right to future gain-sharing. Courts properly grant injunctive relief against the government based on equitable estoppel.²⁴¹

Enjoining the State and DRS from implementing repeal of gain-sharing will not impair government functions. An injunction merely restores the long-term financial commitment outlined by Actuary Allard when gain-sharing was enacted. The Legislature may then decide whether to prefund gain-sharing or restore the prior funding method.

3. Employees Satisfy the Elements of Promissory Estoppel.

Promissory estoppel, like estoppel by silence, is based on the need to protect a party who has been harmed because he or she relied on misinformation from another party:

[I]n either case the party who is estopped has in effect stood by and, in violation of his duty in equity and good conscience to warn another of the real facts, permitted the latter to take some action detrimental to his own interest.²⁴²

The elements of promissory estoppel are:

- (a) a promise;
 - (b) the promisor reasonably expected the promisee to change position;
 - (c) the promisee did change position in reliance on the promise;
- and

²⁴¹ E.g., *Metropolitan Park District of Tacoma v. State*, 85 Wn.2d 821, 827, 539 P.2d 854 (1995); *King v. Riveland*, 125 Wn.2d 500, 518, 886 P.2d 160 (1994).

²⁴² *Central Heat, Inc. v. The Daily Olympian, Inc.*, 74 Wn.2d 126, 133, 443 P.2d 544 (1968).

(d) injustice can be avoided only by enforcing the promise.²⁴³

Promissory estoppel enables the party who has received a “promise of specific treatment in specific situations”²⁴⁴ to enforce the promise²⁴⁵ and it may be asserted against a governmental agency.²⁴⁶

a. DRS made promises to the employees.

A promise is “a manifestation of intention to act or refrain from acting in a specified way, so made as to justify a promisee in understanding that a commitment has been made.”²⁴⁷ In many forms,²⁴⁸ DRS made “clear and unequivocal promises”²⁴⁹ that if there were extraordinary investment gains, gain-sharing would be paid.

b. DRS expected employees to change their position.

The second element – that DRS had a reasonable expectation that members would change their position based upon the promise – is also satisfied.²⁵⁰ Promises of increased benefits strengthen the inducement to continue work that is the purpose of retirement benefits.²⁵¹

²⁴³ *Jones v. Best*, 134 Wn.2d 232, 239, 950 P.2d 1 (1998); *Flower v. T.R.A. Industries*, 127 Wn. App. 13, 31, 111 P.3d 1192 (2005), *rev. den.*, 156 Wn.2d 1030. See “Promissory Estoppel,” *Washington Practice, Contract Law and Practice*, Vol. 25, Ch. 6 at 179-85 (Thomson/West 2007); *Restatement (Second) of Contracts*, § 90, (ALI, 1981); Eric Mills Holmes, *Restatement of Promissory Estoppel*, 32 Willamette L. Rev. 263, 485 (1996) (elements in Washington shortened to “promise, reliance, and injustice”).

²⁴⁴ *Shaw v. Housing Authority*, 75 Wn. App. 755, 760-61, 880 P.2d 1006 (1994).

²⁴⁵ *Id.* at 261, fn 4. (purpose of promissory estoppel is to make a promise binding).

²⁴⁶ *State v. Northwest Magnesite Co.*, 28 Wn.2d 1, 26, 182 P.2d 643 (1947).

²⁴⁷ *Havens v. C & D Plastics*, 124 Wn.2d 158, 172, 876 P.2d 435 (1994), citing, *Restatement(Second) Contracts* § 2(1) (1981).

²⁴⁸ See *supra* notes 39, 46, 51 and accompanying text.

²⁴⁹ *Havens v. C&D Plastics*, 124 Wn.2d 158, 173, 876 P.2d 435 (1994).

²⁵⁰ *King v. Riveland, supra; Flower v. T.R.A. Industries*, 127 Wn. App. at 25 (employer could reasonably expect employee to rely on promise that employment would continue absent gross misconduct).

²⁵¹ *Navlet*, 164 Wn.2d at 836, citing *Jacoby v. Grays Harbor Chair & Mfg. Co.*, 77 Wn.2d 911, 468 P.2d 666 (1970).

c. Employees did change position in reliance on DRS promises.

The evidence in support of reliance is outlined above in the equitable estoppel argument. Under *Dorward*, working with knowledge that a retirement plan is in place establishes reliance.²⁵² Contrary to the State's argument, class-wide reliance on DRS materials that failed to disclose the ROR is appropriate.²⁵³ *CIGNA Corp. v. Amara*.²⁵⁴ (Class-wide reliance on a benefit summary proper, without showing that individual workers read, or took actions specifically in response to summary).

The State's reliance on *Poulos v. Caesars World, Inc.*²⁵⁵ is misplaced. *Kennedy v. Jackson Nat. Life Ins.*²⁵⁶ noted that the holding in *Poulos* "was limited to gambling," given the unique character of gaming transactions.²⁵⁷ *Cole v. Asurion Corp.*²⁵⁸ clarifies that *Poulos* supports a presumption of class-wide reliance where the primary claim is "failure to disclose". In this case, there was a clear failure to disclose the ROR, and the SCPP acknowledged that "*members transferred into Plan 3 from Plan 2 because of the availability of gain-sharing.*"²⁵⁹ A presumption of class-

²⁵² *Dorward*, 75 Wn.2d at 488.

²⁵³ *Peterson v. H&R Block Tax Service*, 174 F.R.D. 78, 84-85 (N.D.Ill. 1997) (reliance presumed where fee was paid for benefit unavailable to class members).

²⁵⁴ 131 S. Ct. 1866, 1881, 179 L. Ed. 2d 843 (2011).

²⁵⁵ 379 F.3d 654, 664 (9th Cir. 2004).

²⁵⁶ 2010 WL 2524360, p. 9 (N.D.Cal. 2010) (presumed class-wide reliance where the seller failed to disclose that the price of annuities exceeded their value).

²⁵⁷ See also *Negrete v. Allianz Life Ins. Co. of N.A.*, 238 F.R.D. 482, 492 (C.D.Cal. 2006) (generalized reliance presumed where uniform materials failed to disclose that deferred annuities were less valuable than comparable products); *King v. Riveland*, 125 Wn.2d at 509 (presumed reliance on promise of confidentiality made to class of inmates to induce participation in program).

²⁵⁸ 267 F.R.D. 322, 329 (C.D. Cal. 2010).

²⁵⁹ CP 1987.

wide reliance is appropriate.

d. Injustice can be avoided only by enforcing DRS promises.

Injustice can be avoided only by restoring the benefits that were promised. Plan 1 members have provided their work and retired, with the expectation that they would receive future gain-sharing. Plan 3 members have lost the security of Plan 2, and cannot transfer back.

D. AN AWARD OF ATTORNEYS' FEES AND INTEREST IS PROPER

The trial court's award of fees and interest was proper. An additional award of fees and costs on appeal is also proper.

1. Attorneys' Fees Were Properly Awarded Against the State, as Employer, Under RCW 49.48.030.

RCW 49.48.030 provides:

In any action in which any person is successful in recovering judgment for wages or salary owed to him or her, reasonable attorney's fees, in the amount to be determined by the court, shall be assessed against said employer or former employer ...

"RCW 49.48.030 is a remedial statute that must be construed liberally in favor of the employee."²⁶⁰ Further, "[t]he Legislature has evidenced a strong policy in favor of payment of wages due employees by enacting a comprehensive scheme (which includes RCW Ch. 49.48) to ensure payment of wages."²⁶¹ That employees should recover their fees from the employer is a part of that policy.

²⁶⁰ *Int'l Ass'n of Fire Fighters, Local 46 v. City of Everett*, 146, Wn.2d 29, 34, 42 P.3d 1265 (2002).

²⁶¹ *Seattle Prof. Engineering Employees Ass'n v. Boeing Co.*, 139 Wn.2d 824, 830, 991 P.2d 1126 (2000).

The State argues that it is not the “employer” of the class within the meaning of RCW 49.48.030, claiming that state agencies, departments, school districts and political subdivisions are the actual employers of the class and that the State, acting through the Legislature, is a third party to this dispute. (App. Br. at 51-52).

The State cannot seriously dispute that it is the employer of workers in its agencies and departments. In federal²⁶² and state courts,²⁶³ the State has successfully asserted 11th Amendment immunity for employees of the same agencies and departments.²⁶⁴ If the State were not the employer of agency and department employees, its assertions of immunity would have been rejected in these cases.²⁶⁵ Elsewhere, the State has asserted that the State and an agency of the State are one and the same.²⁶⁶

²⁶² *Hurst v. University of Washington*, 931 F.2d 60, 1991 WL 65442 (9th Cir. 1991) (unpub.) (University of Washington officials acting in their official capacity are State employees who are immune from suit under Eleventh Amendment); *see also Lojas v. State et al.*, 347 Fed. Appx. 288, 2009 WL 2952173 (9th Cir. 2009) (unpub.) (immunity for Dept. of Fish & Wildlife and departmental officer acting in official capacity); *Barnes v. Byrd*, 511 F. Supp. 693, 699-700 (E. D. Wa. 1981), *aff'd* 692 F.2d 762 (9th Cir. 1982) (immunity for DSHS supervisors acting in official capacities); *Hennessey v. State et al.*, 627 F. Supp. 137, 139 (1985) (immunity for DSHS); *Horsley v. Washington et al.*, 2009 WL 4545081 (W. D. Wa. 2009) (unpub.) (immunity for Dept. of Corrections as arm of the state); *Bush v. Birdsell*, 2010 WL 3120030 (E. D. Wa. 2010) (unpub.) (same); *Gordon v. State of Washington et al.*, 2010 WL 1038462 (W. D. Wa. 2010) (unpub) (immunity for employees of DSHS and Western State Hospital). Unpublished cases cited only to show position taken by State.

²⁶³ *Hontz v. State*, 105 Wn.2d 302, 309-10, 714 P.2d 1176 (1986) (because UW is state agency, and Harborview is operated and managed by UW, “its employees are state employees.”).

²⁶⁴ The Eleventh Amendment provides in pertinent part that the “Judicial power of the United States shall not be construed to extend to any suit...commenced or prosecuted ...against one of the United States....”

²⁶⁵ *Mt. Healthy City Sch. Dist. Board of Education v. Doyle*, 429 U.S. 274, 280, 97 S. Ct. 568 (1977); *Stem v. Ahearn*, 908 F.2d 1, 4 (5th Cir. 1990).

²⁶⁶ *See Gross v. Washington State Ferries*, 59 Wn.2d 241, 243-44, 367 P. 2d 600 (1961) (Washington Toll Bridge Authority entitled to qualified immunity enjoyed by the State in

The State's claim that it was not the employer of workers in state departments was squarely rejected in *Martini ex rel. Dussault v. State*:

The State argues, in effect, that it does not employ its employees; instead, it says, each of its departments separately employs only those employees who work for that department. In our view, however, *the State – not each of its separate departments – employs its employees.*²⁶⁷

In light of these precedents, the State's assertion that it is not the employer of more than 10,000 class members who work in State agencies and departments²⁶⁸ should be rejected.

The State asserts that under RCW 49.48.030, only the “immediate employer” of a public employee can be held liable for fees.²⁶⁹ Yet, the word “immediate” does not appear in RCW 49.48.030, and the State cites no case supporting its “immediate employer” gloss. Appellants offer no state court decisions addressing the issue.²⁷⁰ *Keenan v. Allan*, 889 F.

a tort action); *Centralia College Educational Ass'n v. Board of Trustees etc.*, 82 Wn.2d 128, 129, 508 P. 2d 1357 (1973) (Community College Districts are state agencies, not “local units.”).

²⁶⁷ 121 Wn. App. 150, 167-68, 89 P.3d 250 (2004), *rev. den.*, 153 Wn.2d 1023, 108 P.3d 133 (2005) (emphasis added) (treating departments as separate employers under juror disqualification statute “would be skewing the employment relationship among the State and its employees”).

²⁶⁸ CP 6993-97. The State employs over 10,000 class members. The legislature has created 18 departments listed in RCW 43.17.010, and additional departments listed elsewhere in RCW 43.17. In 2002 (after the enactment of gain-sharing, and before repeal) there were at least 5,166 employees employed by departments of the State (DSHS, UW, DOT, Employment Security, L&I, and WSU) in PERS 1 and 5,300 in PERS 3. TRS 1 and TRS 3 membership also includes some state employees.; see also CP 2634-35 (Fiscal Note to EHB 2391, indicating that more than half of the savings from repeal of gain-sharing accrued to State, rather than Local Government.)

²⁶⁹ App. Br. at 52.

²⁷⁰ *Naches Valley School District No. JT3*, 54 Wn. App. 388, 398-400, 775 P.2d 1916 (1989) (State not defendant; fees awarded against School District); *Bates v. City of Richmond*, 112 Wn. App. 919, 51 P. 3d 816 (2002) (fees granted against City, which was the sponsor of the pension fund, as the State is in this case); *Herring v. DSHS*, 81 Wn.

Supp. 1320 (E.D.WA. 1995), cited by Appellants is not instructive. There, the court relied on a prior state court decision²⁷¹ that the separation of powers doctrine prevented the county commissioners from acting as “employer” of a Superior Court clerk.²⁷² Also, because Keenan’s claims were dismissed, the court’s discussion of RCW 49.48.30 was dictum.²⁷³

The pension programs at issue were established by the State, which then caused harm to its employees by reducing pension benefits.²⁷⁴ Under these circumstances, to deny employees’ recovery under RCW 49.48.030 is inconsistent with the liberal construction of the statute required by *Int’l Ass’n of Firefighters*.²⁷⁵

2. If Fees Pursuant to RCW 49.48.030 Are Disallowed, Respondents’ Common Fund Fee Request Should Be Remanded.

Respondents requested an award of attorney fees based on RCW 49.48.030 or, in the alternative, based on the common fund theory. CP 6605; CP 6779. The trial court awarded fees based on RCW 49.48.030.

App. 1, n.1, 33-34, 914 P. 2d 67 (1996) (defendants included both State and DSHS; fee award does not indicate which defendant is liable for fees).

²⁷¹ *Zylstra v. Piva*, 85 Wn.2d 743, 748-51, 539 P.2d 823 (1975) (because court clerks are employees of the state judiciary, separation of powers prevents county commissioners from negotiating, or otherwise affecting their working conditions).

²⁷² 889 F. Supp. at 1351.

²⁷³ *Id.* at 1380, 1393.

²⁷⁴ The role of the State in this case is analogous the role of the City of Richland in *Bates v. City of Richland*, 112 Wn. App. 919, 925, 927, 939-40, 51 P.3d 816 (2002). Bates worked in Richland’s Police Department, just as many plaintiffs worked in the State’s DSHS. In *Bates*, the City controlled the payment of pensions, and reduced the amounts to be paid. As a result, the City was liable for fees under RCW 49.48.030. Under the State’s reasoning, Richland would have avoided liability because it was not the “direct employer” of the policemen.

²⁷⁵ 146 Wn.2d at 34-35

CP 7111. Should this Court disallow an award pursuant to RCW 49.48, the matter should be remanded to the trial court for an award of attorney fees pursuant to the common fund theory.

3. The Award of Interest Was Proper.

The trial court properly awarded interest on its award of attorneys' fees.²⁷⁶ The State correctly references the general rule that it cannot, without its consent, be held to interest on debts but it fails to apply the caveat: "*unless it has placed itself expressly, or by reasonable construction of a contract or statute, in a position of attendant liability.*"²⁷⁷

By entering into an authorized contract with a private party, the State, absent a contrary contractual provision, waives its sovereign immunity and impliedly consents to the same responsibilities and liabilities as the private party, including liability for interest. *Architectural Woods, Inc. v. State*, 92 Wn.2d 521, 526-7, 598 P.2d 1372 (1979). Here, as in *Woods*, interest is appropriate because complaints²⁷⁸ allege the State breached its contract.²⁷⁹

²⁷⁶ CP 7111.

²⁷⁷ *Union Elevator & Warehouse Co. v. State ex. Rel. Dept of Transportation*, 171 Wn.2d 54, 59, 248 P.3d 83 (2011), citing *State v. Hallauer*, 28 Wn. App. 453, 455, 624 P.2d 736 (1981).

²⁷⁸ Complaints were filed pursuant to RCW 4.92.010. See, e.g., CP 3 (CP 5396).

²⁷⁹ *Architectural Woods*, 92 Wn.2d at 528-9. *Architectural Woods* plaintiffs successfully brought claims pursuant to RCW 4.92.010 for breach of contract, estoppel, and unconstitutional impairment of contract. The court relied on *Shapiro v. Kansas Public Employees Retirement System*, 216 Kan. 353, 357, 532 P.2d 1081, 1084 (1975) (interest awarded on pension benefits wrongfully denied). See also *Smoke v. City of Seattle*, 132 Wn.2d 214, 228, 937 P.2d 186 (1997) (post-judgment interest award proper where city "consent[ed] to suit for damages," thereby "impliedly waiv[ing] immunity from the liabilities attendant to such claims.").

4. Respondents Should Be Awarded Attorneys' Fees and Costs on Appeal.

Respondents request that the Court award attorney fees and costs on appeal, pursuant to RCW 49.48.030 and RAP 18.1.

V. CONCLUSION OF RESPONDENTS' BRIEF

The trial court decision regarding Phase 1 should be affirmed in all respects.

BRIEF IN SUPPORT OF CROSS APPEAL

I. CROSS APPEAL: INTRODUCTION

The same legislation purporting to repeal gain-sharing, EHB 2391, granted new pension benefits to Plans 1, 2 and 3. Members of Plans 2 and 3 received improved Early Retirement Reduction Factors (ERRFs) permitting early retirement for qualified members with either no or a reduced penalty to their pension benefits. Plan 1 members received an adjustment to the annual Uniform Cost of Living Allowance (UCOLA). The legislation referred to these as “replacement benefits.” However, since Plan 2 members never had gain-sharing as a pension benefit, the new ERRFs were “new benefits” for them.²⁸⁰

EHB 2391 contained provisions stating that if the repeal of gain-sharing was invalidated, these replacement benefits, including the “new benefits” for Plan 2, would be automatically repealed.²⁸¹

²⁸⁰ The Cross Appeal only concerns the ERRFs for Plan 2 members.

²⁸¹ The automatic repeal provisions do not take effect until a “final” determination reinstating gain-sharing.” Presumably, that will be the issuance of this Court’s mandate.

Not only was repeal unnecessary to keep the pension system flexible or to maintain its integrity, allowing the automatic repeal is inconsistent with *Bakenhus v. City of Seattle*²⁸² because Plan 2 employees receive absolutely no benefit to replace the loss of the ERRFs. Because the automatic repeal provisions have the same effect as the ROR relied upon to repeal gain-sharing, they are similarly ineffective pursuant to *Navlet v. Port of Seattle*.²⁸³

II. CROSS APPELLANTS' ASSIGNMENTS OF ERROR

A. *Assignments of Error*

1. The trial court erred in dismissing the employees' claims that EHB 2391 unconstitutionally impaired the pension contracts of Plan 2 members.²⁸⁴
2. The trial court erred in denying employees' motion for summary judgment that EHB 2391 unconstitutionally impaired the pension contracts of Plan 2 members.

B. *Issues Pertaining to Assignments of Error*

1. Whether the automatic repeal language in EHB 2391 is effective to permit repeal of the new pension benefits [the ERRFs] for Plan 2 members?
2. Whether the sections in EHB 2391 purporting to repeal the new

²⁸² 48 Wn.2d at 698.

²⁸³ 164 Wn.2d at 848.

²⁸⁴ Automatic repeal provisions for Plan 2 were contained in §§2(3)(b)[TRS], §6(3)(b)[SERS], §9(3)(b)[PERS], §15 [TRS and SERS] and §16 [PERS]. CP 241-58.

benefits [the ERRFs] unconstitutionally impair the pension contracts of Plan 2 members?

III. CROSS APPELLANTS' STATEMENT OF THE CASE

A. STATEMENT OF PHASE TWO PROCEEDINGS.

The parties filed cross motions for summary judgment regarding the constitutionality of the provisions in EHB 2391 automatically repealing the “replacement” benefits. The trial court granted the State’s motion for summary judgment and dismissed employees’ claims.²⁸⁵ The court held that: (1) the contingent repeal provisions were effective; and (2) the automatic repeal did not unconstitutionally impair the employees’ pension contracts.

The Plan 2 class certified in Phase Two was “all Plan 2 members who performed any service for a Plan 2 employer between July 22, 2007 [the effective date of EHB 2391] and the date of legal certainty regarding Phase 1 [this court’s mandate reinstating gain-sharing].”²⁸⁶

B. STATEMENT OF FACTS.

1. Plan 2 Provisions.

PERS, TRS and SERS members have a Plan 2 defined benefit retirement plan similar to Plan 1.²⁸⁷ Plan 2 provides retirement benefits

²⁸⁵ CP 6488-99.

²⁸⁶ CP 5215.

²⁸⁷ Major differences between Plans 1 and Plans 2 are: (1) the contribution rate of Plan 1 members is fixed whereas the Plan 2 rate varies and is borne equally by employees and employers; and (2) the amount of the pension benefit for Plan 2 is generally lower than for Plan 1 because under Plan 2, it is computed based on the employee’s five year “average final compensation” instead of the two years used for Plan 1.

for employees hired after 1977 who did not transfer to Plan 3 or who are not otherwise members of Plan 3.²⁸⁸ Gain-sharing was granted to Plan 1 and Plan 3 members, but not to members of Plan 2.

2. New benefits granted to Plan 2 members.

While repealing gain-sharing for Plans 1 and 3, EHB 2391 granted new pension benefits to members of Plans 1, 2 and 3. The legislation described these new benefits as “replacement benefits” to compensate for the repeal of gain-sharing.²⁸⁹ The new ERRF benefits for Plan 2 members allow Plan 2 members with 30 years of service to retire at age 62 until age 65 with no penalty and those from age 55 until age 62 to retire with a reduced penalty.²⁹⁰

The Legislature included language directing the automatic repeal of the ERRFs upon the occurrence of a condition, thereby reinstating the previous penalties for early retirement²⁹¹ for those who had not exercised the ERRFs by the effective date of the automatic repeal. The specific language provided:

The new benefits provided... will not become a contractual right thereafter if the repeal of chapter 41.31A RCW [Gain-sharing] is held to be invalid in a final determination of a court of law.²⁹²

If the repeal of chapter 41.31A RCW is held to be invalid in a final determination of a court of law, and the court orders reinstatement

²⁸⁸ See, App. Br., at notes 2 and 4.

²⁸⁹ CP 241-55. CP 1058. CP 5286-87. Replacement benefits provided to Plan 1 and Plan 3 members are not addressed in this Cross Appeal. See Resp. Br. at 43-44.

²⁹⁰ EHB 2391 §§2(3)(b)[TRS 2], 6(3)(b)[SERS 2], 9(3)(b)[PERS 2]. CP 5298.

²⁹¹ Pre-existing early retirement provisions had an actuarial reduction of 3 percent per year for employees retiring before age 65.

²⁹² EHB 2391, §§15 and 16. CP 258.

of gain-sharing or other alternate benefits as a remedy, then retirement benefits for any member who has completed at least thirty service credit years and has attained age fifty-five but has not yet received the first installment of a retirement allowance under this subsection shall be computed using the reduction in (a) [the pre-existing, more severe, reductions to retirement benefits] of this subsection.”²⁹³

3. Value of new benefits to Plan 2 members with 30 years of service.

Employees who utilized the new ERRFs and retire at age 62 would receive 100 percent of their retirement benefit instead of having to wait until age 65 to receive the same pension benefit.²⁹⁴ Without the new ERRFs, the same employee would be penalized and only receive 91 percent of that amount at age 62. Early retirement benefits were also increased by 9 to 10 percent for Plan 2 members aged 55 to 62.²⁹⁵

Another way to measure the value of the ERRFs is the \$130 million in additional contributions paid by Plan 2 employees through 2011 to fund the ERRFs,²⁹⁶ and the projected cost for the 2011-13 biennium of \$239 million.²⁹⁷

Under the trial court’s Phase 2 ruling, Plan 2 members would lose the benefit of the ERRFs granted in EHB 2391.

²⁹³ EHB 2391 §§2(3)(b)[TRS 2], 4(3)(b)[TRS 3], 6(3)(b)[SERS 2], 8(3)(b)[SERS 3], 9(3)(b)[PERS 2], 10(3)(b)[PERS 3]. §§2(3), 6(3) and 9(3) concern Plan 2. CP 241-55.

²⁹⁴ CP 1053-1072.

²⁹⁵ CP 1065. See CP 5894-95 for a table comparing the pre-existing reductions (“Existing ERF”) and the reductions after EHB 2391 (“New 2008 ERF”).

²⁹⁶ CP 1379.

²⁹⁷ CP 5420-21, Opinion 2.

4. Health of Plans 2/3 with the new ERRFs.

The funding status of Plan 2/3²⁹⁸ does not necessitate repeal of the new ERRFs. The cost of the new ERRFs does not jeopardize the integrity of the pension system,²⁹⁹ even when the cost of restoring gain-sharing is included.³⁰⁰ An April 2011 Pew Report notes that at 99 percent, the Washington Retirement Systems are the third best funded of all fifty states.³⁰¹

State Actuary Smith concluded, in an August 31, 2011 memorandum, that the funded status³⁰² on an actuarial basis, of PERS Plans 2/3, with both restoration of gain-sharing *and* continuation of the “replacement” benefits, is 112 percent while it is 105 percent for SERS Plan 2/3 and 109 percent for TRS Plan 2/3.³⁰³ Since these calculations include the cost of the new ERRFs for Plan 3, the funded status would be even higher if the new ERRFs continued for only Plan 2 members. Actuary Alan Stonewall agrees that there is no threat to the fiscal integrity of the plans or to the state pension system as a whole by both continuing to pay for the new

²⁹⁸ Plan 2 and Plan 3 are a combined fund. App. Br. at p. 5.

²⁹⁹ In the trial court, the State attempted to obfuscate the issue that the plan itself is sound by focusing on the general state of the economy and the State’s general fiscal condition at the time of trial. Neither has any relationship to the legal requirements necessary to modify a pension benefit: whether the pension system at issue is sufficiently flexible and/or whether those plans have adequate financial integrity at the time of the modification. *Bakenhus*, 48 Wn.2d at 701-702.

³⁰⁰ CP 5422-24, 5426-27, 6308-09, 6318.

³⁰¹ CP 6314, 6351. The Pew Report of February 2010 confirms the 100 percent funded status. CP 5773.

³⁰² See Actuary Smith’s definition of actuarial health and funded status, CP 6031-32.

³⁰³ CP 6318. http://osa.leg.wa.gov/Actuarial_Services/Publications/PDF_Docs/Pension_Studies/2011EESCombinedReports.pdf. See also Smith’s October 18, 2011 “State of the State’s Pensions” confirming these calculations. CP 6315.

ERRFs and restoring gain-sharing.³⁰⁴

5. Plan 2 members' work and contributions while new ERRFs in place.

In addition to working for the new benefits, every Plan 2 member paid the cost of the new benefits for both themselves and for Plan 3 members through increased contribution rates.³⁰⁵ The State admits this.³⁰⁶

Plan 2 members have already paid at least \$130.1 million for the ERRFs: during 2007-09 and 2009-2011 biennia, members of PERS 2 paid \$108.1 million, TRS 2 members paid \$16.0 million and SERS 2 members paid \$6.0 million.³⁰⁷ Plan 2 members have continued to pay since then. If the automatic repeal is implemented, Plan 2 members who have not yet retired will receive no benefit from these contributions.

IV. BRIEF SUMMARY OF THE CROSS APPEAL ARGUMENT

Plan 2 employees have worked, and have paid millions of dollars in higher contribution rates, expecting to receive the new ERRFs if otherwise eligible.

The automatic repeal of the new ERRFs, is similar to the reservation of rights in Phase One (gain-sharing), and is equally ineffective because it unconstitutionally eliminates promised deferred compensation for services and contributions already provided to the employer.

The right to the ERRFs is therefore part of the Plan 2 employees'

³⁰⁴ CP 6350, citing CP 6315 and 6318.

³⁰⁵ Plan 2 and Plan 3 are a combined fund. Plan 2 employee rates vary and equal the rate paid by the employer. Employer contributions solely fund Plan 3. App. Br. at p. 5, fn. 4.

³⁰⁶ CP 5998, note 45.

³⁰⁷ CP 1379, 6310.

pension contract. Their automatic repeal unconstitutionally impairs the employees' contract rights because: (1) the repeal was not necessary to preserve the flexibility and financial integrity of the retirement system; and (2) once repealed, the new benefits will not be replaced by any new benefit.

V. CROSS APPEAL ARGUMENT

A. THE AUTOMATIC REPEAL LANGUAGE IS INEFFECTIVE.

1. Automatic Repeal Language Cannot Be Used to Deny a New Pension Benefit After the Employee Has Performed Service.

The trial court held that the language in EHB 2391 automatically repealing the new ERRFs³⁰⁸ is valid because it is in the same legislation granting them³⁰⁹ and because that legislation gave employees actual or constructive knowledge of their contingent nature.³¹⁰ The court's focus was misplaced, however, and such a contingency in pension legislation is not effective in Washington, just as a reservation of rights in pension legislation is ineffective in Washington. *Navlet v. Port of Seattle*.³¹¹

The *Navlet* court plainly held that it "cannot give effect" to reservation of rights language purporting to reserve the right to repeal a pension

³⁰⁸ See *supra* note 284.

³⁰⁹ CP 6490-91.

³¹⁰ DRS did not include any information concerning the contingent nature of the benefit in any of its publications until at least two years after the legislation took effect. CP 5891 ¶3. A pension benefit is not dependent upon employees' knowledge. *Dorward* 75 Wn.2d at 483.

³¹¹ 164 Wn.2d at 848. Because the effect of the language automatically repealing the new ERRFs and the Legislature's exercise of the reservation to repeal gain-sharing is identical -- the elimination of an expected pension benefit -- Cross Appellants incorporate the argument regarding the ineffectiveness of the gain-sharing ROR made by Respondents in Phase One. See Resp. Br. at 24-26.

benefit even though it is “aboriginal” [part of the grant].³¹² The court reasoned that an employer cannot enjoy the continued service that was elicited by its promise of retirement benefits and simultaneously reserve the potential elimination of the benefit after the employee provides the service the benefit is intended to induce.³¹³

This same reasoning applies to a provision purporting to automatically repeal a benefit upon the fulfillment of a certain condition, particularly when, by the time the event will have occurred, the employer will have already received the benefit of the employees’ service.

Here, the trial court ruled to the contrary, saying the contingency was: an objectively ascertainable event that does not depend for its occurrence on the discretion of the employer and which would necessarily occur or not occur within a limited and ascertainable period of time.³¹⁴

However, the rule in *Navlet* protects against such arbitrary provisions as the automatic repeal provision in EHB 2391. Whether a lawsuit would even be filed, much less the date on which there would be finality in any litigation regarding the repeal of gain-sharing, was uncertain and impossible to predict. It is unfair and arbitrary that Plan 2 members eligible for the new ERRFs prior to this random date can take advantage of them, while those who have worked an identical amount or more, and who have contributed millions of dollars to their cost but will not have

³¹² *Navlet v. Port of Seattle*, 164 Wn.2d at 848 citing *Jacoby v. Grays Harbor Chair & Mfg. Co.*, 77 Wn.2d 911, 468 P.2d 666 (1970). In *Navlet*, the plan documents contained the reservation.

³¹³ *Id.*

³¹⁴ CP 6490.

reached their 62nd birthday or 30 years of service by the “date of finality,” cannot take advantage of these benefits. And those between ages 62 and 65 with 30 years of service who are currently eligible to take advantage of the ERRFs, but choose to work longer, may lose the right.

The reasonable expectations of the employee are comparable whether the reservation is based on the possibility of a future legislative act (as with the exercising of the reservation in the gain-sharing legislation) or a judicial act. The employee in either case has worked, expecting to receive the benefit (in this case the right to retire early with no penalty) and the employee’s right to the benefit vested as soon as work was performed with such an expectation.³¹⁵

The effect in either case is also exactly the same. Implementation of either the Reservation of Rights (ROR) or the automatic repeal provision, acts to cut off benefits that have been earned by working. Simply put, it is unconstitutional for the State to retroactively modify its contracts after the work has been performed regardless of the mechanism used.³¹⁶ This principle has guided Washington law protecting pension rights, from *Bakenhus* to *Navlet*.

³¹⁵ The trial court erroneously relied upon *Federated American Ins. Co. v. Marquardt*, 108 Wn.2d 651, 658, 741 P.2d 18, 23 (1987) citing *Minish v. Hanson*, 64 Wn.2d 113, 115, 390 P.2d 704 (1964) for the proposition that a contract is not considered impaired by a statute or regulation in force when the contract was made, since it is presumed that the contract was made in contemplation of existing law. CP 6490. However, those cases are not pension cases and do not involve the concept of deferred compensation: that the retirement benefit is earned when the work is performed and cannot later be withdrawn without unconstitutionally impairing the contract.

³¹⁶ Even in the non-pension context, retroactive reduction in compensation for services already provided is an absurdity *Caritas*, 123 Wn.2d at 407. *See also* Resp. Br. at 45-46.

The *Bakenhus* rule was created to “give[] effect to the reasonable expectations of the employee” who worked with the expectation of certain retirement benefits.³¹⁷ The *Navlet* court explained, contrary to the trial court ruling, that the *Bakenhus* analysis focuses “on the expectations of the employee at the time retirement benefits are conferred, rather than the express language of the contract,³¹⁸ to determine whether retirement benefits are vested.”³¹⁹

Navlet also reaffirmed the statement in *Jacoby*³²⁰ that a reservation of rights provision in a pension agreement will be given no effect because it would enable an employer to avoid paying deferred compensation for work already performed.³²¹ The same is equally true for the automatic repeal provision regarding the new ERRFs.

2. Plan 2 Members’ Right to Deferred Compensation (the New ERRFs) Does Not Depend on Legislative Intent.

Although the trial court focused on the Legislature’s intent that employees receive either gain-sharing or the new benefits, but not both,³²² under *Navlet*, the intent of the employer is not controlling – or even

³¹⁷ 48 Wn.2d at 701.

³¹⁸ The automatic repeal language in EHB 2391, §§15 and 16 (CP 258) is also unenforceable because it is ambiguous. *Caritas*, 123 Wn.2d at 406 (reservation of powers clause ambiguous and not enforceable). By stating that the legislature has the right to abolish the ERRFs before July 2008, it is not clear whether the automatic repeal language can be exercised subsequent to July 2008 when the date of “a final determination in a court of law” is subsequent to July 2008.

³¹⁹ 164 Wn.2d at 835. i.e. They vest from the date of employment. *See, e.g., Marysville v. State*, 101 Wn.2d 50, 57-61, 676 P.2d 989 (1984); *Crabtree* 101 Wn.2d at 557.

³²⁰ 77 Wn.2d at 915.

³²¹ 164 Wn.2d at 848.

³²² CP 6489.

relevant – to the analysis.³²³ The right to receive retirement benefits is protected, even if the reservation of rights language indicates the employer did not intend to be bound. The *Navlet* court explained that it could not give effect to a reservation of rights because to do so would be inconsistent with the employee having acquired vested rights in the benefits by having accepted employment (i.e. working).³²⁴ Consistent with this statement, the court held that, regardless of the reservation of rights language, the right to deferred compensation vested when the employee rendered the required service.³²⁵

This is consistent with the rule that a statute may not be given retroactive effect regardless of the intention of the legislature, where the effect would be to interfere with vested rights.³²⁶ That rule controls here, where giving effect to the automatic repeal provision would defeat Plan 2 members' vested right to the new ERRFs.

3. Giving Effect to the Automatic Repeal Provisions in EHB 2391 Would Make Public Employees Uniquely Disadvantaged Under Washington Law.

Long before the enactment of gain-sharing in 1998 with its reservation, or the granting of the new ERRFS with its automatic repeal provision in 2007, this Court stated in *Jacoby*³²⁷ that reservation of rights

³²³ 164 Wn.2d at 835. See Resp. Br. at 22-25 for a more complete recitation of Washington cases addressing this issue.

³²⁴ *Navlet*, 164 Wn.2d at 848.

³²⁵ 164 Wn.2d at 828, n.5, citing *Leonard v. City of Seattle*, 81 Wn.2d 479, 487, 503 P.2d 741 (1972).

³²⁶ *Gillis v. King County*, 42 Wn.2d 373, 376, 255 P.2d 546 (1953).

³²⁷ 77 Wn.2d at 915 (1970). This principle is affirmed by *Navlet*, *supra*.

language could not defeat an employee's right to retirement benefits after he had performed the required work.

If the reservation of rights clause, in the form of an automatic repeal provision, is given effect in this case, it would mean the probable insertion of such provisions in any legislation granting new pension benefits and the end of the *Bakenhus* doctrine, eviscerating the legal underpinnings and protections long embedded in Washington's public pension system. Such a result is inconsistent with the very nature of a pension. Thus, this Court should not give effect to the automatic repeal provisions.

B. REPEALING THE NEW ERRFs UNCONSTITUTIONALLY IMPAIRS THE PLAN 2 PENSION CONTRACTS.

1. Plaintiffs Established a Contractual Right to Receive the New Benefits by Performing Work (and Paying for Those Benefits) While the New Benefits Were in Effect.

Since the automatic repeal provision is invalid, Plan 2 members who performed work since EHB 2391's passage in 2007 and made contributions to pay for the benefits (ERRFs), have accepted the new benefits and are entitled to receive them as part of their pension contract, when they have 30 years in the system prior to age 65.³²⁸

2. Repeal of the new benefits would impair Plan 2 retirement benefits.

A contract is impaired by a statute which alters its terms, imposes new

³²⁸ *Bowles v. DRS*, 121 Wn.2d at 79; *Retired Public Employees Council of Wash. v. State*, 104 Wn. App. 147, 150, 16 P.3d 65, rev. den. 143 Wn.2d 1023 (2001); *Charles*, 148 Wn.2d at 624, citing *Bakenhus*, 48 Wn.2d at 698-99. See also *Campbell v. King County*, 38 Wn. App. 474, 685 P.2d 659 (1984).

conditions, or lessens its value.³²⁹ Automatic repeal of the new benefits clearly reduces the value of Plan 2 members' pension benefits.³³⁰ Employees retiring at ages 62, 63 and 64 will receive a benefit for retiring before age 65 without any penalty (reduction).³³¹ Under the pre-EHB 2391 ERRFs, at those same ages, employees are penalized and receive only 91 percent, 94 percent and 97 percent of their full, unreduced benefit payable at age 65.³³² Between ages 55 and 62, employees with 30 years of service will receive 9 to 10 percent more per year than they would receive without the ERRFs.³³³ The difference is a significant disadvantage and easily resolves the threshold issue of whether there is a substantial impairment.

3. The Repeal of the New Benefits Is Not Necessary to Maintain the Flexibility of the Retirement System.

Bakenhus and its progeny establish the clear test regarding modification of a public employee's pension contract.³³⁴ The purpose of the "flexibility" requirement is to assure that the retirement system can adapt to changing conditions:

[P]ension plans can be modified...to keep the system flexible enough to permit adjustments in accord with changing conditions and at the same time maintain the integrity of the system.³³⁵

³²⁹ *Wash. Fed'n of State Employees v. State*, 127 Wn.2d 544, at 563, 901 P.2d 1028 (1995).

³³⁰ The table in the parties' Stipulation (CP 5382) (in columns A and B) illustrates the difference in the retirement benefits for the class representatives retiring early with 30 years of service with and without the ERRFs.

³³¹ CP 1065, 5420.

³³² *Id.*

³³³ See table at CP 5894-95.

³³⁴ See sources cited *supra* note 106.

³³⁵ *Bakenhus*, 48 Wn.2d at 701.

The repeal of the new ERRFs is automatic upon re-instatement of gain-sharing for Plans 1 and 3 and independent of any determination by the Legislature of the fiscal need for the repeal or whether it is necessary to maintain the flexibility of the pension system.

There is no evidence to suggest a determination by the Legislature in 2007, when EHB 2391 was enacted, or at any other time, that the automatic repeal of the ERRFs for Plan 2 would be necessary to keep the system flexible if the repeal of gain-sharing was invalidated. Without any independent determination that repeal is necessary to maintain flexibility, the State cannot meet its burden of proof on this issue.³³⁶ Indeed, as previously demonstrated, the pension systems retain substantial flexibility.

4. The Repeal of the New Benefits Was Not Necessary to Maintain the Financial Integrity of the Retirement System.

The State also cannot establish that an automatic repeal of the new Plan 2 benefits (ERRFs) was necessary to maintain the financial integrity of the system.³³⁷ To do so, it must show that, at the time it adopted the automatic repeal provision in 2007, it determined that it would be necessary to take away the new benefits for Plan 2 members if the repeal of gain-sharing was invalidated at some future date.³³⁸

The State cannot meet this burden. In 2007, the retirement plans, and

³³⁶ *Id.*

³³⁷ Pension modification constitutes an unconstitutional impairment unless necessary to maintain the fiscal integrity of the system. *Bowles*, 121 Wn.2d at 65.

³³⁸ Of course, the State could have minimized the financial cost of the benefit by not making it a benefit for new employees hired after the effective date of the automatic repeal, as suggested in *Bowles, supra*. Cross Appellants' class certification is consistent with this approach.

particularly Plan 2, were financially healthy and far from needing intervention to preserve financial integrity. A DRS Briefing for the Governor in August 2006 stated: “Twelve of the 14 [retirement] plans [including all of the Plan 2s] are well-funded by Government Accounting Standards Board (GASB) standards against which governmental entities are audited.”³³⁹ Since then, the fiscal condition of Plans 2 has remained healthy³⁴⁰ as the State Actuary admits.³⁴¹

5. That Plan 2 Members Receive No Replacement Benefit for Loss of the ERRFs Renders the Repeal Unconstitutional.³⁴²

Any change in the pension system that results in disadvantages to an employee *must* also be offset by a corresponding benefit for that employee.³⁴³ Even if elimination of the ERRFs was necessary to maintain the flexibility and financial integrity of the retirement system, the change constitutes an unconstitutional impairment of contracts because Plan 2 members receive nothing when the new ERRFs are repealed.³⁴⁴ Retirement benefits that are increased for members of other Plans (Plans 1 and 3) cannot be utilized to offset the disadvantages to Plan 2 members.³⁴⁵

³³⁹ CP 1355. See also *supra* note 301.

³⁴⁰ See, e.g., CP 5418-5427; 5773; 5720.

³⁴¹ CP 6315; 6318; 6319-13.

³⁴² Plans 1 and 3 will get the gain-sharing benefit restored, but Plan 2 never had gain-sharing.

³⁴³ *Bakenhus*, 48 Wn.2d at 702; *Bowles*, 121 Wn.2d at 65, citing *Washington Fed'n of State Employees v. State*, 98 Wn.2d at 683-84.

³⁴⁴ The State's argument that contribution rates will be lowered in the future and is therefore a benefit is disingenuous. If this were the law, the State could always argue that employees will not have to pay for a benefit in the future any time it wanted to take away a benefit.

³⁴⁵ *Bakenhus*, 48 Wn.2d at 703.

The trial court erred in concluding that increased funding of the system from prior contributions, and the possibility of lower contribution rates in the future might constitute an adequate replacement benefit.³⁴⁶ The trial court's opinion also ignores the fact that all Plan 2/3 funds are already more than 100 percent funded.³⁴⁷

The ruling also failed to consider that the savings associated with not paying the employees' half of the cost of the new ERRFs (the employers pay the other half) is not comparable to the value of exercising the right to the new ERRFs. Plan 2 members have lost the entire value of the ERRFs, but saved only their half of the cost. In addition, the trial court's decision fails to consider that employees who are closest to retiring under the new ERRFs will leave employment before receiving the "benefit" from any reduced employee contribution rate.

Without any replacement benefit for the loss of the new ERRFs, the provisions repealing them constitute an unconstitutional impairment of Plan 2 employee's pension contracts.

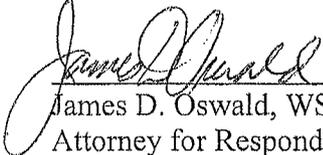
VI. CONCLUSION OF CROSS APPELLANTS' BRIEF

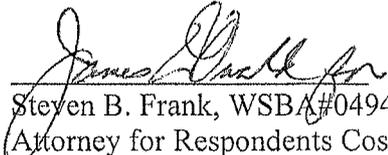
This Court should not give effect to the automatic repeal provisions of EHB 2391 because to do so would unconstitutionally impair Plan 2 members' pension contract rights to the new ERRFs.

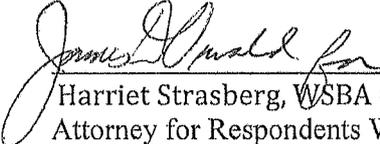
³⁴⁶ The trial court stated: "Those contributions will remain as a credit to the overall system and ultimately either reduce the level of contributions required to maintain the system or lessen the need for future increases. It is not a perfect correlation on an individual basis, but the higher assessments will ultimately benefit the system as a whole and all of its members by its contribution to the overall funding of the plan." Order Denying Plaintiffs' Motion, p. 3 at lines 17-18. CP 6490.

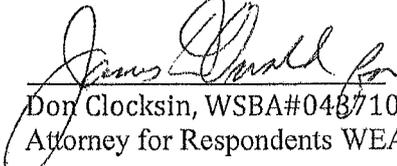
³⁴⁷ See *supra* note 301.

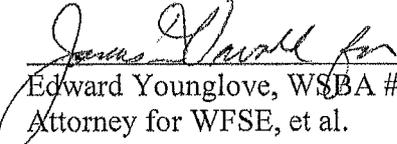
RESPECTFULLY SUBMITTED this 28th day of February, 2013.


James D. Oswald, WSBA #11720
Attorney for Respondents Costello


Steven B. Frank, WSBA #04944
Attorney for Respondents Costello


Harriet Strasberg, WSBA #15890
Attorney for Respondents WEA, et al


Don Clocksin, WSBA #048710
Attorney for Respondents WEA, et al

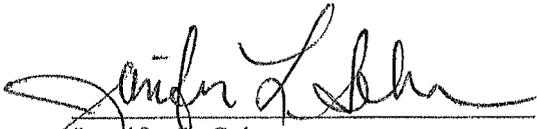

Edward Younglove, WSBA #05873
Attorney for WFSE, et al.

CERTIFICATE OF SERVICE

I certify under penalty of perjury in accordance with the laws of the State of Washington that the original of the preceding Respondents' Brief and Cross Appellants' Brief was filed by electronic mail with the Washington State Supreme Court. I also certify that a copy of the same was served via Electronic and United States First Class Mail to the following:

Anne E. Hall
Spencer W. Daniels
Sarah E. Blocki
7141 Cleanwater Drive SW
Olympia, WA 98504

Executed this 28th day of February, 2013, at Seattle, Washington.


Jennifer L. Schnarr
Paralegal

OFFICE RECEPTIONIST, CLERK

To: Jennifer Schnarr
Cc: James D. Oswald; clocksinlaw@qwestoffice.net; Steve Frank (sfrank@frankfreed.com); hstrasberg@comcast.net; edy@ylclaw.com; anneH@atg.wa.gov; spencerD@atg.wa.gov; sarahB@atg.wa.gov
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Supreme Court Clerk –

Please find attached the Respondent's Brief and Cross Appellant's Brief in *WEA, et al. v. WA State DRS*, Supreme Court Case No. 87427-7. I am the paralegal for the filing attorney, James Oswald, whose information is as follows:

James D. Oswald
WSBA# 11720
Schwerin Campbell Barnard Iglitzin & Lavitt, LLP
18 W Mercer Street, Suite 400
Seattle, WA 98119
206-285-2828
Oswald@workerlaw.com

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Sincerely,

Jennifer L. Schnarr

Jennifer L. Schnarr | Legal Secretary/Paralegal | Schwerin Campbell Barnard Iglitzin & Lavitt LLP | 206.257.6018 | www.workerlaw.com | schnarr@workerlaw.com

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