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87424-7

SUPREME COURT
OF THE STATE OF WASHINGTON

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

Respondents/Cross-Appellants,

v.

STATE OF WASHINGTON and DEPARTMENT OF RETIREMENT SYSTEMS,

Appellants/Cross-Respondents,

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

Respondents,

v.

STATE OF WASHINGTON and DEPARTMENT OF RETIREMENT SYSTEMS,

Appellants,

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

Respondents/Cross-Appellants,

v.

STATE OF WASHINGTON and DEPARTMENT OF RETIREMENT SYSTEMS,

Appellants/Cross-Respondents.

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ORIGINAL

WSAC'S *AMICUS CURIAE* BRIEF
IN SUPPORT OF THE STATE OF WASHINGTON

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I. INTRODUCTION[1]

Respondents in these companion cases ask the Court to hold that alleged employee expectations, which are inconsistent with explicit statutory language, should trump clear statutory language reserving the Legislature's right to amend or repeal enhancements to pension benefits as well as the valid expectations of taxpayers and public employers. The Court should decline.

Respondents challenge the Legislature's 2007 repeal of future gain-sharing increases and its 2011 repeal of a future uniform cost of living adjustment (referred to as "UCOLA"). When the Legislature enacted these pension enhancements, both statutes contained a reservation of rights explicitly allowing the Legislature to cancel future benefit enhancements through amendment or repeal of the enabling legislation. The subsequent repeal of these pension enhancements did not remove accrued benefits, but rather ended the obligation of public employers to fund future increases that were never guaranteed. It did so at a time when extension of these enhancements would have threatened funds available for basic public services and primary pension obligations.

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[1] In the interest of efficiency for the Court and all parties involved, WSAC is filing a single amicus brief to raise its concerns with both the "UCOLA" and "gain-sharing" cases currently before the Court, under cause numbers 88546-0 and 87424-7, respectively. Because there are two sets of clerk's papers for these separate cases, all citations to the record in Cause No. 88546-0 will have the notation (UCOLA) after the CP number.

This litigation has wide public import and significant economic consequence. The effects of the Court's ruling here will not only have an immediate and significant fiscal impact on public employers, and taxpayers, but will impact the ability of state and local government to legislate future benefits for their employees. If a reservation of rights clause cannot be relied on to effectuate the Legislature's clear intent, public employers will be reticent, if not completely unwilling, to expand pension benefits in the future.

II. INTERESTS OF AMICUS CURIAE

The Washington State Association of Counties (WSAC) is a non-profit association whose membership includes elected county commissioners, council members and executives from all of Washington's 39 counties. WSAC also serves as an umbrella organization for affiliate organizations representing county road engineers, local public health officials, county administrators, emergency managers, county human service administrators, clerks of county boards, and others. Because of the potential impact of the Court's decision on its members, WSAC has a strong interest in the outcome of this case.

III. ISSUES PRESENTED FOR REVIEW

1. Whether the trial court erred in concluding that the Legislature's repeal of future gain-sharing and UCOLA distributions,

pursuant to explicitly reserved statutory authority, violated the Washington State Constitution's Contracts Clause.

2. Whether the trial court erred in concluding that the gain-sharing and UCOLA legislation created a contractual right, despite the clear reservation of rights to amend or repeal and explicit statutory disclaimer of contractual rights, and requires continued public employer funding of the repealed benefits.

3. Whether the trial court erred in concluding that the Legislature lacks authority to reserve the right to terminate pension enhancements where such reservation is adopted as part of the establishing legislation and clearly disclaims creation of any contractual rights.

IV. STATEMENT OF THE CASE

WSAC incorporates by reference the factual discussion of the relevant legislative history presented in the Appellants' Opening Briefs in the gain-sharing and UCOLA cases. WSAC provides the following factual discussion to emphasize and supplement the Appellants' briefing.

A. Gain-sharing

When the Legislature considered adoption of a gain-sharing provision to supplement existing pension benefits for certain public employees, this type of pension benefit was new and largely untested. Because it was uncertain how this pension enhancement would work out

over time, the Legislature took the extra cautionary step to protect both public employers' and public employees' interest in a fiscally sound pension system by reserving the right, within the enabling legislation, to amend or repeal the gain-sharing benefit in the future. CP 1619.

The Legislature had, on other occasions, included such reservations of rights where it was uncertain what the future cost would be and it was unclear if the new benefit would be financially sustainable when adopted. CP 1618-19. The ability to confer new benefits with the option of amending or repealing those benefits in the future if they turn out to be financially unsustainable provides the best of both worlds: immediate benefits to public employees and long-term financial security for public employers. This statutory process allows *all parties* to be on notice of the limitations and obligations of the benefit structure.

The reservation of rights in the gain-sharing statute was explicit: it established both the Legislature's right to amend or repeal gain-sharing, and declared that the statute did not create a contractual right to any future gain-sharing distribution that was not granted prior to the statutes' amendment or repeal. The language is unambiguous:

> [Plan 1] 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.

> [Plan 3] The legislature reserves the right to amend or repeal this section in the future and no member or beneficiary has a contractual right to receive this distribution not granted prior to that time.

Former RCW 41.31.030 (2006) (Repealed by 2007 c 491 § 13, effective January 2, 2008). (Plan 1); former RCW 41.31A.020(4) (as amended by 2007 c 491)., .030(5), .040(5) (2006) (Plan 3).

Ultimately, gain-sharing proved to be unduly costly for public employers who, in a declining economy, were left to cover the costs of gain-sharing events through higher employer contribution rates. The cost to public employers if gain-sharing was reinstated is estimated at $3.364 billion dollars over 25 years. CP 1699-1702, 5886-89, 5935-40, 5941-71, 5972-76, 6172-6226. Repeal of the gain-sharing statute directly avoided further cuts to basic public services. *See discussion infra*, at 7, 17.

B. UCOLA

The 1995 legislation adopting a UCOLA for Plan 1 members granted an annual, defined enhancement to the basic retirement allowance. The "U" in front of the "COLA" is significant. Prior to 1995, cost of living adjustments were *ad hoc* increases to pension benefits that varied in frequency and amount. CP 605 (UCOLA); CP 560-597 (UCOLA). The UCOLA created a more reliable framework for employees and a more determinate process for public employers.

However, like the prior *ad hoc* increases, the UCOLA was not permanent. The Legislature expressly reserved discretion to repeal the UCOLA and declared that no contract right was created by its adoption:

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

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

The Legislature cancelled future UCOLA increases in 2011, reverting to a system that would use *ad hoc* legislation for any future cost of living adjustments. Laws of 2011, ch. 362, §§ 3, 6; RCW 41.32.489(1); RCW 41.40.197(1). Notably, there was no revocation of UCOLA increases that had already been granted. Those prior increases will indefinitely remain part of monthly retirement allowances.

The UCOLA repeal was necessitated by extraordinary declines in public employers' financial resources. CP 622 (UCOLA); CP 5972-5976. If the UCOLA had remained in place, those benefit distributions would have come at the expense of public services and, ultimately, stable funding for basic pension benefits. CP 702 (UCOLA); CP 628 (UCOLA). Between 2011 and 2013, the UCOLA would have cost local government employers over $370 million dollars and approximately $3.3 billion over

the next 25 years. CP 707-08 (UCOLA). This would have caused immediate and direct cuts in essential public services. CP 5972-5976.

C. Key Characteristics of the UCOLA and Gain-sharing Statutes

In both the UCOLA and gain-sharing cases, the relevant statutes created a pension benefit enhancement with the following relevant characteristics: the benefit (1) was created by a statute that explicitly reserved the Legislature's right to repeal or amend the enhancement; and (2) was supplemental to existing, primary pension benefits.

D. Public Employer Hardships

In the past decade, the national economy has reached a point of crisis, and state and local governments have been significantly impacted by this downturn. As investment returns and tax receipts have plummeted, so has the ability of public employers to fund essential public services. Public employer contributions to fund pension plans come at a direct cost to other public services. CP 5972-76. Lay-offs, increased tax rates, and steep cuts to basic public health services have become the norm as counties struggle to continue to fund the programs required by the state and needed most urgently by their taxpayers. CP 5862-75 (listing "Coping Actions by Local Government"). In Clark County, for example, cuts to the Department of Health resulted in significant reductions in staff for Child Protective Services, vaccinations and drug treatment. CP 5888.

V. ARGUMENT

A. The gain-sharing and UCOLA statutes do not create a contract.

The fundamental dispute here is whether public employees have a contractual right to continued enhanced benefit distributions under the UCOLA and gain-sharing statues. Neither the express language of the statutes, nor the fact of public employment after their effective date, creates a contract. Without a contract, there is no obligation to reinstate future gain-sharing or UCOLA pension enhancement benefits.

1. The Legislature did not establish a permanent right to future distributions of enhanced benefits under the UCOLA or gain-sharing statutes.

Article I, section 23 of the Washington Constitution sets forth the Contracts Clause. To determine whether this constitutional provision has been violated, the Court first asks whether "a contractual relationship exists[s]." *Washington Fed'n of State Employees v. State*, 127 Wn.2d 544, 561, 901 P.2d 1028, 1037 (1995).

Washington law disfavors finding that a statute creates contractual rights. "Under very limited circumstances a statute may be treated as a contract: when the statutory language and the circumstances establish a legislative intent to create rights contractual in nature which are enforceable against the State." *Noah v. State*, 112 Wn.2d 841, 843-44, 774 P.2d 516, 517 (1989), citing *Washington Fed'n of State Employees*

Coun. 28 v. State, 101 Wn.2d 536, 539 (1984). Where a statute may be amended in the future, it does not create an enforceable contract. "If a statute is subject to full legislative control by future amendments and repeals, the statute declares policy to be pursued until the Legislature ordains otherwise, in contrast to creating contractual or vested rights." *Id.*

This framework is still the proper vehicle for determining contractual rights in the context of pension benefits. *Retired Public Employees Council of Washington v. Charles*, 148 Wn.2d 602 (2003). "The fact that state employees' pension rights have some characteristics of a contract does not make the statute a contract...*Bakenhus* never held that a public retirement statute in and of itself constitutes a complete contract. In fact there is no statutory analysis in *Bakenhus*." *Noah,* at 844.

In *Bakenhus v. City of Seattle*, 48 Wn.2d 695, 296 P.2d 536 (1956), the Washington Supreme Court held that a pension was deferred compensation earned by a public employee by accepting and retaining public employment, not a gratuity that could be changed at whim by the Legislature. *Bakenhus*, at 698-700. The Court held that the public employer offered a pension with finite terms through the statute establishing the pension, and the employee accepted the offer by accepting and retaining public employment.

The reasoning of *Bakenhus*, however, has no application in either the UCOLA or gain-sharing cases. The explicit statutory language and the legislative intent of both the gain-sharing and UCOLA statutes make it clear that they created no contractual right. The language in the "reservation of rights" clauses in each statute explicitly and unambiguously retains full legislative control to amend or repeal the gain-sharing and UCOLA benefits that have not accrued at the time of the amendment or repeal. *See supra*, at 5-6. The legislative intent of these statutes is equally straight-forward. The Legislature included the option of repeal or amendment to address the uncertain long-term financial viability of the benefit enhancements. CP 1619. There is no basis for a court to imply a prohibition on amending or repealing these statutory pension enhancements when the Legislature has explicitly provided that these enhancements may be modified or repealed.

Modification of a basic pension right, where no such modification right has been reserved, presents a far different question than amendment or repeal of an experimental pension enhancement where the right to amend or repeal the enhancement has been explicitly reserved. There is no doubt that the Legislature can limit the duration of a pension enhancement as they have done many times in the past. CP 605; CP 560-597.

Analytically, there is no difference between the Legislature providing that a uniform COLA shall be in effect for five years and the Legislature providing that a uniform COLA shall be in effect unless and until it is modified, which modification occurs five years after the original enactment. The authority of the Legislature to limit the duration of a pension enhancement, as well as the practical effect on public employees, is the same in either case.

Any argument that the lack of a definite end date creates a reasonable expectation among affected employees that the enhanced benefit will continue in perpetuity is logically unavailing. As described more fully below, an employee cannot reasonably rely on receiving a benefit enhancement in perpetuity when the Legislature has explicitly provided that the enhanced benefit may be modified or repealed in the future. Under such circumstances, an expectation that enhanced benefits will continue in perpetuity is patently unreasonable.

Whether a statutory contract exists is the only question the Court needs to consider to assess whether the Contracts Clause has been violated here. In both cases, the answer here is no. There is no contractual right established where enabling legislation disclaims such a right and contains an express reservation of rights to amend or repeal the benefit. There is no doubt that the Legislature has authority to provide pension enhancements

of limited duration. That is exactly what it has done in these cases, and there is no basis for this Court to imply a result different than the Legislature has explicitly provided.

2. A contractual right was not created by virtue of being a public employee while the gain-sharing and UCOLA statutes were in effect.

Respondents assert that the Court should look beyond the clear statutory language and create a contractual relationship anytime public employers confer a pension benefit to public employees during their tenure. This is an unconvincing and over-broad application of the relevant cases.

Respondents rely primarily on *Bakenhus* and *Navlet* to support their argument. But these cases are distinguishable from the cases of first impression at bar. *Bakenhus* explains that once a contract is in place, a person has a "reasonable expectation" that the terms of the contract be performed. *Bakenhus*, 48 Wn.2d at 701; *see discussion supra*, at 9-10. In *Navlet*, the plaintiff was denied welfare benefits that were granted in a collective bargaining agreement (CBA) while he was an employee. *Navlet v. Port of Seattle*, 164 Wn. 2d 818, 841, 194 P.3d 221, 233 (2008). The benefits enumerated in the CBA were bargained for, comprised the entire package of retirement welfare benefits, and there was no reservation of rights contained in the CBA. These facts were pivotal in the Court's

decision. The Court examined the terms of the CBA and recognized that the CBA provided welfare benefits *without limitations*.[2] *Id.* at 842. The reasonable expectation of the plaintiff, therefore, was that the retirement welfare benefits would continue unchanged throughout his life.

These cases involve a fact specific analysis that must consider what is "reasonable" under the facts of the individual case. While prior decisions consider the ability of a public employer to eliminate pension benefits, they do not consider circumstances where the benefits were created by statute with a clear reservation of the right to amend or repeal and the benefits were supplemental to existing primary pension benefits. These factors, taken together, create a significantly different framework for review and render prior cases such as *Bakenhus* and *Navlet* inapposite.

In situations where a benefit is granted *without reservation*, it is predictable that the parties would have "reasonable expectations" that the benefit would continue indefinitely for those who are (or become) employees when the benefit is conferred. For example, in *Bakenhus*, the plaintiff was denied basic pension benefits that were established by statute, *without reservation*, while plaintiff was an employee. The plaintiff could look to the statutory language that existed when he was

[2] The Court made the critical point that "[i]f the Port wanted to limit its obligation to provide welfare benefits, then it could have insisted on limiting the right to retirement welfare benefits in the CBA itself." *Id.* at 849.

hired and expect that his pension benefits would be bound by those terms. The plaintiff's reasonable expectation was that the amount of his primary pension benefit would be commensurate with what the relevant statute established at the time he was hired. In *Navlet*, the expectation was even stronger where the welfare benefit was promised in a bargained for CBA.

In both *Bakenhus* and *Navlet*, the relevant benefits were granted without any indication that they could be revoked or modified in the future. These are not the circumstances here. The explicit language in the statutes reserving the right to amend or repeal in the future could not be clearer. The gain-sharing and UCOLA benefit enhancements could not be reasonably relied upon as indefinite benefits as the state retained the power to repeal these enhancement benefits at any time.[3]

A "reasonable person is deemed to know the law, or, as the old cliché puts it, 'ignorance of the law is no excuse.'" *Retired Pub. Employees Council of Washington v. State, Dep't of Ret. Sys.*, 104 Wn. App. 147, 152, 16 P.3d 65, 68 (2001). This duty to know the applicable law is specifically applicable in the context of pension benefits. *Id.*[4] The

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[3] As there was never a promise to provide gain-sharing and UCOLA benefits in perpetuity, there was no ability to vest to the benefit in perpetuity and consequently, no contractual right to continue to accrue these benefits after the statutes were repealed.

[4] Plaintiffs "knew they were members of PERS I; thus, a reasonable person in their shoes would have inquired into PERS I's benefits, including COLAs." *Retired Pub. Employees Council of Washington v. State, Dep't of Ret. Sys.*, 104 Wn. App. 147, 152 (2001).

statutory language at issue here expressly puts all interested parties on notice that the gain-sharing or UCOLA benefits may be repealed.

Thus, to the extent reasonable expectations are relevant, the calculus of determining what is a "reasonable expectation" changes under the distinct facts of this case. Employees cannot reasonably expect a benefit to continue forever where the statutory language explicitly establishes the opposite. An employee's "reasonable expectation" must take the reservation of rights language into consideration and should be circumscribed accordingly.

Moreover, if expectations are considered at all, the reasonable expectations of state and local government in adopting (or supporting) legislation that contains a clear reservation of rights are also relevant.[5] Public employers reasonably expected that they were protected against the possibility that these benefit enhancements would become both financially untenable and irrevocable. It is entirely plausible that public employers (and their constituent taxpayers) would have opposed adoption of these gain-sharing and UCOLA provisions but for the reserved right of the state to amend or repeal the benefits. Once adopted, public employers reasonably relied on the plain language of the statutes in supporting repeal

[5] Reservation clauses have been utilized and relied on by public employers in many pension statutes. CP 2144-145.

of the gain-sharing and UCOLA benefits to protect funding for the pension plans and basic public programs.

Additionally, if the trial court's position is confirmed, the likely result will be an unwillingness of local government to expand or modify benefits for employees in the future. Public employers will be less likely to "share the wealth" in good times if they are precluded from pulling back on those pay-outs (even where such a revocation is clearly embedded in the enabling legislation) when times are less prosperous.

Respondents' argument is essentially that the Legislature may not ever reserve the right to repeal a statute conferring a pension benefit. As discussed above, this argument steps well beyond the scope of *Bakenhus* and its progeny. From a practical standpoint, the *Bakenhus* decision successfully protects public employees from being denied benefits promised by statute. The subsequent case law, however, has taken this contract style analysis as far as it can go without nullifying the Legislature's right to legislate limitations on pension benefits.

Accepting Respondents' position would effectively mean that employees have a right to billions of dollars in benefits they were explicitly never promised, and it would negate the statutory language on which public employers and taxpayers have reasonably relied. Contracts have two parties and the state has not contracted to indefinitely provide

these enhancement benefits. The litigation at bar provides an opportunity for the Court to recognize that reasonable expectations have an end point. One cannot reasonably rely on the perpetual continuation of benefits that are conditionally granted.

B. Imposition of a contractual obligation to provide future benefits will result in immediate and detrimental impacts to essential public services and public employers' ability to adequately fund the basic pension systems.

As the Court is aware, state and local government has experienced dire financial circumstances in the past several years. As the economy has taken a hit, so has the ability of local government to provide essential public services. Counties throughout the state have been forced to take drastic measures such as implementing lay-offs, increasing tax rates and fees, shutting down courthouses and other government offices, and making direct cuts to primary services in public health and roads. CP 5862-875. In Clark County, for example, cuts to the Department of Health resulted in dramatic reduction in staff for Child Protective Services home visits, vaccinations and alcohol and drug treatment. CP 5889. Public employers have looked at every available option to facilitate the continuation of the most basic services and operational expenses.

All public employers pay employer contributions to cover the pension benefits of their employees. For example, in 2011, Clark County

paid $6.2 million into the PERS pension fund. CP 5889. King County's 2012 budget included $69.5 million in employer retirement contributions. CP 5976. These costs threaten to increase dramatically if gain-sharing and UCOLA benefits are reinstated.

Restoration of gain-sharing benefits would result in an $865 million increase in employer contributions over 25 years. CP 1719. At a minimum, King County's employer contributions would increase at least $5.6 million per year. CP 5976. These additional costs, the equivalent of 80 full time employee salaries, would directly reduce funding available for roads and public health and human services. *Id.* Already King County has had to reduce general fund support for human services from $22 million in 2007 to less than $1 million in 2011. CP 5974. In the same time frame, the County lost 143 Sheriff's officers and 36 deputy prosecutors. *Id.* A $5.6 million dollar[6] per year increase in employer pension contributions is hugely significant where services are already operating at a skeletal level.

Similarly, reinstating UCOLA will increase non-state governmental employers' contributions by $3.3 billion over the next 25 years. CP 708 (UCOLA). And in the short term, when the funds are arguably needed most for basic public services, the UCOLA repeal will

[6] This is the *minimum* projected increase.

reduce non-state governmental employer contributions by over $370 million by 2013. CP 707 (UCOLA).

The reservation of rights in these statutes served a purpose. As much as the benefit conferred gave a direct monetary boost to a public employee, the reservation of rights protected public employers from just this type of economic crisis. The gain-sharing reservation of rights clause was included because of concerns that gain-sharing would "be so expensive that it would adversely affect the ability of the State and its political subdivisions to fund the public pension plans which had gain-sharing as one of their provisions." CP 1619. And that time came, for gain-sharing in 2007 and for the UCOLA in 2011. Continuing these pension enhancements would not only threaten basic pension benefits, but also directly take money away from already hemorrhaging essential public services. In a time of historic cuts to public services, the future costs for these employee benefits are simply not sustainable. CP 5976. "Left unaddressed, the [pension] plans would simply run out of money to pay any beneficiary benefits, not just UCOLAs." CP 608 (UCOLA).

Unlike the benefits in the cases relied on by Respondents, the gain-sharing and UCOLA distributions are not basic or primary benefits. They are enhancements to already existing core pension benefits (providing monthly allowances based on services and salary). Respondents are over-

inflating their own claimed expectations and ignoring the equally reasonable expectations and needs of public employers.

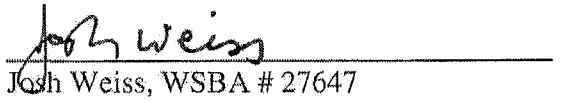
The Legislature has taken the reasoned path of supporting long-term public needs. In a time of economic crisis, these interests should prevail over private gain. *SEIU Healthcare 775NW v. Gregoire*, 168 Wn.2d 593, 601, 229 P.3d 774, 778 (2010). The Legislature needs to have the flexibility to provide enhancement benefits *and* protect employers and taxpayers. These statutes reflect a successful balancing of employees' immediate requests with employers' long-term concerns about the financial impact of these benefits.

VI. CONCLUSION

Based on the foregoing, WSAC urges the Court to reverse the decision of the trial court and recognize the Legislature's statutory reservation of rights in the UCOLA and gain-sharing legislation.

DATED this 24th day of September, 2013.

Respectfully submitted,
Washington State Association of Counties



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Attached please find a motion for leave to file an amicus brief and related amicus brief on behalf of the Washington State Association Counties in the matter of:

Washington Education Association et. al. v. State of Washington, cause #87424-7

If you should have any questions or issues with this filing, please contact me at the number below. Thank you.

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