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January 30, 2012

LEOFF I Coalition Board  
Attention Mark Curtis, V.P.  
855 Trosper Road, #108-27  
Olympia, WA. 98512-8108

**VIA EMAIL AND  
FIRST CLASS MAIL**

**RE: Analysis of House Bill 2350  
Constitutional and Contractual Aspects**

Dear LEOFF I Coalition Chair and Board Members:

By letter of January 12, 2012 I provided you with my views of some of the problems that appear to me to be present in HB 2350. As that letter was already nine pages long, I did not then take the additional time to discuss, at any length, the constitutional and contractual issues that would be raised in the event that the Bill were to become law. The purpose of this letter then is to revisit the problem provisions of HB 2350 as I see them, and to discuss them in terms of the *Bakenhus* decision and related caselaw.

Before we discuss the specific provisions of HB 2350 that I see as problematic in relation to *Bakenhus*, I would like to spend a little time discussing *Bakenhus v. City of Seattle*, 48 Wn.2d 695, 296 P.2d 536 (Wash. 1956) and the related cases that have followed it.

In 1956, our Supreme Court was presented with the question of whether H.D. Bakenhus, a retired police officer, was entitled to receive a pension from the City of Seattle based upon the law as it existed at the time of his initial hire, or a reduced pension based upon a change to the law that occurred during his term of employment.

At the time that the Court considered the issue, the majority of states in this country that had considered that same issue or similar issue had held that the amount of an employee's pension was determined by the laws in effect at the time of retirement. They believed that the employee who continued to work beyond the change in the law should be presumed to have agreed to the change and was, therefore, bound by it.

A very small minority of the states, including California, which has a similar constitution as our own, held that a contract is created at the time of initial employment, and that it is that contract which controls the amount of an employee's pension.

The *Bakenhus* Court, after considering numerous cases from both the minority and the majority view of the issue, sided with the minority view, holding that: "In this state, a pension granted to a public employee is not a gratuity but is deferred compensation for services rendered." This was not a unanimous decision, however. Justice Hill, a highly thought of justice of his time, filed a dissenting opinion taking the position that by continuing his employment beyond the date of the change in the pension law, Bakenhus acquiesced in the change, and that such acquiescence constituted an agreement to the change and acceptance of the reduced pension. Chief Justice Hamley joined in the dissenting opinion. The decision is, therefore, only a seven to two decision, but still the law of the land today.

The Bakenhus Court did not hold that no pension provisions can ever be changed to the disadvantage of a pensioner. The Court qualified its decision by further holding:

(While) the employee who accepts a job to which a pension plan is applicable contracts for a substantial pension and is entitled to receive the same when he has fulfilled the prescribed conditions. His pension rights may be modified prior to retirement, but only for the purpose of keeping the pension system flexible and maintaining its integrity. (Emphasis added).

Our Supreme Court cited, with approval, the consolidated cases of *Allen v. City of Long Beach* and *Alger v. City of Long Beach*, Cal.1955, 287 P.2d 765, 767, which held that:

An employee's vested contractual pension rights may be modified prior to retirement for the purpose of keeping a pension system flexible to permit adjustments in accord with changing conditions and at the same time maintain the integrity of the system. Such modifications must be reasonable, and it is for the courts to determine upon the facts of each case what constitutes a permissible change. To be sustained as reasonable, alterations of employees' pension rights must bear some material relation to the theory of a pension system and its successful operation, and changes in a pension plan which result in disadvantage to employee should be accompanied by comparable new advantages. (Emphasis added).

Only three years after *Bakenhus*, In *Dailey v. Seattle*, 54 Wash.2d 733, 738, 344 P.2d 718, 721 (1959), our Supreme Court held that:

Members of a public pension system "will be presumed to have acquiesced in legislative modifications that do not unreasonably reduce or impair existing pension rights; or, stated positively, if the modifications are reasonable and equitable." We further stated in *Dailey*, at pages 738-39, 344 P.2d at page 721: That an act of the legislature, making a change in pension rights, will be weighed against pre-existing rights in each individual case to determine whether it is reasonable and equitable. If the over-all result is reasonable and equitable, the employees (prospective pensioners) will be presumed to have acquiesced in the modifications; if the over-all result is not reasonable and equitable, there will be no such presumption. (Emphasis added).

Approximately five years after *Dailey*, In *Tembruell v. Seattle*, 64 Wash.2d 503, 506, 392 P.2d 453, 455 (1964), the Court clarified the *Bakenhus* decision and provided some guidelines for determining whether a pension law change which adversely affects pensioners rights will be allowed under the *Bakenhus* rule. The Court held that:

Pension rights thus vesting from the inception become a property right and may not be divested except for reasons of the most compelling force. What are these "reasons of the most compelling force"? They must be (1) for the purpose of keeping the pension system flexible (*Bakenhus v. Seattle*, supra ); and

(2) for the maintenance of the integrity of the system. Bakenhus v. Seattle, supra. We have further held that any change must be equitable to the employee or, put another way, any change which results in a disadvantage to the employee must be accompanied by comparable new advantages. See Bakenhus v. Seattle, supra, and Eisenbacher v. Tacoma, supra. (Emphasis added).

In the case of *Vallet v. City of Seattle*, 77 Wn.2d 12, 459 P.2d 407 (Wash. 1969) our Supreme Court took the opportunity to summarize the then current state of the law, quoting, in part, from *Dailey v. Seattle*, stating that The substance of our holdings is:

1. That employees who accept employment to which pension plans are applicable contract thereby for a substantial pension, and are entitled to receive the same when they have fulfilled the prescribed conditions. (Emphasis added).

2. That employees (prospective pensioners) will be presumed to have acquiesced in legislative modifications that do not unreasonably reduce or impair existing pension rights; or, stated positively, if the modifications are reasonable and equitable. (Emphasis added).

3. That an act of the legislature, making a change in pension rights, will be weighed against pre-existing rights in each individual case to determine whether it is reasonable and equitable. If the over-all result is reasonable and equitable, the employees (prospective pensioners) will be presumed to have acquiesced in the modifications; if the over-all result is not reasonable and equitable, there will be no such presumption. (Emphasis added).

Where the modifications in a pension plan are reasonable and equitable, they are considered under the foregoing cases to be constitutional. In such cases, a pensioner's rights will be determined by the latest act which can be constitutionally applied to him. Dailey v. Seattle, Supra; Eisenbacher v. Tacoma, 53 Wash.2d 280, 333 P.2d 642 (1958); Letterman v. Tacoma, 53 Wash.2d 294, 333 P.2d 650 (1958). (Emphasis added).

From the foregoing decisions, it is evident that a pension plan can be modified by the legislature, after its enactment, where the modifications are reasonable and equitable. Where the changes are reasonable and equitable, the pensioner will be presumed to have acquiesced in the modification. The modifications then become the law and are constitutional as to the pensioner's retirement rights. In such cases, the pensioner derives his right to a pension from the latest law and he must retire thereunder. (Emphasis added).

Finally, we come to the case of *Bates v. City of Richland*, 112 Wn.App. 919, 51 P.3d 816 (Wash.App. Div. 3 2002). This case explains that pension rights constitute property rights which are protected from governmental impairment by both the Federal and State Constitutions. The Court explained it this way:

In Washington, pension rights are contractual rights that vest at the beginning of the employment relationship. *Bakenhus v. City of Seattle*, 48 Wash.2d 695, 700, (1956). Pension rights vesting from the inception of employment become property rights and may not be divested unless the changes are equitable to the employee or are necessary to maintain the flexibility and integrity of the pension system. *Eagan v. Spellman*, 90 Wash.2d 248, 256, (1978) (citing *Bakenhus*, 48 Wash.2d at 701.). Article I, section 23 of the Washington Constitution and article I, section 10 of the United States Constitution prohibit any form of legislative action impairing existing obligations. *Washington Fed'n of State Employees v. State*, 127 Wash.2d 544, 560, (1995). The prohibition against any impairment of contract is not absolute and the court uses a three-part test to determine if there has been an impairment of public contract: (1) is there a contractual relationship; (2) does the legislative action substantially impair the contractual relationship; and (3) if there is substantial impairment, is it reasonable and necessary to serve a legislative purpose. *Id.* at 561, (citing *Tyrpak v. Daniels*, 124 Wash.2d 146, 151-52, (1994)). (Emphasis added).

I do apologize for the lengthy discourse on *Bakenhus* and the subsequent cases that have helped to explain it; but if we are to analyze HB 2350 in terms of *Bakenhus*, we should have a good understanding of exactly what safeguards *Bakenhus*, affords us as well as what it does not do. With

LEOFF I Coalition Board  
Attention Mark Curtis, V.P.  
January 30, 2012  
Page - 6

this background let us take a look at the most troubling provision of HB 2350 to see if they are likely to pass the *Bakenhus* test as modified and explained by subsequent caselaw.

### SECTION 5

As you know, LEOFF I members receive medical benefits from two sources under the Act. The first is RCW 41.26.030(19) which enumerates a laundry list of healthcare services which are mandatory in nature, and are clearly contractual, and therefore, come under the protection of *Bakenhus v. City of Seattle*. The second source of healthcare benefits enjoyed by LEOFF I members is the designation of additional medical services by local Disability Boards. These additional medical services are made available by Disability Boards through RCW 41.26.150(1)(b) and may be regulated and controlled by the Disability Board having jurisdiction over the particular LEOFF I member. Because local Disability Boards may either increase or decrease these RCW 41.26.150(1)(b) benefits, I do not believe that they can be considered to be contractual in nature.

Local Disability Boards have had the power to increase or decrease such benefits since the inception of the LEOFF act. As a result, any of these RCW 41.26.150(1)(b) benefits may be taken away from LEOFF I members without violating the principles said down by *Bakenhus* and subsequent cases. This does not mean, however, that the Legislature may divest LEOFF I members of their healthcare benefits, in the manner suggested by Section 5 of HB 2350

The right of LEOFF I members to have their healthcare needs and benefits decided and regulated by the local Disability Board under whose jurisdiction they fall, I do believe to be a contractual element; and, as such, it may not be infringed in the manner suggested by Section 5 of HB 2350. This is a substantial right accorded LEOFF I members by the Act, and the Bill offers no *quid pro quo* for divesting LEOFF I members of the right to have local Disability Boards determine and regulate their healthcare benefits. Thus Section 5 of HB 2350, in so far as it places healthcare decisions regarding LEOFF I members in the new Board of Trustees, fails the test that the modifications must be reasonable and equitable. As a result, at least that portion of Section 5 violates *Bakenhus* and would constitute violations of Article I, section 23 of the Washington Constitution and article I, section 10 of the United States Constitution.

### SECTION 6

Please see my letter of January 12, 2012 for a more complete explanation of the problems that I see in Section 6 of HB 2350; but to the extent that the Bill purports to make contractual those benefits in existence on July 1, 2003 it would constitute a benefit for LEOFF I members, because this would appear to include those healthcare benefits provided by local LEOFF I Disability Boards that were in effect on July 1, 2003. The problem with this section is, of course, that it defines all subsequent healthcare benefits granted pursuant to RCW 41.26.150(1)(b) as “increased benefits.” Such benefits, as we will see later in the Bill, can be taken away, modified, or may require contributions by members to be continued.

Everything I said concerning Section 5, above, holds true for this portion of the Bill, as well. In my view, the question with regard to whether or not Section 6 of HB 2350 satisfies the three part test enumerated by the caselaw comes down to whether or not the changes are equitable to the employee or are necessary to maintain the flexibility and integrity of the pension system. In other words, is the benefit gained by the Section’s guarantee of the healthcare benefits in existence on July 1, 2003 a fair and equitable exchange for the loss of those healthcare benefits that were granted subsequent to July 1, 2003.

This change in existing pension law is certainly not required to maintain the flexibility and integrity of the pension system, and I do not believe that a case can be made for the proposition that these changes are equitable to LEOFF I members. After all, LEOFF I members were already entitled to the healthcare benefits that were in existence on July 1, 2003. I believe we could show that, in almost every case, local Disability Boards have increased rather than diminished healthcare benefits since July 1, 2003. Although this could be a close question, I believe that so much of Section 6 as seeks to divest local Disability Boards of the right to regulate what the Bill calls “increased benefits” in favor of regulation by the new Board of Trustees is unconstitutional and violative of the rule in *Bakenhus*.

### SECTIONS 7 AND 9

Sections 7 and 9 would appear to eliminate local Disability Boards by transferring virtually all of their powers to the new Board of Trustees. This would divest the members of the right to have their own local Disability Board regulate healthcare benefits. I consider this right to be a substantive

right, and the substitution of the new Board of Trustees for local Disability Boards is far from equitable for the members of the LEOFF I system. This is especially so when you consider the composition of the Board of Trustees envisioned by HB 2350. There is no requirement that even a single LEOFF I member be allowed to sit on that Board. Certainly the current relations between LEOFF I members and Plan 2 members is not likely to assure fair representation of the interests of LEOFF I members by the new Board of Trustees.

To the extent that these sections do away with local Disability Boards or reduce their power to regulate LEOFF I health and disability benefits, it is, I believe unconstitutional as an impairment of contractual rights and violative of *Bakenhus*. The comments that I made under Section 5, above, apply to these sections with equal force.

#### **SECTION 10**

Section 10 of HB 2350 is unclear as to its intent. It may be read, without much strain, to require all LEOFF members, including those members who are presently LEOFF I, to pay a portion of the cost (up to 50%) of their "increased benefits." At least at the present time, it does not appear that such a co-pay is "necessary to maintain the flexibility and integrity of the pension system," and LEOFF I members do not appear to be receiving any comparable benefit in exchange for this potential detriment; and certainly this provision can not be said to be equitable to the LEOFF I employee. Thus I believe that it fails the three part test and would be an unconstitutional infringement of LEOFF I contract rights, violative of the *Bakenhus* rule, and contrary to both Article I, section 23 of the Washington Constitution and article I, section 10 of the United States Constitution.

#### **SECTION 18**

While Section 18 may hold some problems for LEOFF I members in the future, I do not believe that it needs much discussion at this time.

#### **SECTIONS 19**

Sections 19 of HB 2350 would seem to divest the Public Safety Subcommittee and the Select Committee on Pension Policy of their oversight of the Law Enforcement Officers and Fire Fighters Retirement System, in favor of to Board of Trustees as constituted by this Bill. This presents a

LEOFF I Coalition Board  
Attention Mark Curtis, V.P.  
January 30, 2012  
Page - 9

much closer question as to whether such a change is constitutional. I suspect that a Court presented with this question would say that the change is permissible and not a violation of the *Bakenhus* rule.

## SECTION 20

This section of HB 2350 purports to allow the Board of Trustees to pay all legal expenses and litigation costs incurred primarily in the protection of the fund or incurred in compliance with the statutes governing the fund from the interest earnings of the fund. This provision is quite common in statutory schemes, and I have no doubt would be upheld by our Courts. The unanswered question is exactly which litigation expenses are truly expended in the protection of the fund or incurred in compliance with the statutes governing the fund; and that question can only be answered with regard to the particular piece of litigation.

As you can see from the foregoing discussion of *Bakenhus* and the related caselaw, and from the discussion of the current state of the law in relation to the various sections of the Bill that I believe to be problematic, I am of the opinion that virtually all of the portions of HB 2350 which cause LEOFF I members concern can not stand in light of the *Bakenhus* rule and the constitutional prohibition against impairment of contract rights. It is important to understand, however, that litigation is an uncertain remedy, at best. A judge or a panel of judges can always see the question a little differently and reach what might appear to be an incorrect decision. In virtually every litigation one of the lawyers turns out to be wrong. I have been fortunate not to be that lawyer in any LEOFF related cases so far, but the fact remains that litigation is uncertain.

Thank you for the opportunity to have been of service. In the event that any further explanation or discussion of my views seems appropriate; or if you have any questions, please do not hesitate to call me at your convenience.

Very truly yours,

J.E. Fischnaller