DISTRICT COURT, DENVER COUNTY, COLORADO 1437 Bannock Street, Room 256 Denver, Colorado 80202 P: 303-861-1111	▲ COURT USE ONLY ▲
TRACEY LAWLESS, ***Plaintiff*,** **v.** **STANDARD INSURANCE COMPANY; COLORADO PUBLIC EMPLOYEES' RETIREMENT ASSOCIATION; COLORADO PUBLIC EMPLOYEES' RETIREMENT ASSOCIATION BOARD OF TRUSTEES; CAROLE WRIGHT, in her Official Capacity only; MARYANN MOTZA, in her Official Capacity only; and RICK LARSON, in his Official Capacity only;** ***Defendants*.**	**No. 2010-cv-9848** **Division 7** **Courtroom:**

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STANDARD INSURANCE COMPANY'S MEMORANDUM IN SUPPORT OF ITS MOTION FOR SUMMARY JUDGMENT

Defendant, STANDARD INSURANCE COMPANY ("Standard"), by its attorneys, Swift & Bramer, LLP, submits its Memorandum in Support of its Motion for Summary Judgment pursuant to C.R.C.P. 56(b).

INTRODUCTION

The Colorado General Assembly created the Public Employees' Retirement Association ("PERA") as an instrument of the State of Colorado responsible for providing welfare and pension programs to Colorado public employees. C.R.S. §24-51-201. One of PERA's responsibilities is to provide public employees with short-term disability insurance coverage. The General Assembly charged PERA with the duty to provide a short-term disability program, to enact rules governing that program, and to purchase a short-term disability insurance policy that conforms to PERA's rules. C.R.S. §§24-51-702, 24-51-703 (the short-term disability insurance policy "shall conform to rules adopted by the board"). PERA adopted rules and obtained legislative approval for its rules, including Rule 7.45, as required by the Administrative Procedures Act, C.R.S. §24-4-103. After PERA's rules obtained the Colorado Attorney General's stamp of approval, PERA purchased a Group STD Policy from Standard that conforms precisely to PERA's rules.[1]

The crux of Tracey Lawless's Third Amended Complaint is that PERA Rule 7.45 is *ultra vires* and unconstitutional. Lawless alleges that Rule 7.45 contains a more restrictive definition of short-term disability than prescribed by the General Assembly in C.R.S. §24-51-702.[2] By adopting Rule 7.45 and procuring a Group STD Policy that *by statute* must "conform" to PERA's rules, PERA allegedly deprived its members of property in violation of the Due Process

[1] The "Group STD Policy" refers to the Group Short Term Disability Insurance Policy issued to PERA by Standard with an effective date of January 1, 1999, attached hereto as Exhibit A. "Lawless" refers to the plaintiff, Tracey Lawless, both individually and on behalf of the putative class. Citations to "3rd Am. Comp. pg. _ ¶_" are to the "Third Amended Complaint and Jury Demand (Class Action)."

[2] For ease of reference, C.R.S. §§24-21-702 and 703 are referred to as the "PERA Statute" or "Statute."

Clause of the Fourteenth Amendment. She seeks a declaration that PERA Rule 7.45 is *ultra vires* and unconstitutional. But Lawless seeks to hold Standard financially liable for PERA's constitutional violations.

Standard, however, is an independent contractor whose legal obligations are determined by the contractual terms of the Group STD Policy. The General Assembly charged PERA—not Standard—with the authority and duty to design and provide the short-term disability program. In fact, the General Assembly specified that the short-term disability insurance policy must conform to PERA's rules. C.R.S. §24-51-703. Nothing in the PERA Statute requires that Standard guarantee the constitutionality of PERA's rules, police the Attorney General's approval of PERA's rules, and bear financial responsibility if PERA's rules are subsequently found by a court to be *ultra vires*.

Lawless wants the Court to rewrite PERA Rule 7.45, then reform the Group STD Policy to conform to the judicially rewritten Rule, and then order Standard to pay under the judicially reformed Policy retroactive to January 1, 1999. She appends to her reformation claim the usual cast of insurance claims, including breach of contract, bad faith, consumer fraud, and unreasonable delay in paying benefits, enumerated as the Fourth, Fifth, Seventh, and Eighth Claims of the Third Amended Complaint. All the claims against Standard are founded on the false premise of reformation.

Lawless cannot make it past the first step toward reformation. The promulgation of rules is a legislative function, not a judicial function. Lawless's entreaty for the Court to judicially rewrite PERA's rules, and reform the Group STD Policy based on the judicially rewritten rules, encroaches on a core legislative function. If PERA's rules are valid and enforceable, as

Colorado's Attorney General declared, then Lawless and the putative class have no claims against PERA or Standard. But if PERA's rules are *ultra vires*, the judicial task is to strike down the rules and void the insurance contract, not to judicially redesign Colorado's disability welfare program. If the Court determines that PERA's Rule 7.45 is *ultra vires* and violates the Fourteenth Amendment, then Lawless must look to the State for a remedy.

ARGUMENT

I. Lawless Cannot Impose Liability On Standard For PERA's Alleged *Ultra Vires* Acts And Constitutional Violations.

All of Lawless's claims in the Third Amended Complaint emanate from PERA's adoption of Rule 7.45. She claims that by adopting Rule 7.45 and procuring the Group STD Policy that conforms to Rule 7.45, PERA acted *ultra vires* and deprived PERA members of property in violation of the Due Process Clause of the Fourteenth Amendment. (3rd Am. Comp. pg. 9 ¶¶ 58, 60-62). Lawless seeks a declaration that Rule 7.45 is *ultra vires* and unconstitutional. But she wants Standard to bear financial responsibility for redressing PERA's constitutional violations.

The Due Process Clause of the Fourteenth Amendment forecloses Lawless from holding Standard liable for PERA's alleged *ultra vires* acts and constitutional violations. The Fourteenth Amendment applies only to acts of the State.[3] PERA is an instrument of the State of Colorado. C.R.S. §24-51-201; *Tepley v. Public Employees Retirement Ass'n*, 955 P.2d 573, 580 (Colo. Ct. App. 1997). Standard never assumed the role of a state sovereign when it issued the Group STD Policy to PERA. Standard is a private entity and a corporate citizen of Oregon. The Colorado Court of Appeals has held that Standard, as the insurer of PERA's short-term disability program,

[3] The Fourteenth Amendment provides, "No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law …." (U.S. Const., amend. XIV, §1).

is not a public entity. *Moran v. Standard Ins. Co.*, 187 P.3d 1162, 1166 (Colo. Ct. App. 2008) ("Standard's status as a private corporation, even one that has entered a contract with a public entity, precludes its treatment as a public entity under the CGIA [Colorado's General Immunity Act]."). As a private entity, Standard cannot be liable for alleged violations of PERA members' due process rights. See *Rendall-Baker v. Kohn*, 457 U.S. 830, 837 (1982) (The Fourteenth Amendment "applies to acts of the states, not to acts of private persons or entities."); *Paige v. Coyner*, 614 F.3d 273, 278 (6th Cir. 2010) ("[T]he Fourteenth Amendment prohibits only states (as opposed to private entities) from depriving individuals of due process.").

Lawless tries to shift the State's constitutional liability onto Standard through the back door of the PERA Statute. Lawless infers that the General Assembly imposed a public duty on Standard to pay benefits *under the PERA Statute*, separate and independent of PERA's rules and the contractual terms of the Group STD Policy. If the General Assembly is to impose statutory duties on private entities that contract with the State, and sanction civil liability for failing to fulfill those statutory duties, then the legislature's intent must be stated "loud and clear" in the text of the statute. *Quintano v. Indus. Comm'n*, 495 P.2d 1137, 1139 (Colo. 1972). "This is not a subject in which we should attempt to infer such a legislative intent." *Id.* See also *Crossgrove v. Wal-Mart Stores, Inc.*, -- P.3d --, 2010 WL 2521744, at *5 (Colo. Ct. App. June 24, 2010) ("[S]tatutes in derogation of the common law must be strictly construed….") (quoting *Van Waters & Rogers, Inc. v. Keelan*, 840 P.2d 1070, 1076 (Colo. 1992)). Courts must implement the statutory language that the legislature actually enacted, giving words their plain and ordinary meaning. *Salinas v. United States*, 522 U.S. 52 (1997); *Golden Animal Hosp. v. Horton*, 897 P.2d 833, 836 (Colo. 1995).

The PERA Statute imposes duties and responsibilities directly on PERA. But Standard's obligations are contractual. The General Assembly charged PERA—not Standard—with the duty to design and provide two disability programs for Colorado employees: a short-term disability program and a disability retirement program. Section 702(1) charges PERA with the duty *to provide* these programs, and §702(1)(a) describes the structure of the short-term disability program that PERA is responsible for providing:

> (1) *The association shall provide* for two types of disability programs for disabilities incurred on or before termination of employment:
>
> > (a) Short-term disability. A member who is found by the disability program administrator to be mentally or physically incapacitated from performance of the essential functions of the member's job with reasonable accommodation as required by federal law, but who is not totally and permanently incapacitated from regular and substantial gainful employment, shall be provided with reasonable income replacement, or rehabilitation or retraining services, or a combination thereof, under a program provided by the disability program administrator for a period specified in the rules adopted by the board. The cost of the program shall be funded by the association.

C.R.S. §24-51-702(1)(a) (emphasis added). Section 703 instructs PERA to promulgate rules establishing the substantive and procedural standards for determining disability, and to purchase an insurance contract that "shall conform to rules adopted by the board." C.R.S. §24-51-703.

PERA purchased a group short-term disability insurance policy from Standard that conforms precisely to PERA's Rules. Standard's obligations are governed by the terms of the Group STD Policy, and not by the PERA Statute which is expressly directed at PERA. The Administrative Services Agreement ("ASA") between PERA and Standard further confirms that Standard's role fundamentally is contractual. The ASA states that "Standard will administer and be financially responsible for payment of claims under the short term disability program, *in*

accordance with the terms of the Group STD Policy (# 633387-A) issued by Standard to Plan Sponsor." (Ex. B, ASA, pg. 1) (emphasis added). The ASA provides that Standard acts in the capacity of an "independent contractor." (Ex. B, ASA, pg. 2 "Scope of Authority"). The ASA confirms that Standard's payment obligations are contractual in nature: to administer and pay claims "in accordance with the terms of the Group STD Policy." (Ex. B, ASA, pg. 1).

The PERA Statute requires that PERA design (by promulgating rules) and provide (by purchasing an insurance policy that *conforms* to PERA's rules) a short-term disability program. Nothing in the Statute makes Standard legally responsible for the content of PERA's rules, or requires that Standard recompense public employees in the event PERA enacts rules that are *ultra vires* and unconstitutional. The Statute does not transform Standard into a guarantor of PERA's governmental responsibilities.

Colorado's Administrative Procedures Act establishes a procedural check to prevent the abuse or misuse of governmental authority. PERA submitted its rules to the Attorney General of Colorado for review in compliance with the Administrative Procedures Act. The Attorney General gave PERA's rules her stamp of approval:

> The above-referenced rules [including PERA's Rule 7.45] were submitted to this office on November 23, 1998, as required by §24-4-103, C.R.S. (1997). This office has reviewed them and finds no apparent constitutional or legal deficiency in their form or substance."

(Ex. C, Opinion of the Attorney General).

The General Assembly empowered PERA to make the rules, to obtain approval for its rules from the Attorney General, and once the rules were approved, to purchase an insurance contract that conforms to PERA's rules. PERA purchased a Group STD Policy from Standard that

conforms exactly to the coverage requirements specified in PERA's legislatively approved rules. The PERA Statute does not empower or require Standard to look behind the rules, police PERA's compliance with the Administrative Procedures Act, and second-guess the judgment of Colorado's Attorney General. Nor is it desirable to force legislative oversight responsibilities on Standard, an independent contractor and corporate citizen of Oregon, and impose civil liability on Standard for the alleged *ultra vires* acts of a Colorado State instrumentality such as PERA. That would be tantamount to a declaration of "no confidence" in the Administrative Procedures Act.

If PERA exceeded its rulemaking authority and Rule 7.45 is *ultra vires*, then the safeguards embodied in the Administrative Procedures Act failed the citizens of Colorado. Public employees must look to PERA and the State of Colorado for a remedy. Standard's obligations are governed by the terms of the Group STD Policy, and there is no dispute that Standard has fully complied with the Group STD Policy's terms. Standard has no statutory or contractual obligation to pay Lawless and the putative class for the purported constitutional violations and *ultra vires* acts of the State.

II. Lawless Cannot Obtain Judicial Reformation Of The Group STD Policy.

Lawless tries to metamorphose PERA's *constitutional* liability into Standard's *contractual* liability through the conduit of "reformation of contract." Lawless's reformation theory in the Second Claim of the Third Amended Complaint provides the framework for all her claims against Standard. She seeks to reform the Group STD Policy retroactive to January 1, 1999, and then she charges Standard with breach of the judicially reformed Policy, bad faith, consumer fraud, and unreasonable delay in paying benefits, all retroactive to January 1, 1999. Lawless's

retroactive reformation theory is the cornerstone of all her claims against Standard. Expose the false premise of reformation, and all the claims against Standard topple as a matter of law.

Lawless postures her reformation claim as a straightforward claim to reform an insurance policy "to meet statutory requirements for coverage" (3rd Am. Comp. pg. 10 ¶ 65), analogous to an action to reform an automobile insurance policy to comply with Colorado's now repealed Auto Accident Reparations Act ("CAARA"), C.R.S. §10-4-701 *et seq*.

CAARA was a comprehensive statutory regime for the purpose of regulating auto insurers and protecting Colorado consumers of auto insurance policies. CAARA was specifically directed at insurance companies: "[A]n insurer authorized to transact or transacting business in this state may not exclude the minimum coverages required by operation of [this statute] in any contract of liability insurance for injury, wherever issued, covering ownership, maintenance, or use of a motor vehicle while it is in this state." C.R.S. §10-4-711 (2002). CAARA delineated extensive "Required Coverage" terms for inclusion in every "complying policy." C.R.S. §10-4-706 (2002). CAARA implemented a dispute resolution system (all insurers "shall be deemed to have agreed" to mandatory arbitration), compliance reporting requirements (insurers must file a certification affirming that their policies comport with the statutory definition of a "complying policy"), and a mechanism to police insurer compliance (through the insurance commissioner). C.R.S. §§10-4-703, 704, 717 (2002).

The PERA Statute is not a statutory regime regulating private insurance companies. The PERA Statute applies to only a single purchaser—the State of Colorado, through its proxy PERA. The Statute does not impose duties on private insurance companies or regulate insurer conduct. In fact, the PERA Statute is not directed at private insurers at all; it is directed solely

and exclusively at PERA. The PERA Statute is an expression of the General Assembly's spending power, not its police power. The Statute authorizes PERA to provide a short-term disability program, to enact rules, and to purchase a short-term disability insurance policy that *conforms to PERA's rules*. C.R.S. §§24-51-702, 703.

To infer duties and civil remedies that are not contained in the statute's terms "is tantamount to judicial legislation." *Golden Animal Hosp.*, 897 P.2d at 836. "When the meaning of a statute is plain and unambiguous, a court cannot substitute its opinions as to how the law should read in place of the law already enacted." *Dawson v. PERA*, 664 P.2d 702, 707 (Colo. 1983); *Burns v. City Council of City & County of Denver*, 759 P.2d 748, 749 (Colo. Ct. App. 1988) ("Courts will not interpret a statute or an ordinance to mean that which it does not express.").

Lawless's simple reformation theory is not so simple. In fact, it's unprecedented. By statute, the Group STD Policy must conform to PERA's Rules. C.R.S. §24-51-703. Lawless seeks to rewrite the Group STD Policy to conform to non-existent rules that she contends PERA *should have adopted*. She wants the Court to reform PERA's Rule 7.45, then reform the Group STD Policy to conform to PERA's judicially reformed Rule, and then order Standard to specifically perform under the reformed Policy retroactive to January 1, 1999.

Lawless cannot move beyond step one. Rule-making is a function specifically granted to PERA by the General Assembly. Judicial reformation of PERA's rules would encroach on a core legislative function. Courts may find a state agency's rules to be *ultra vires* and strike them as void, but courts are not authorized to legislate from the bench and rewrite the rules. See *Jaskolski v. Daniels*, 427 F.3d 456, 462 (7th Cir. 2005) ("[W]hat judges deem a 'correction' or 'fix' is from another perspective a deliberate interference with the legislative power to choose

what makes for a good rule."). The judiciary's assumption of legislative powers is strictly verboten by the separation of powers. See *Lamie v. U.S. Trustee*, 540 U.S. 526, 542 (2004) ("If Congress enacted into law something different from what it intended, then it should amend the statute to conform it to its intent. 'It is beyond our province to rescue Congress from its drafting errors, and to provide for what we might think … is the preferred result.' This allows both of our branches to adhere to our respected, and respective, constitutional roles.") (quoting *United States v. Granderson*, 511 U.S. 39, 68 (1994) (concurring opinion)).

If PERA exceeded its statutory charter by adopting Rule 7.45 and purchasing an insurance policy that conforms to Rule 7.45, then Rule 7.45 is *ultra vires* and the insurance policy is void. "Any contract which will disable a public or quasi public corporation from performing the duty which it has undertaken, or has been imposed upon it, for public weal, … is void." *Colburn v. Bd. of Comm'rs of El Paso County*, 61 P. 241, 243 (Colo. Ct. App. 1900). See also *Cherry Creek Aviation, Inc. v. City of Steamboat Springs*, 958 P.2d 515, 519 (Colo. Ct. App. 1998) ("Contracts executed by municipal corporations are void when there is a failure to comply with the mandatory provisions of the applicable statutes or charters."); *Normandy Estates Metro. Recreation Dist. v. Normandy Estates Ltd.*, 534 P.2d 805, 807 (Colo. Ct. App. 1975), modified in part on other grounds, 553 P.2d 386 (Colo. 1976) ("We recognize that a contract with the District is void if the District fails to comply with statutory requirements governing such a contract.").

Voiding a contract between a private entity and a governmental entity does not hinge on whether the contract required post-execution legislative ratification or pre-execution legislative authorization. When a public entity enters a contract that exceeds its statutory authority, the contract is void. In *Colorado Ass'n of Public Employees v. Dept. of Highways*, 809 P.2d 988 (Colo.

1991), the Supreme Court of Colorado held that contracts between the Department of Highways and private vendors were inconsistent with the state personnel system created by the Colorado Constitution and therefore were void. *Id.* at 996-97. The Department's Director signed contracts with private vendors to perform maintenance and utility work in place of more expensive state employees. Although the Department had authority to contract for private sector services, the duration of those contracts could not exceed six months under Colorado law, C.R.S. §24-50-128(3). The Department's contracts exceeded the six-month limit and therefore "could not be validly approved by the Director and must be considered unauthorized and void." *Id.* at 997. See also *Black v. First Fed. Sav. & Loan Ass'n of Fargo, N.D., F.A.*, 830 P.2d 1103, 1109 (Colo. Ct. App. 1992) ("[I]f a special district's contract is beyond the scope of its constitutional or statutory powers, the contract is *ultra vires* and, consequently, void.").

PERA endorses Lawless's theory of retroactive reformation of the Group STD Policy, if the Court finds PERA's Rule 7.45 *ultra vires* and unconstitutional. By advocating retroactive reformation as a cognizable remedy, PERA endeavors to shift liability for its alleged *ultra vires* acts and constitutional violations onto Standard, and thereby preserve the coffers of the State. PERA's approval of retroactive reformation highlights why this remedy conflicts with the Takings Clause of the Constitution, which bars the state from taking private property for public use without just compensation. (U.S. Const. amend. V, "[n]or shall private property be taken for public use, without just compensation") (Colo. Const. art. II, §15, "Private property shall not be taken or damaged, for public or private use, without just compensation.").[4]

[4] The Supreme Court of Colorado has interpreted Colorado's Takings Clause as consistent with the federal Takings Clause. See *Animas Valley Sand & Gravel, Inc. v. Bd. of County Comm'rs of La*

If a state violates the Due Process Clause of the Fourteenth Amendment, the state cannot seize private property to obtain the funds to pay for its violation. Lawless and PERA cannot use the judicial system to achieve the same objective. "It would be absurd to allow a State to do by judicial decree what the Takings Clause forbids it to do by legislative fiat." *Stop the Beach Renourishment, Inc. v. Fla. Dept. of Envtl. Prot.*, 130 S.Ct. 2592, 2601 (2010). Yet that's precisely the remedy Lawless and PERA ask this Court to sanction. Lawless and PERA propose to obtain by judicial fiat the private property of Standard for public use, to compensate Colorado employees for PERA's constitutional violations, without just compensation to Standard. The Takings Clause "stands as a shield against the arbitrary use of governmental power." *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155, 164 (1980). The State's appropriation of Standard's funds would amount to an unconstitutional taking of private property, in violation of the Takings Clause. See *E. Enters. v. Apfel*, 524 U.S. 498, 537 (1998) (holding that the State's enforcement of an act to require coal operators to pay more money into a retirement fund retroactively to 1966 is an unconstitutional taking of private property in violation of the Takings Clause).

Lawless's elaborate remedy of judicially rewriting PERA's rules, then reforming the Group STD Policy to conform to the judicially rewritten rules, is not reformation of contract at all. It is an entreaty for the Court to redesign PERA's rules and "fix" Colorado's disability benefit program, which is a legislative function that courts must abjure. "The separation of powers doctrine imposes upon the judiciary a proscription against interfering with the executive or

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Plata, 38 P.3d 59, 63 (Colo. 2001). When construing Colorado's Takings Clause, courts look to federal case law for guidance. *Id.* at 64.

legislative branches...." *Colo. State Dept. of Health v. Geriatrics, Inc.*, 699 P.2d 952, 959 (Colo. 1985) (quoting *Pena v. Dist. Court of the Second Judicial Dist.*, 681 P.2d 953, 956 (Colo. 1984)).

If PERA exceeded its statutory authority when it adopted its rules and purchased an insurance policy that conformed to its rules, the legal remedy is to void the insurance contract. Standard cannot be liable for breach of a void contract, or for bad faith, consumer fraud, or unreasonable delay in paying benefits under an insurance contract that is void. Because Lawless is not entitled to reformation as a matter of law, all claims against Standard that are based on purported obligations under a "reformed" Group STD Policy collapse and must be dismissed.

CONCLUSION

If PERA Rule 7.45 is valid and enforceable, then Lawless and the putative class have no claims against PERA or Standard. But if PERA's rules are *ultra vires*, the judicial task is to strike down the rules and void the Group STD Policy, and not to judicially redesign Colorado's disability welfare program under the guise of reformation of contract. Lawless and the putative class have no legal remedy against Standard for declaratory judgment under the PERA Statute, reformation of contract, breach of contract, bad faith, consumer fraud, or vexatious delay in paying benefits. Because Lawless's theory of reformation fails as a matter of law, judgment should be entered in favor of Standard on all claims of the Third Amended Complaint.

WHEREFORE, Defendant, STANDARD INSURANCE COMPANY, respectfully requests entry of judgment as a matter of law on all claims for relief asserted against Standard in the Third Amended Complaint, including the claims in the First, Second, Fourth, Fifth, Seventh, and Eighth Claims for Relief of the Third Amended Complaint.

Respectfully submitted,

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