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:**

Attorneys for Standard Insurance Company:

Clinton P. Swift, #7127
Megan R. Peterson, #37781
SWIFT & BRAMER, LLP
1230 West Ash, Suite C
Windsor, Colorado
P: 970-460-0266
F: 970-237-4838
swiftp@swiftbramerlaw.com
megan@swiftbramerlaw.com

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

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

INTRODUCTION

Tracey Lawless initiated this lawsuit on the premise that she and the putative class are entitled to payment of "statutorily guaranteed benefits." She seeks judicial reformation of the Group Policy to provide statutorily guaranteed income replacement benefits calculated at 60% of predisability earnings for a maximum period of 22 months. But Lawless now concedes that the PERA Statute does not guarantee income replacement payments to disabled public employees, or mandate a 22-month maximum benefit period. The Statute does not mandate that employees who are disabled from their assigned jobs yet are fully able to work in another occupation (but choose not to) must receive precisely the same benefit as employees who cannot work at all. The Statute contains a menu of benefit options that PERA may choose to provide, alone or in innumerable combinations.

Lawless and PERA debate the appropriate benefit PERA's disability program should provide to a hypothetical teacher, who cannot perform the tasks of her assigned job but who can work in another gainful occupation. Lawless questions whether the teacher should be forced to work in another occupation until she can return to teaching, or whether PERA's disability program "should step in and help her survive financially." Lawless prefers the latter option, while PERA prefers the former. The nature of their debate is imbued with subjective value judgments about public policy interests, which is a debate that Lawless cannot win. The General Assembly delegated its legislative powers to PERA to balance the competing public policy interests required to make these benefit choices, which is a core legislative function. Lawless's entreaty for the Court to design a substitute disability program, and to implement that program through a judicially reformed Group Policy, runs afoul of the separation of powers.

If PERA's rules are valid and enforceable, as PERA maintains, then Lawless and the putative class have no claims against PERA or Standard. Summary judgment should be entered in favor of PERA and Standard on all claims in the Third Amended Complaint. But if PERA's rules are *ultra vires*, the judicial task is to strike down the rules and declare the Group Policy void, not to judicially redesign Colorado's disability welfare program. Summary judgment should be entered in favor of Standard on all claims in the Third Amended Complaint, because all of Lawless's claims are based on the false premise of retroactive reformation.

ARGUMENT

I. Standard Cannot Be Liable For PERA's Alleged Due Process Violations.

All of Lawless's claims in the Third Amended Complaint stem from PERA's adoption of rules defining Colorado's short-term disability program. Under PERA's rules—enacted in compliance with the Administrative Procedures Act and approved by Colorado's Attorney General—Lawless does not qualify for disability benefits. Because the General Assembly statutorily directed PERA to purchase a disability insurance policy that "conforms" to PERA's Attorney General-approved rules, Lawless is ineligible for a benefit under the Group Policy.

Lawless asserts that PERA exceeded its statutory authority by adopting rules that provide no monetary benefit to public employees who are able to work in another gainful occupation. She claims that by adopting Rule 7.45 and purchasing a Group Policy that conforms to PERA's rules, PERA deprived public employees of property in violation of the Due Process Clause of the Fourteenth Amendment. She seeks a declaration that PERA Rule 7.45 is *ultra vires* and unconstitutional. But she wants Standard to pay any damages sustained as a result of PERA's alleged constitutional violations, under the guise of "reformation" of the Group Policy.

Lawless cannot transform the State's constitutional liability into Standard's contractual liability. Only instruments of the state are liable for unconstitutional deprivations of property. Standard, as a private entity, is not an instrument of the State and cannot be liable for damages caused by PERA's adoption of unconstitutional rules. 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.").

Although Lawless tries to characterize her claims as seeking payment of statutorily mandated benefits under a judicially reformed insurance contract, her claims are for damages sustained as a result of PERA's alleged deprivation of property in violation of the Due Process Clause. Her damages might be measured by the value of the benefit PERA might choose to provide. But the measure of damages does not transform Lawless's Due Process claims against an instrument of the State into claims to recover benefits from a private entity under a judicially reformed insurance contract. 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*.

All of Lawless's damages emanate from PERA's unconstitutional deprivation of property, which cannot lie against a private entity such as Standard. Lawless's argument that only Standard is "statutorily authorized" to pay disability benefits is irrelevant. Lawless's claim is for damages for PERA's violations of the Due Process Clause, not for "statutorily guaranteed" payment of benefits.

II. Lawless's Claim For "Reformation Of Contract" Violates The Separation Of Powers Doctrine.

Lawless, in her Responses to Standard's Motion for Summary Judgment and Motion to Dismiss, postures her claim for reformation of the Group Policy as a claim to enforce "statutorily guaranteed benefits" mandated by the PERA Statute. She argues that the Statute imposes a duty directly on Standard to pay statutorily guaranteed "STD" benefits to eligible public employees, and that the Group Policy fails to meet "statutory requirements for coverage." (Pl. Response, pgs. 6, 8). She describes her reformation theory as a straightforward claim to reform an insurance policy analogous to an action to reform an auto insurance policy under Colorado's now repealed Auto Accident Reparations Act ("CAARA"), C.R.S. §10-4-701 *et seq*., which delineated specific terms of "Required Coverage" to be included by operation of law into every auto insurance policy issued in Colorado.

But in her Response to PERA's Motion for Summary Judgment, Lawless concedes that the PERA Statute gives PERA benefit "choices" and does not mandate payment of monetary benefits. (Pl. Response, pg. 5). The Statute gives PERA innumerable choices in designing the State's disability program. PERA may choose to provide "reasonable income replacement," or "rehabilitation" services, or "retraining" services, "or a combination thereof." C.R.S. §24-51-702(1)(a). The General Assembly never mandated payment of income replacement benefits to public employees who cannot perform their assigned jobs, and the General Assembly never mandated a 22-month maximum benefit period.

PERA, exercising its legislative powers delegated by the General Assembly, chose to design its disability program to redress the public policy deficiencies of the pre-1999 program. PERA,

therefore, designed a program that provides income replacement benefits (calculated at 60% of predisability earnings for a maximum of 22 months) to public employees who are disabled from their assigned jobs and cannot work in any other occupation. PERA chose that public employees who are fully able to work in another gainful occupation should not receive income replacement benefits.

If PERA exceeded its statutory authority in enacting Rule 7.45, as Lawless maintains, then PERA Rule 7.45 is *ultra vires* and unconstitutional and the Court may strike down the Rule. But Lawless wants the Court to judicially redesign Colorado's disability welfare program. She asks that the Court rewrite PERA's rules to provide an income replacement benefit that she thinks PERA *should have chosen* to give to public employees like her, who are fully able to work in another occupation. She asks that the Court reform the Group Policy to conform to PERA's judicially reformed Rule. Then she asks that the Court order Standard to specifically perform under the judicially reformed Policy retroactive to January 1, 1999. Lawless describes this complex process as a "simple reformation of contract." (Pl. Response, pg. 10).

Lawless asks for a remedy that the Court is not empowered to deliver. The General Assembly delegated legislative powers to PERA to choose what benefit to provide from the Statute's menu of options. The PERA Statute authorizes PERA to promulgate rules and specifies "All rules shall be promulgated in accordance with the provisions of section 24-4-103 [the Administrative Procedures Act], and such rules shall be consistent with the provisions of this article or other provisions of law." C.R.S. §24-51-204(5). The Administrative Procedures Act stands as a procedural check to prevent the abuse or misuse of governmental authority. PERA's rules must be approved by Colorado's Attorney General then submitted to the General

Assembly's office of legislative legal services for review and final adoption. C.R.S. §24-4-103(8)(b)-(d). PERA's rule-making is an integral part of the legislative process.

If PERA made choices in designing its disability program that exceeded its delegated authority, PERA's unauthorized choices are void. The Court cannot seize PERA's legislative powers, circumvent the Administrative Procedures Act, and decide what disability benefit choices would best serve Colorado's public interests, as Lawless requests. If a legislative body adopts rules that are *ultra vires* and unconstitutional, the judicial task is to strike down the rules. "The separation of powers doctrine imposes upon the judiciary a proscription against interfering with the executive or 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)). "This doctrine insures that the judiciary will not 'under the pretense of deciding a case,' preempt an executive agency from exercising powers properly within its own sphere." *Id.* (quoting *People v. Montgomery*, 669 P.2d 1387, 1389 (Colo. 1983)).

The separation of powers precludes the judiciary from assuming legislative powers and making discretionary choices about benefit program design. In *Malone v. Bureau of Indian Affairs*, 38 F.3d 433 (9th Cir. 1991), the Ninth Circuit held that the Bureau of Indian Affairs adopted eligibility criteria for educational grants that exceeded the Bureau's statutory authority. The Ninth Circuit invalidated the Bureau's rules. The Ninth Circuit further held that the district court violated the separation of powers by judicially promulgating new rules, which is a legislative power consigned to the Bureau. "[A]fter invalidating §40.1, we lacked the authority to dictate the precise standard that the BIA should adopt under the proper statutory authority." *Id.* at 437. "[T]here can be no question that the promulgation of eligibility criteria for a program established

under the Act is a matter consigned to the agency in the first instance." *Id.* at 439. The court explained:

> [B]y sending its statute to the relevant agency for implementation, [Congress] has delegated to that agency the function of choosing between implicit statutory options. The duty of the court in this circumstance is to keep the agency within the bounds of its delegated authority.... Thus, the judicial role may often be, as one commentator has put it, to "specify what the statute cannot mean, and some of what it must mean, but not all that it does mean."

Id. at 437 (citations omitted).

Separation of powers precludes the judiciary from usurping an agency's legislative authority and judicially mandating benefit eligibility criteria. Lawless argues that PERA already exercised its legislative prerogative by choosing to provide income replacement benefits calculated at 60% of predisability earnings for 22 months. According to Lawless, the Court only needs to cross-out Rule 7.45(E) so she can qualify for income replacement benefits calculated at 60% of predisability earnings for 22 months. Excising a portion of a rule is no different than rewriting the rule. By excising subsection (E), the Court would be making a discretionary decision to provide income replacement benefits to employees like Lawless who are able to work in another gainful occupation, which is a benefit PERA specifically chose not to provide to that group of employees. See *McCulloch Gas Processing Corp. v. Dept. of Energy*, 650 F.2d 1216, 1230 (Tem. Emer. Ct. App. 1981) ("[T]he district court erred in excising specific language from the regulations and in effect rewriting the regulations."); *Danly Mach. Corp. v. U.S.*, 492 F.2d 30, 33 (7th Cir. 1974) ("If, as it claims, the regulation was arbitrary and a misapplication of statutory authority, our only power as judges would be to prohibit the Secretary from applying the

regulation…. We as a court have no power to give, or to direct the Secretary to give, an enlarged bounty to classes of persons not heretofore covered by any regulation.").

The judiciary's function ends when an unconstitutional rule is laid bare. "Authorities applying a separation of powers analysis instruct that courts should not interfere with the exercise of power by other branches of government except to enforce ministerial acts requiring no discretion." *E. Mo. Coal. of Police v. City of Univ. City*, -- S.W.3d --, 2011 WL 1661075, at *4 (Mo. Ct. App. May 3, 2011) (court refused to interfere with city employee matters when the legislature delegated that authority to the city manager); *York v. Civil Serv. Comm'n*, 689 N.W.2d 533, 541 (Mich. Ct. App. 2004) (rejecting the plaintiff's request for the court to rewrite a state agency's employee classification rules to place plaintiff in a higher paying job classification: "This would not only infringe on the CSC's 'absolute,' plenary,' and constitutionally mandated authority to classify its employees, but it would also violate the separation of powers doctrine.").

If the Court finds the PERA Statute requires that some benefit must be provided to public employees even though they are able to work in another occupation, then PERA must exercise its legislative responsibilities and determine what benefit to provide. PERA has innumerable benefit choices, income replacement benefits being only one possible choice. PERA might choose to provide retraining or rehabilitation services to employees who are able to work in another gainful occupation. PERA might choose to provide lesser income replacement benefits for a shorter duration for employees who can work in another occupation (maybe 35% of predisability earnings rather than 60%, for 6 months rather than 22 months). PERA might choose to provide the same income replacement benefit to all public employees, but shorten the benefit period, or diminish the benefit calculation formula, to ensure that the program does not become too costly. These

are quintessentially legislative choices shaped by public policy, from which the Court must abjure.

Lawless's reformation theory is not a simple claim to reform an insurance policy to conform to statutory minimum coverage requirements. Lawless wants the Court to assume PERA's legislative rulemaking authority, make discretionary public policy decisions about what benefits the State should offer, and seize Standard's assets to fund the judicially redesigned program retroactive to January 1, 1999, under the guise of reformation of contract. Lawless's request for judicial rewriting of PERA's rules and judicial rewriting of the Group Policy circumvents the safeguards of the Administrative Procedures Act and is inimical to Colorado Constitution's separation of powers.

If PERA exceeded its statutory charter by adopting Rule 7.45 and purchasing an insurance policy that conforms to Rule 7.45, the judicial remedy available to Lawless is to declare Rule 7.45 unconstitutional and the Group Policy void. When a public entity enters a contract that exceeds its statutory authority, the contract is void. See *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."); *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.").[1]

[1] Lawless and PERA continue to argue—as they did in response to Standard's Motion to Dismiss—that declaring a contract void is limited to cases where the public contract required subsequent ratification by the legislature, a public official, or by public vote. Declaring a contract void 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

PERA mistakes Standard's argument about the remedy of declaring the Group Policy void as a request by Standard to rescind the Group Policy.[2] PERA asserts that the Group Policy's incontestability clause precludes the Court from declaring the Policy void. Incontestability clauses preclude insurers from *rescinding* insurance policies after expiration of the incontestability period based on material misrepresentations in the insurance application. *Yumukoglu v. Provident Life & Acc. Ins. Co.*, 131 F.Supp.2d 1215, 1221-22 (D. N.M. 2001). Incontestability provisions do not apply to policies that are void *ab initio*. An incontestability clause "presupposes a valid contract and not one void *ab initio*—it cannot be used to sanctify that which never existed." *Obartuch v. Security Mut. Life Ins. Co.*, 114 F.2d 873, 878 (7th Cir. 1940) (distinguishing voidable policies, which are subject to being "cancelled" by the insurer for misrepresentations in the application, from policies void *ab initio*, which are invalid and never came into existence).

PERA enthusiastically endorses Lawless's false theory of "retroactive reformation." By advocating retroactive reformation as a cognizable remedy, PERA endeavors to transform its constitutional liability into Standard's contractual liability, and thereby preserve the State's treasury. But the remedy that Lawless and PERA call "reformation" entails judicially rewriting PERA's rules to provide expanded monetary benefits to public employees in violation of the separation of powers, and imposing the judicially rewritten rules on Standard as retroactive

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enters a contract that exceeds its statutory authority, the contract is void. See *Colo. Ass'n of Public Employees v. Dept. of Highways*, 809 P.2d 988, 996-97 (Colo. 1991) (contracts entered by the Department of Highways declared void where the Department exceeded its statutory authority in agreeing to certain contract terms). Standard addressed Lawless's and PERA's argument in its Reply in Support of its Motion to Dismiss. Lawless and PERA offer no further rebuttal; they merely reiterate the same arguments that Standard refuted in its Reply.

[2] Standard is not asking to rescind or declare the Group Policy void.

contract terms. The proposed judicially rewritten law (Rule 7.45 *sans* subsection (E)), incorporated into a judicially "retroactively reformed" Group Policy, would impose new duties and obligations on Standard to pay income replacement benefits to public employees who are not entitled to receive a monetary benefit under the current PERA disability regime, retroactive to January 1, 1999. The judicially rewritten Rule 7.45 would be an unconstitutional retrospective law. Colo. Const. art 2, §11. *Saxe v. Bd. of Trs. of Metro. State Coll. of Denver*, 179 P.3d 67, 74 (Colo. Ct. App. 2007) (A retroactive law is unconstitutionally retrospective when it "impairs a vested right or creates a new obligation, imposes a new duty, or attaches a new disability.") (citing *In re Estate of DeWitt*, 54 P.3d 849 (Colo. 2002)).

PERA argues that Standard implicitly agreed to the remedy of reformation by including a provision in the Group Policy that provides for changes in premium rates when "[a] change or clarification in law or governmental regulation affects the amount payable under the [Group Policy]." (PERA Response, pg. 7). Standard, by incorporating a provision in the Group Policy that permits increased premiums when a law alters the risk insured cannot absolve the State of Colorado from compliance with the foundational protections of the Colorado Constitution. The Group Policy's provision for adjusting premiums when a change in law affects its contractual obligations does not turn invalid unconstitutional retrospective laws into enforceable constitutional laws.

Retrospective "reformation" of PERA's Rules and the Group Policy also violates the Takings Clause of the Colorado Constitution, Colo. Const. art. 2, §15. If PERA enacted a legislative rule that violates the Due Process Clause, the state cannot seize private property to obtain the funds to pay for its violation. Lawless proposes to obtain by judicial fiat the private

property of Standard to pay Colorado employees for PERA's alleged Due Process violations. Lawless argues that a governmental taking of property for the public good assumes the legitimacy of the governmental action, citing cases that reflect disputes over the amount of compensation to be paid where the government's taking of property was proper. Lawless declares that after the State seizes Standard's property for the benefit of public employees, Standard can sue PERA for just compensation.

Lawless's "so sue me" solution for governmental seizures would make every seizure lawful. She ignores the cardinal purpose the Takings Clause serves in the Bill of Rights and Colorado's Constitution, to protect private citizens against the abuse of government authority. 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 is not for the public good. The appropriation aims to take Standard's funds to pay damages caused by PERA's alleged Due Process violations, to preserve the State's treasury. That's not a legitimate exercise of governmental authority for the public good. It is an arbitrary exercise of governmental authority for the financial benefit of the State.

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 declare the Group Policy void, and not to judicially redesign Colorado's disability welfare program under the guise of reformation of contract. 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.