

**IN THE SUPERIOR COURT FOR THE DISTRICT OF COLUMBIA  
CIVIL DIVISION**

NATIONAL ASSOCIATION OF	)	
STATE FARM AGENTS, INC.,	)	
	)	
Plaintiff,	)	C.A. No. 02ca0004089
	)	Calendar 7
vs.	)	Judge Neal E. Kravitz
	)	
STATE FARM MUTUAL	)	
AUTOMOBILE INSURANCE	)	
COMPANY, et al.,	)	
	)	
Defendants.	)	

**PLAINTIFF’S MEMORANDUM OF LAW  
IN SUPPORT OF ITS MOTION FOR A  
PRELIMINARY INJUNCTION**

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## I. INTRODUCTION

Plaintiff, National Association of State Farm Agents, Inc. (“NASFA”), submits this memorandum in support of its motion for a preliminary injunction against Defendants State Farm Mutual Automobile Insurance Company, State Farm General Insurance Company, State Farm Fire and Casualty Company, and State Farm Life Insurance Company (hereinafter collectively referred to as “State Farm”), seeking to enjoin State Farm from improperly restricting the ability of NASFA Agents (“Agents”) from selling new insurance policies.

State Farm requires its Agents to maximize their sales. State Farm requires its Agents to make their State Farm business their principal occupation. Yet, State Farm has recently established a two-pronged restriction which has effectively slammed the door on Agents’ ability to sell new policies and generate customers. Thus, State Farm has dramatically restricted Agents’ rights in most states to sell new State Farm policies, in its drive to exit the business that granted it wealth and prominence. The coup de grace, however, is that, while State Farm has suddenly declined to issue new policies, it also has refused to consent to its Agents’ selling comparable policies of other insurers. It has done so despite the fact that the Agents’ Agreements expressly contemplate a procedure for consent by State Farm to such sales, that State Farm has given such consent in the past, and that it is virtually denying all consent now, in spite of the fact that it is not even competing for these policies and that such a blanket refusal, coupled with its refusal to write new State Farm business, threatens the livelihoods and continuation in business of its Agents.

State Farm’s policy not only advances its withdrawal from the insurance business, it also cleverly but cynically enables State Farm to accomplish termination of its older Agents, who earn greater commissions on the same policies than do younger Agents. This is accomplished through manipulation of the retirement payment system, which (in the older Agents’ form of Agreement) is based on Agent’s book of business in the last year before retirement. Unless enjoined, State Farm will force the older Agents to retire now, rather than to continue in

business, and watch their books decline drastically, thus suffering a corresponding loss in retirement payments.

In this Memorandum, NASFA first sets forth the facts, then discusses each of the elements, proof of which is required by this and other courts for a party to obtain a preliminary injunction. NASFA can establish a substantial likelihood of success on the merits. Given the tremendous irreparable harm faced by its members if State Farm is not enjoined (loss of new customers and potential destruction of their businesses), compared to the negligible “harm” State Farm will face if it honors its obligations, and is required either to allow its Agents to sell new State Farm policies as previously, or to sell new policies of other insurers where State Farm declines to insure, the balance of hardships tips decidedly in favor of NASFA. As such, NASFA’s required showing of likelihood of success is reduced. Whatever the test, however, NASFA prevails.

NASFA can prevail on multiple bases, but any one of these bases, standing alone, is substantial and justifies the injunction. Thus, NASFA can prevail because of State Farm’s breach of express contract, and/or because of State Farm’s breach of the implied covenant of good faith and fair dealing, and/or on the basis of “de facto termination.” Finally, while it is not necessary in deciding this motion for this Court to reach the issue of whether the Agents are “franchisees” of State Farm, NASFA discusses that also, because the existence of a franchise relationship provides significant further support for its position.

## **II. STATEMENT OF THE FACTS**

NASFA is a District of Columbia corporation composed of State Farm Agents throughout the United States. State Farm and each of NASFA's member Agents are parties to contracts consisting of the written Agreements between the parties, their oral representations, the written representations of State Farm, the course of dealing and practice between the parties, and the implied covenant of good faith and fair dealing.

Agents have always been State Farm’s principal avenue for selling insurance policies. Affidavit of NASFA President David Swift (hereinafter “Swift Aff.”) at ¶ 3. The Agents are

required to conduct field underwriting, solicit insurance, collect premiums and assist with insurance claims. Agents have protected territories and receive commissions for every policy they sell. See id. at Exs.1-2 (hereinafter “Agent’s Agreements”). It takes years for Agents to build and establish their clientele and reputations within their communities. Id. at ¶ 11. Agents invest considerable time, effort, and resources into marketing and advertising strategies, networking, record keeping, and selling State Farm insurance policies. Id. at ¶ 12.

The two primary categories of insurance policies that the Agents sell are automobile insurance policies and fire insurance policies.<sup>1</sup> Id. at ¶ 5. Until recently, and since at least 1977, State Farm never maintained a national or widespread program which restricted its Agents, by month or otherwise, as to how many new automobile and fire insurance policies they were allowed to sell. State Farm has implemented occasional state-specific limits, in response to identified natural disasters, such as hurricanes and earthquakes in limited geographic areas. As set forth below, State Farm new policy is dramatically different. Id. at ¶ 6.

A typical unrestricted Agent sells, on average, at least 15 policies a month for fire insurance, and at least 30 policies per month for automobile insurance, thus selling, on average, 45 applications for insurance per month, per Agent, for State Farm. Id. at ¶ 7. Commencing in September of 2001, and intensifying steadily since then, however, State Farm began restricting the ability of its agents to sell new insurance policies by imposing limitations on how many insurance policies an Agent could submit each month.<sup>2</sup> Id. at ¶ 8. This new policy, coupled with State Farm’s simultaneous refusal to consent to its Agents selling policies to other insurers even when State Farm is not interested in competing (a consent process expressly included in the

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<sup>1</sup>Fire insurance is also commonly referred to as homeowner’s insurance.

<sup>2</sup>These limitations are also commonly known and referred to as State Farm’s “no-new-business” policy.

Agents' Agreement), has necessitated this Motion. The situation is well summarized in ¶ 8 of the Affidavit of NASFA President David Swift, which paragraph we reproduce in full below for the Court's convenience:

8. Commencing in September of 2001, State Farm, without any notice, started what has now become a nearly nationwide policy severely restricting the number of new insurance policies Agents may sell in any given month (a "no-new business" policy). The restrictions vary, but in general, these restrictions range from the elimination of an Agent's right to sell new fire and automobile insurance policies, to the imposition of limits in the number of new insurance policies an agent can sell per month. State Farm has insured that this policy will in fact threaten the livelihoods of its Agents by denying them customers, because it has coupled the "no-new business" policy with a near-blanket refusal to consent to Agents selling comparable policies offered by other insurers. As recited below, such a near-blanket refusal is different from State Farm's prior practice, and makes a mockery of the good faith and fair dealing required of State Farm in implementing its "consent" procedure. In other words, State Farm decided not to insure against a risk, denying the Agent the ability to sell the policy, and having decided not to accept or compete for that business, State Farm also bars the Agent from obtaining the customer by writing the business for another company which is willing to insure against the risk, on comparable terms. State Farm's policy is thus double-barreled. The Agent is in a room which has two doors, and, whichever way she or he turns, State Farm has slammed the door. State Farm's policy advances at least two goals: First, in violation of its contractual obligations to its Agents, State Farm is able to withdraw over time from the business of insurance. Second, and even more cynically, State Farm is able to drive from the business its experienced Agents, whose State Farm Agreements cannot be terminated (except for breach) until their deaths. This is accomplished because the older, more experienced Agents have Agreements with State Farm that enable them to earn greater commissions on policies than the newer Agents, functioning under newer Agreements, earn from the same business. The older Agreements, (form AA3), however, unlike the newer Agreements (form AA97) contain provisions that provide termination payments and extended termination payments to the Agent based substantially on a percentage of the Agent's book of business existing in the last year before retirement. (Form AA3, Sections IV and V). Therefore, it is crucial that an Agent retire when her book of business is substantial—but State Farm's new policies,

unless enjoined, will result in the significant swift reduction in the Agents' books of business. As a result, the older, better compensated Agents whose termination (retirement) payments are tied to their last year, must retire now, or very soon, unless State Farm's Draconian policy of "heads I win, tails you lose" is enjoined.

State Farm's refusal to allow its Agents to sell new State Farm policies and its corresponding limitations have drastically disabled, or entirely eliminated, the ability of many Agents to obtain new customers, which threatens destruction of their businesses. Id. at ¶ 10. As set forth in the Affidavit of NASFA's Robert E. O'Connor, Jr., State Farm has implemented these limitations in at least 36 of the 47 states in which it has Agents, as follows:

**NUMBER OF POLICIES AGENTS NOW MAY SELL BY ZONE AND POLICY**<sup>3</sup>

**Southern**

STATE	AUTOMOBILE	FIRE
Alabama	1% <sup>4</sup>	1%
Georgia	1%	1%
Mississippi	1%	1%
South Carolina	1%	1%

<sup>3</sup>Agents in the remaining states, i.e., Ohio, Connecticut, Maine, Michigan, New Hampshire, Vermont, Missouri, Kansas, Oklahoma, and Arkansas do not, at this point in time, have limitations on the number of policies they can sell. No information is currently available for the State of Rhode Island.

<sup>4</sup>Unless indicated in terms of a percentage, the limit set forth in the chart is a limit imposed per month. Where the chart indicates a limitation in terms of a percentage, an Agent is limited to selling a percentage of the policies the Agent currently is servicing for an entire year. Thus, if the limit is 1.7%, an Agent who has, as typical Agents do, 2000 automobiles insured, will be limited to selling 34 new automobile policies in a year, where absent the restriction, Agents generally sell 30 policies per month, or over 360 policies per year. Swift Aff. at ¶ 7.

**Great Western**

STATE	AUTOMOBILE	FIRE
Arizona	25	6
Colorado	40	10
Nevada	25	5
New Mexico	40	8
Utah	30	6
Wyoming	23	8

**Great Lakes**

STATE	AUTOMOBILE	FIRE
Illinois	--- <sup>5</sup>	0
Indiana	---	0

**Heartland**

STATE	AUTOMOBILE	FIRE
Iowa	---	0
Minnesota	---	2.2%
Nebraska	---	0
North Dakota	---	0
South Dakota	---	0
Wisconsin	---	2.2%

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<sup>5</sup>Indicates that no limitation has yet been imposed.

**Mid Atlantic**

STATE	AUTOMOBILE	FIRE
Delaware	---	0
Maryland	---	0
North Carolina	---	0
Virginia	---	3%
Washington, DC	---	0
West Virginia	---	0

**East Central**

STATE	AUTOMOBILE	FIRE
Kentucky	---	0
Ohio	---	---
Tennessee	0	0

**Pacific Northwest**

STATE	AUTOMOBILE	FIRE
Alaska	---	10-15-20 <sup>6</sup>
Hawaii	---	10-15-20
Idaho	---	10-15-20
Montana	---	10-15-20
Washington	---	5-7-10

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<sup>6</sup>In the Pacific Northwest zone, limitations vary based upon the number of policies the agents had in effect the preceding calendar year.

**Colonial**

STATE	AUTOMOBILE	FIRE
New Jersey	0	---
New York	50%	---
Pennsylvania	---	Replacement Only

**California**

AUTOMOBILE	FIRE
---	0

**Florida**

AUTOMOBILE	FIRE
0	0

**Texas**

AUTOMOBILE	FIRE
---	0

Affidavit of Robert E. O'Connor, Jr. at ¶ 3.

Thus, in all but one of the 36 states identified above, State Farm has drastically reduced the number of policies that an Agent is permitted to sell. In 17 of the above-listed states, State Farm has entirely eliminated an Agent's ability to sell new fire insurance policies, and in Florida, New Jersey, and Tennessee, Agents have been entirely stripped of their rights to sell new automobile insurance policies.

The business that is affected by these limitations is both an Agent's new business (selling insurance policies to new customers) and the business of maintaining and servicing the needs of

existing customers. Swift Aff. at ¶ 13. In fact, new business is a critical component of the Agents' abilities to sustain their current customer levels. Id. at ¶ 14. Each year, some customers either let their policies lapse or they cancel their policies. Id. at ¶ 15. The lapse/cancellation rate, during times when Agents have been allowed to sell new insurance policies, has been, on average, fifteen percent per year. Id. at ¶ 16. The Agents have always been able to sustain or increase their levels of business, despite this lapse/cancellation rate, because they have been able to sell new insurance policies. Id. at ¶ 17. Without the ability to sell new insurance policies (be they State Farm policies or the policies of other insurance providers), however, not only will the lapse/cancellation rate surely increase (because the Agents will not be able to meet all of their clients' insurance needs), but the Agents will have no way to replace the business they lose each year due to these lapses and cancellations -- an equation that amounts to certain doom for the Agents' businesses. Id. at ¶ 18.

Additionally, the goodwill that each Agent has worked for years and sometimes decades to develop has been jeopardized by State Farm's limitation on, or elimination of, the Agents' abilities to sell new insurance policies. Id. at ¶ 19. With State Farm's implementation of its restrictive policy, Agents are now unable to service the changing insurance needs of their existing customers. Id. at ¶ 20. Additionally, Agents have to turn away new customers seeking their services. Id. If Agents cannot serve their existing customers, as well as new customers who often are referred by the Agents' existing customers, the Agents stand to lose not only the good will of their existing customers, but that cultivated to attract prospective customers as well. Id. at ¶ 21.

State Farm has declared that its reason for essentially terminating the Agents' abilities to sell new insurance is that it does not want to underwrite any new insurance policies and undertake the risks associated thereto. Id. at Ex. 4. While State Farm has the right to make underwriting decisions, the wholesale abandonment of the business is irreconcilable with a basic requirement of and expectation in the Agreements between State Farm and the Agents. As referred to in Mr. Swift's affidavit, each Agent Agreement ("Preamble") states:

It is to our mutual interest to satisfactorily serve the insuring public, to comply with all applicable laws, to increase business commensurate with the available potential, and to maintain the Companies' operations on a profitable basis in order to assure the necessary financial strength to protect the policyholders' interests.

(Emphasis added.)

In an effort to accommodate State Farm's business objectives, and despite the fact that such objectives, as implemented, violate the Agreements, Agents sought to mitigate the harm imposed on them by State Farm by instead seeking to sell insurance for other insurance providers – a practice contemplated by their Agreements. Hence, on November 25, 2002, Mr. Swift, on behalf of NASFA and its member Agents, sent a letter to State Farm, requesting that State Farm permit the Agents to sell new insurance policies for other insurance providers, in light of State Farm's decision to withdraw from the business of selling new insurance policies. Id. at Ex. 5. Again, as President Swift's affidavit states, the Agreements between the parties recite, in this regard, that an Agent may sell insurance for other providers provided that the Agent has received written consent from State Farm. Specifically:

[Y]ou will not directly or indirectly write or service insurance for any other company, other than a State Farm subsidiary or affiliate or through any governmental or insurance industry plan or facility, or for any agent or broker, except in accordance with the terms of any written consent we may give you.

See Agent's Agreements, ¶ G (emphasis added).

State Farm refused to reply to NASFA's request. Swift Aff. at Ex. 6. In sum, despite the request by NASFA, as well as similar requests by Agents, not only has State Farm advised that it will not permit the Agents to continue to sell new insurance policies for State Farm, as they have done for years, State Farm also has refused to allow the Agents to mitigate the harm caused by State Farm's "no-new-business" policy, by refusing to consent to their selling policies for other insurance providers. See letters enclosed with Affidavit of Jennifer L. Gehrig (hereinafter "Gehrig Aff.") at Exs. 2-5. In so doing, State Farm has rendered the Agents' "right" to sell policies of other insurance providers, with State Farm's consent, to be worthless. It is black

letter law, discussed infra, that where “consent” is required, the right to give or withhold consent must be interpreted in good faith and cannot be a subterfuge for a blanket refusal to consent. This is especially true where, as here, the refusal to consent will have an (intended) effect of promptly forcing State Farm’s experienced, better-compensated Agents into retirement or out of business.

To reiterate, absent the ability to sell new State Farm insurance policies without restriction, or, in the alternative, at least to sell insurance policies for other insurance companies, the goodwill that each Agent has spent significant time, energy and resources to develop will be damaged beyond repair, and the very viability of each Agent’s business will be severely jeopardized, if not destroyed. Swift Aff. at ¶¶ 21-22. The harm posed to the Agents from the implementation of State Farm’s straitjacket of its Agents is immediate and irreversible. Accordingly, NASFA cannot wait any longer to seek interim relief, for trial of this issue on the merits will come too late for many Agents. Therefore, NASFA respectfully requests that this Court issue a preliminary injunction permitting the Agents either to engage in the business of selling new State Farm insurance policies, or to permit them to sell new policies of other insurers where State Farm has restricted their State Farm sales.

### **III. ARGUMENT**

#### **A. NASFA HAS SATISFIED THE STANDARDS FOR PRELIMINARY INJUNCTIVE RELIEF**

The Court, in deciding whether to grant a preliminary injunction, considers:

(1) [the] likelihood of irreparable harm in the absence of a preliminary injunction; (2) [the] likelihood of success on the merits in the underlying cause of action; (3) [whether] the “balance of injuries” favors granting an injunction; and (4) [whether] the public interest would be served by granting the injunctive relief sought.

In re Antioch Univ., 418 A.2d 105, 109 (D.C. 1980); see District of Columbia v. Eastern Trans-Waste of Maryland, Inc., 758 A.2d 1, 14-15 (D.C. 2000). The purpose of a preliminary injunction is to preserve the rights of a party until they can be fully determined at trial. District

of Columbia v. Eastern Trans-Waste, 758 A.2d at 14-15 (“the primary justification for the issuance of a preliminary injunction is always to prevent irreparable injury so as to preserve the court’s ability to render a meaningful decision on the merits”) (quotation omitted); accord Wieck v. Sterenbuch, 350 A.2d 384, 387 (D.C. 1976), citing Canal Authority v. Callaway, 489 F.2d 567 (8<sup>th</sup> Cir. 1974). Preservation of the “status quo” does not mean perpetuation of the situation at the time of the motion, if to do so would be to “undermine the final disposition of the case on the merits.” 7 Moore’s Federal Practice, ¶ 65.04(1). Thus, “courts also have awarded preliminary injunctions when it is necessary to compel defendant to correct injury already inflicted by defining the status quo as ‘the last peaceable uncontested status’ existing between the parties before the dispute developed.” 11 A Wright & Miller & Kane, Federal Practice & Procedure § 2948 at 136 (citing thirteen cases, including District 50 United Mine Workers of Am. v. International Union, United Mine Workers of Am., 412 F.2d 165 (D.C. Cir. 1969)). District 50 is relied on by the D.C. Court of Appeals in Wieck, 350 A.2d at 387.

The “last peaceable uncontested status” in this case is the status existing before State Farm implemented and extended the double-barreled restrictions that now threaten to destroy its Agents’ livelihoods. The Agents, since at least 1977, had been permitted to sell new insurance policies, be they automobile, fire or otherwise, without any comprehensive policy of restriction on how many insurance policies they could sell in any given time period, Swift Aff. at ¶ 6. By this motion, NASFA is simply asking that such right be preserved. This Court has before it two options as to how to achieve this goal; either State Farm can remove the newly-imposed restrictions so that the Agents may sell new State Farm insurance policies without limitation, or State Farm can “consent” to allow the Agents to meet the needs of their customers by selling new insurance policies for other insurance providers where State Farm does not choose to compete. The Agents’ businesses are built on their abilities to service all of their existing customers’ insurance needs, as well as their abilities to maintain and grow their businesses by meeting the needs of new customers who are often referred by existing customers because of the goodwill and reputation the Agents have cultivated over the years. Id. at ¶¶ 19-20. The rights of

the Agents to conduct their businesses as they have done for years must not be fatally impaired unless, and until, this Court decides otherwise after hearing the case presented in full and on the merits.

**B. NASFA AGENTS WILL SUFFER IRREPARABLE AND PERMANENT INJURY IF THE INJUNCTION IS NOT GRANTED**

“While ‘economic loss does not, in and of itself, constitute irreparable harm,’ such harm will be found if economic ‘loss threatens the very existence of the movant’s business.’” Eastern Trans-Waste, 758 A.2d at 15 (citation omitted); see e.g., Montgomery Cty. Assoc. of Realtors, Inc. v. Realty Photo Master Corp., 783 F. Supp. 952, 959 (D. Md. 1992) (when the anticipated economic injury is of such severity that the company will be put out of business altogether such injury sufficiently establishes irreparable harm). Here, State Farm has effectively terminated the rights of the Agents to sell new policies to new customers and to service their existing customers, and thus has placed the Agents’ businesses on the certain road to failure.

In Federal Leasing, Inc. v. Underwriters, 650 F.2d 495, 500 (4<sup>th</sup> Cir. 1981), the plaintiff was in the business of leasing computers. Id. at 497. The plaintiff had an insurance policy which protected it from any losses due its inability to re-market returned computers. Id. When the plaintiff attempted to collect on this policy after several million dollars of computers became obsolete, however, the insurance company refused to honor this policy. Id. at 498. The record established that if the insurance company refused to honor its policy, the plaintiff would have been driven out of business. Id. at 499. The Fourth Circuit upheld the district court’s grant of injunctive relief to plaintiff, finding that the plaintiff would suffer irreparable harm, stating:

Plaintiff seeks to preserve its existence and its business . . . the continuation of its present predicament endangers its relations with customers and investors, the goodwill built up by a heretofore successful enterprise; such damage is incalculable not incalculably great or small, just incalculable.

Id. at 500 (emphasis added) (citations omitted). The concept that loss of a business and all that is attached thereto, including goodwill, cannot be compensated in money damages, was underlined by Chief Judge Henry Friendly in Semmes Motors, Inc. v. Ford Motor Co., 429 F.2d 1197 (2<sup>nd</sup> Cir. 1970). In Semmes, the court enjoined the termination of a Ford dealer because of the inability to adequately compensate, in monetary terms, the potential loss of good will established over the 20-year duration of the dealership. Id. at 1205. Judge Friendly held, in words cited frequently across the decades:

The right to continue a business is not measurable entirely in monetary terms; [plaintiffs] want to sell automobiles, not to live on the income from a damages award.

Id.

Just as in Federal Leasing and Semmes, State Farm's restriction on, and elimination of, the rights of the Agents to sell new insurance policies threatens the Agents with the inevitable loss of their businesses. Virtually all Agents are completely dependent upon their State Farm insurance businesses for their livelihoods. Swift Aff. at ¶ 10. The implementation of State Farm's "no-new-business" policy is leading to and will surely culminate in the demise of each Agents' business, because servicing existing policies alone will not sustain the Agents' businesses. Id. at ¶¶ 17-18. Furthermore, a damages award cannot sufficiently remedy the loss of the Agents' businesses. The Agents sell insurance, and once their goodwill and reputation have been destroyed, it cannot be regained. Loss of goodwill is not compensable in damages, and constitutes irreparable harm to the Agents. See, e.g., Federal Leasing, 650 F.2d at 500; Reins of Life, Inc. v. Vanity Fair Corp., 5 F. Supp. 2d 629, 632 (N.D. Ind. 1997).

As in Semmes, the Agents want to sell insurance, not live on the income that may come from a damages award, and a preliminary injunction should be entered. Id. at 1205; see also TJS Brokerage & Co. v. Hartford Casualty Ins. Co., 2000 WL 1060645 (Pa. Cmmn. Pl. April 24, 2000) (granting plaintiff's request for a preliminary injunction when failure to do so would result in plaintiff going out of business); Heck Implement, Inc. v. Deere & Co., 926 F. Supp. 138

(W.D. Mo. 1996) (granting injunction to a dealer due to debatable statutory issues and balance of hardships favoring dealer because the court found that the “likely harm to [the dealer] from loss of dealership greatly outweighs any likely harm to Deere from continuing [the relationship] ... for six months”); Ross-Simons of Warwick, Inc. v. Baccarat, Inc., Bus. Franchise Guide (CCH) ¶ 11,074 (1<sup>st</sup> Cir. 1996) (preliminary injunction granted even though product involved accounted for very modest portion of moving party’s annual sales); Roso-Lino Beverage Distribs., Inc. v. Coca-Cola Bottling Co. of New York, Inc., 749 F.2d 124 (2<sup>d</sup> Cir. 1984) (granting preliminary injunction prohibiting termination of 11-year dealership because “it is unlikely that Coca-Cola will suffer greatly if the 11-year relationship continued for a short while”); Matt Lamb & Sons, Inc. v. Christian Schmidt Brewing Co., 485 A.2d 836, 842 (Pa. Super. Ct. 1984) (holding that a distributor would suffer immediate and irrevocable loss because it would “lose 35% of its most profitable business, 21% of gross sales, and \$75,000 to \$100,000 in gross profit if its role as primary distributor of Schmidt’s products was terminated, and if it was forced to purchase as a secondary distributor”).

By its blanket refusal to permit Agents to sell new State Farm policies and its evisceration of the “consent” process concerning their sales of other insurance company products into a de facto 100% restraint, State Farm has provided its Agents with no choice but this motion. As discussed below, given that State Farm will suffer little, if any, harm if the Agents are permitted to either sell State Farm insurance without limitation, or in the alternative insurance policies for other insurance providers, for at least the interim period until a determination of this case on the merits, the balance of harms weighs greatly in favor of granting NASFA’s requested injunctive relief.

**C. STATE FARM WILL SUFFER LITTLE, IF ANY, INJURY IF THE INJUNCTION IS GRANTED**

If State Farm is enjoined and the Agents are allowed to sell new insurance policies without restriction, whether those insurance policies are State Farm policies or the policies of other insurance providers, the injury State Farm may suffer, during the time this case is in

litigation, is negligible. State Farm may argue that it will be harmed if it is forced to underwrite new insurance policies without limitation because it will be forced to undertake risk that it has determined it does not want to, and perhaps cannot, take on. But even if State Farm is correct (and query whether this is correct, especially given the interim nature of a preliminary injunction), it need not take on such risk, because it has a viable option that is expressly contemplated and provided for in the agreements -- i.e., consenting to allow the Agents to sell policies for other insurance providers.

Thus, while State Farm may arguably benefit from the injunction requested because the Agents will continue to generate income for State Farm from the Agents' sales of State Farm insurance policies, State Farm has available to it an alternative that will allow State Farm to implement its business decision (even though this "no-new-business" policy violates State Farm's agreements with its Agents) in a manner that will not irreparably harm the Agents in the process. State Farm can, under the express language of the written agreements, permit the Agents to sell new insurance policies for other insurance providers. To reiterate, the Agreements between the Agents and State Farm specifically contemplate this remedy:

[Y]ou will not directly or indirectly write or service insurance for any other company, other than a State Farm subsidiary or affiliate or through any governmental or insurance industry plan or facility, or for any agent or broker, except in accordance with the terms of any written consent we may give you.

See Agent's Agreements at ¶ G (emphasis added.) Furthermore, the Agents do not ask that State Farm do something it has never done. State Farm has historically permitted Agents to write for Baldwin Mutual in Alabama. Swift Aff. at ¶ 26. Additionally, Agents who have signed the "IPSI" Agreement are permitted to sell Fortis Insurance and "Select Agents" are permitted to sell life insurance for Phoenix Mutual. Id. at ¶ 27. Thus, State Farm specifically contemplated the need to allow, and implemented a method for allowing, Agents to write and service insurance for other providers. No other situation is more suited to implementation of this

remedy, specifically provided for in the Agents' Agreements, than the situation presented by the "no-new-business" policy, a policy that is entirely the responsibility of State Farm.

State Farm cannot argue that it will be harmed by consenting to its Agents' selling new insurance policies for other insurance providers, because State Farm has decided it does not want to generate new business by selling policies to either its existing customers or to new customers. Therefore, State Farm cannot argue credibly that allowing Agents to sell new insurance policies for other insurance providers will lead to the sale of fewer State Farm policies.

In contrast with State Farm's negligible injury, the Agents are faced with the certain destruction of their businesses. Clearly, the balance of harms strongly favors granting NASFA's request for a preliminary injunction.

**D. NASFA IS SUBSTANTIALLY LIKELY TO SUCCEED ON THE MERITS**

As demonstrated above, NASFA will suffer irreparable injury if the injunction is not granted, as opposed to State Farm's injury if it is granted, which is negligible at most. When the balance of hardships decidedly favors the party seeking the injunction, the traditional likelihood-of-success test does not control; the party seeking the injunction need not prove it has a "substantial" likelihood of success on the merits. Instead, it need only raise serious, substantial, difficult, and doubtful questions going to the merits. Blackwelder Furniture Co. of Statesville, Inc. v. Seilig Mfg. Co., 550 F.2d 189, 195 (4<sup>th</sup> Cir. 1977) (citation omitted); see also Montgomery County Association of Realtors, 783 F. Supp. at 959 (citation and quotation omitted). Consistent therewith, the District of Columbia courts hold that "the necessary 'level' or 'degree' of possibility of success will vary according to the Court's assessment of the other factors (of the analysis)." In re Antioch Univ., 418 A.2d at 110. Notwithstanding NASFA's lessened burden of proof, however, it is abundantly clear that NASFA will succeed in its claims against State Farm.

NASFA has asserted 19 causes of action against State Farm. A true and correct copy of the Complaint is attached hereto as Exhibit 1 to Affidavit of Jennifer L. Gehrig. For the purpose

of this motion, NASFA addresses the claims for breach of contract and the implied covenant of good faith and fair dealing, several of the statutory claims, and its tortious interference claims.

1. State Farm's refusal to grant permission to the Agents to sell insurance for other insurance providers, as well as State Farm's "no-new-business" policy constitute breaches of contract and the implied covenant of good faith and fair dealing implied therein.

- a. Breach of contract

State Farm's conduct in drastically limiting the number of new insurance policies that an Agent can sell constitutes a breach of the Agreements between the Agents and State Farm. The Agreements between the parties are specifically premised on the notion that the Agents must increase business and must sell as many new insurance policies as they can. The Agreements themselves do not limit the number of insurance policies an Agent may sell. In fact, to reiterate, the Preamble to the agreements between the parties states:

It is to our mutual interest to satisfactorily serve the insuring public, to comply with all applicable laws, to increase business commensurate with the available potential, and to maintain the Companies operations on a profitable basis in order to assure the necessary financial strength to protect the policyholders' interests.

Agent's Agreements at Preamble (emphasis added). The manner in which the Agents are compensated -- i.e., via commissions -- also strongly supports the position that the Agents are contractually entitled to sell new insurance policies without limitation. See Agent's Agreements at "Attachments." In fact, the ability to sell as many insurance policies as possible is the very essence of the bargain between the Agents and State Farm. Swift Aff. at ¶¶ 13-14.

Furthermore, from at least 1977 until recently, State Farm has never comprehensively limited the number of policies that Agents may sell. Id. at ¶ 6. Thus, the contract between the Agents and State Farm, as confirmed by the parties' course of dealing over several decades, is that the Agents may sell new insurance policies without limitation. State Farm's implementation

of limitations on the Agents' sales of new insurance policies breaches the parties' longstanding Agreements.<sup>7</sup>

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<sup>7</sup>See Restatement (Second) of Contracts § 223 at 157-58 (a course of dealing is a sequence of previous conduct between the parties to an agreement which is to be fairly regarded as establishing a common basis of understanding for interpreting their expressions and other conduct; unless otherwise agreed, a course of dealing between the parties gives meaning to or supplements or qualifies their agreement); Childs v. Adams, 909 S.W.2d 641, 645 (Ark. 1995) (formation of a contract is “made wholly by spoken words or by conduct”) (citations omitted); Mathis v. Daines, 639 P.2d 503, 505 (Mont. 1981) (holding that a contract may be explained by reference to the circumstances under which it was made and the matter to which it relates); Southworth v. Oliver, 587 P.2d 994, 998 (Or. 1978) (holding that in order to determine the terms of contract “the definiteness or indefiniteness of the words used in opening the negotiation must be considered, as well as the usages of business, and indeed all accompanying circumstances”) (citations omitted); Harper v. Cedar Rapids Television Co., 244 N.W.2d 782, 789 (Iowa 1976) (holding that “manifestation [to the terms of the contract] may be wholly or partly by written or spoken word or by other acts or failure to act”); Grammar v. Evans, 1998 WL 181998 \*2 (Ark. Ct. App. 1998) (“The courts may look to the conduct of the parties to determine their intent”) (citations omitted); Hartland Computer Leasing Corp. v. Insurance Man, Inc., 770 S.W.2d 525, 527 (Mo. Ct. App. 1989) (“As with all contracts, the court seeks to enforce the reasonable expectations of the parties garnered not only from the words of a standardized form imposed by it proponent, but from the totality of the circumstances surrounding the transaction...[s]uch provisions of the standardized form which fail to comport with such reasonable expectations [of the parties] or which are unexpected and unconscionably unfair are held to be unenforceable”) (citations omitted); Steinberg v. Arnold, 402 A.2d 1302, 1305-06 (Md. Ct. App. 1979) (“Another rule long recognized by the courts in Maryland is to admit extrinsic evidence of the negotiations leading up to the formulation of a contract, of the circumstances of the parties at the time of entering into the contract and of the parties own construction of the contract in order to discern their intention”) (citations omitted); Maryland Supreme Corp. v. Blake Co., 369 A.2d 1017, 1026 (Md. Ct. App. 1977) (holding that “where the contract for sale involves repeated occasions for performance by either party with knowledge of the nature of the performance and opportunity for objection by the other, any course of performance accepted or acquiesced without objection shall be relevant to determine the meaning of the agreement).

Additionally, the Agent's Agreements provide that:

...no change, alteration, or modification of the terms of this Agreement may be made except by agreement in writing signed by an authorized representative of the Companies and accepted by you.

Agent's Agreements at Section VI, ¶ E (Ex. 1) and Section VI, ¶ H. Thus, State Farm has also breached the parties' Agreements by imposing changes to the Agreements without complying with the terms of the provision prohibiting unwritten, unilateral changes to the Agents' Agreements with State Farm. It has modified a central requirement and right in the Agreements – that the Agent shall and must “increase business commensurate with the available potential” – greatly to the Agent's detriment. Hence, NASFA has demonstrated a likelihood that it will succeed on the merits of its breach of contract claim. Injunctive relief, particularly in light of the balance of hardships in favor of NASFA, is warranted.

b. Implied covenant of good faith and fair dealing.

Implied in every contract is a covenant of good faith and fair dealing that provides that neither party will deprive the other party of the fruits of the contract. Hais v. Smith, 547 A.2d 986 (D.C. 1988)(implied duty of good faith and fair dealing exists in every contract and prevents a party from evading the spirit of the contract, or from interference with another party's performance); Aronof v. Lenkin Co., 618 A.2d 669 (D.C. 1992) (implied covenant also requires that a party extend cooperation to another, clearing the way for performance). Here, State Farm did the opposite: it “evaded the spirit” of the contract; it “interfered with [the Agents'] performance; and, far from “cooperating so as to clear the way for performance,” it acted to frustrate and block that performance.

Additionally, the covenant of good faith and fair dealing requires that, even when a

party is vested with discretion, it must exercise that discretion reasonably.<sup>8</sup> Thus, under the covenant of good faith and fair dealing, which is implied in the Agreements between the Agents and State Farm, State Farm is obligated to exercise its discretion to consent “that Agents may sell insurance policies for other insurance providers” in a reasonable manner. State Farm, however, has acted in the most unreasonable manner possible.

Furthermore, State Farm cannot impose limitations on the Agents’ rights to sell new

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<sup>8</sup>See Southern Implement v. John Deere, 122 F.3d 503, 506 (8<sup>th</sup> Cir. 1997) (holding that a claim for a violation of the implied covenant of good faith and fair dealing would lie, and plaintiff could proceed to trial to attempt to show Deere’s bad faith in exercising [or failing to exercise] its contractual discretion with respect to another dealer marketing its product in plaintiff’s trade area); Wilson v. Amerada Hess Corp., 773 A.2d 1121, 1130 (N.J. 2001) (“ . . . when considering whether Hess breached the implied covenant, we must respect and give effect to the parties’ bargain as expressed in the contract, that is, the right of Hess to set the price of gasoline sold to its dealers. But the discretion afforded to Hess is not unbridled discretion. Hess’s performance under the contract is tempered by the implied covenant of good faith and fair dealing and the reasonable expectations of the parties”); Interim Health Care of Northern Illinois, Inc. v. Interim Health Care, Inc. 225 F.3d 876, 884 (7<sup>th</sup> Cir. 2000) (the implied covenant of good faith and fair dealing obligates a party who is vested with contractual discretion to exercise that discretion reasonably and with proper motive, and in a manner consistent with the reasonable expectations of the parties); Sons of Thunder, Inc. v. Borden, Inc., 690 A.2d 575 (N.J. 1997) (a manufacturer terminated a supply contract with a supplier in accordance with the literal terms of the agreement. Nonetheless, the court held that the manner of termination -- the manufacturer had reduced orders prior to termination, had arbitrarily rejected product, and had terminated in order to take advantage of a better deal elsewhere -- was a violation of the implied covenant of good faith and fair dealing); Wayman v. Amoco Oil Co., 923 F. Supp. 1322 (D. Kan. 1996) (holding that even when franchisor had unfettered discretion under the contract, the franchisor was required to exercise its discretion in good faith).

insurance policies in a manner that upsets the reasonable expectations of the Agents.<sup>9</sup>

It is instructive that State Farm might have attempted, but did not attempt, to grant itself greater and more arbitrary discretion in the Agreements. Thus, if a party wishes to retain the right not to act reasonably, it might be able to do so, by characterizing its decision to consent as one in its “sole and absolute subjective discretion.” See, e.g., Julian v. Christopher, 320 Md. 1, 11-12 (1990). Absent that, however, no party – not even, or perhaps especially, the country’s largest property/casualty insurer – can treat its Agents with such unbridled impunity.

Here, State Farm must, in some way, advance the reasonable expectations of the Agents that they will be permitted to sell new insurance policies without restriction or limitation. If

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<sup>9</sup>See RESTATEMENT (SECOND) OF CONTRACTS § 305, cmt. d. (the implied covenant of good faith and fair dealing protects a party from “evasion of the spirit of the bargain, lack of diligence and slacking off, willful rendering of imperfect performance, abuse of a power to specify terms, and interference with or failure to cooperate in the other party’s performance”); Dunafon v. Taco Bell Corp., Bus. Franchise Guide (CCH) ¶ 10,919 (D.C. Mo. 1996) (finding that plaintiffs had alleged sufficient facts to avoid dismissal of their claim that Taco Bell had acted in bad faith to prevent plaintiffs from enjoying the fruits of an oral expansion agreement with defendant Taco Bell because of franchisee’s involvement in an independent franchisee association); Venta, Inc. v. Frontier Oil & Refining, 827 F. Supp. 1526 (D. Colo. 1993) (recognizing the common-law claim for breach of the implied covenant of good faith and fair dealing arising out of the discriminatory practices of a motive yoke supplier’s favoritism of certain distributors over others); Juliano v. Sunoco, Inc., Bus. Franchise Guide (CCH) ¶ 11,562 (3d Cir. 1998) (applying Pennsylvania law and finding a breach of the covenant of good faith and fair dealing where the supplier’s pricing policies, while consistent with the requirements of the franchise agreement, violated the spirit of the agreement by making it nearly impossible for the dealer to make a profit). Globe Distrib., Inc. v. Adolph Coors Co., Bus. Franchise Guide (CCH) ¶ 9,821 (Bankr. N.H. 1991) (holding that, while not required by the specific terms of the written distributor agreement, the covenant of good faith and fair dealing required a brewer to make a prior demand for payment before it could, in good faith, invoke its termination rights, and awarding over \$5.1 million, doubled pursuant to statute, in damages for the breach of the implied covenant); Carmichael v. Adirondack Bottled Gas Corp. of Vermont, 635 A.2d 1211 (Vt. 1993) (finding that the implied duty of good faith and fair dealing continues after termination of a distribution agreement where the supplier failed to negotiate with its distributor for a new arrangement or to allow its distributor sufficient time to sell to another party); Newman v. Hinky Dinky Omaha-Lincoln, Inc., 427 N.W.2d 50, 54 (Neb. 1988) (“Where a contract confers one party a discretionary power affecting the rights of the other, a duty is imposed to exercise that discretion in good faith”)

State Farm neither allows the Agents to continue to sell new State Farm insurance policies, nor, in the alternative, allows the Agents to sell new insurance policies for other providers, as it is now doing, State Farm is acting in an arbitrary and unreasonable manner, which prevents the Agents from receiving the benefit of their bargains, in breach of the implied covenant of good faith and fair dealing.

Moreover, again under the implied covenant of good faith and fair dealing, State Farm also is limited by its historical course of dealing with its Agents. For over twenty-five years, State Farm virtually always allowed Agents to sell as many new insurance policies as they were able, imposing almost no limitations on the sale of new insurance policies. *Swift Aff.* at ¶ 6. Now, a sea change has occurred. State Farm's conduct is analogous to that in Carvel Corp. v. James Baker, 79 F. Supp. 2d 53 (D. Conn. 1997). In Carvel, a franchisor of ice cream parlors, Carvel, sold exclusively to franchisees for many years. Carvel then promulgated a new contract that gave it the right to sell through other channels of trade, and, particularly harmful to its franchisees, Carvel began selling in supermarkets that competed with franchisees. *Id.* at 56-59. *Id.* The franchisees sued. The court rejected the franchisor's contention that the integrated franchise agreement gave the franchisor immunity from liability in selling to supermarkets. The court stated:

[A]t the time the parties executed the . . . agreement, Carvel had, for decades, conducted its business exclusively through its company-owned stores and its franchisees. . . . It is therefore reasonable that the parties expected that the benefit accruing to the [franchisees] would include an unique relationship with Carvel, to the exclusion of supermarkets. . . . Under this construction, the supermarket program deprives the defendants of their right to receive the benefits of the agreement.

*Id.* at 62. The court when on to hold:

While Carvel has the discretion to institute an alternative distribution program, the [franchisees] could have reasonably expected, at the time of contracting, that Carvel would not use such a system to compete directly against them, especially since distribution to supermarkets and other retail outlets was not a

practice that existed prior to the agreement. While the [franchisees] are not entitled to abrogate Carvel's right to "sell or license to sell products under Carvel's trademarks ..." the [franchisees] are entitled to expect that Carvel will not act to destroy the right of the [franchisees] to enjoy the fruits of the contract.

Id. at 66.

Here, as in Carvel, State Farm, despite a historical course of dealing granting the Agents the right to sell new insurance policies without limitation, has decided that it no longer wants to undertake the risks associated with underwriting new insurance policies. In the face of this decision, State Farm must, at the very least, grant the Agents permission to sell new insurance policies for other insurance providers. Anything less destroys the right of the Agents to enjoy the fruits of their contracts with State Farm.

There is no bona fide reason (i.e., a reason that comports with the principle of good faith and fair dealing) for State Farm to deny the Agents the right to sell new policies for other insurance providers. State Farm has removed its companies from the business of selling new insurance policies. Therefore, it has no reason to fear the impact of allowing its Agents to sell policies for other providers -- State Farm has decided it does not want to do business and compete in this arena. Additionally, State Farm already permits Agents to sell for other insurance providers under the IPSI Agreement and has historically permitted Agents to write for Baldwin Mutual in Alabama.

State Farm's exercise of its discretion to grant permission to the Agents to sell insurance for other insurance providers must be reasonable, and the only reasonable exercise of that discretion in this context is for State Farm to permit its Agents to engage in the type of business with other insurance providers in which State Farm no longer wants to participate, namely the sale of new insurance policies. State Farm's denial of the Agents' requests for permission to sell policies for other insurance providers, while simultaneously strangling their contractual right and expectation to maximize sales of State Farm's policies, amounts to a breach of the Agreements between the parties and a breach of the implied covenant of good faith and fair dealing.

NASFA has demonstrated a substantial likelihood of success on the merits, clearly warranting the grant of injunctive relief as requested. Because of the drastic imbalance of hardship, NASFA need not have demonstrated such a strong likelihood of success, but it has done so.

2. State Farm's policy limiting and/or eliminating the rights of the Agents to sell new insurance policies also amounts to a de facto or constructive termination in violation of the Agents' agreements with State Farm.

As set forth above, the imposition of limitations that drastically reduce, or entirely eliminate, an Agent's right to sell new policies will have the effect of forcing Agents to close their businesses. By its action of both actually and effectively eliminating the rights of the Agents to sell new insurance policies to both new and existing customers, whether those new policies are State Farm policies or the policies of other insurance providers, State Farm has eliminated the Agents' abilities to maintain the amount of business necessary to keep their offices operating profitably, and has, therefore, effectively ruined the Agents' businesses. Thus, in addition to constituting breaches of express contract and of the implied dealing of good faith and fair dealing, State Farm's policy also amounts to a de facto or constructive termination of the Agents' Agreements with State Farm. This violates the Agreements, which provide that the term of the Agreements is the life of the Agent. See Petereit v. S.B. Thomas Inc., 853 F. Supp. 55 (D.C. Conn. 1993) aff'd in part, rev'd in part, 63 F.3d 1169 (2d Cir. 1995), cert. denied, 517 U.S. 1351 (1996) (a constructive termination may be found when a franchisor's actions result in a substantial decline in franchisee net income); Coast to Coast Stores, Inc. v. Gruschus, 667 P.2d 619, 628 (Wash. 1983) (when the means of continuing a business is taken away, the agreement has been terminated in fact); Meyer v. Kero-Sun, Inc., 570 F. Supp. 402, 407 (W.D. Wis. 1983) (grantor effectively terminated dealership by imposing substantial changes on the dealer at the

time of renewal); American Bus. Interiors, Inc. v. Haworth, Inc., 798 F.2d 1135 (8<sup>th</sup> Cir. 1986) (franchise terminated in effect when franchisor refused to provide franchisee with information necessary to conduct its business); Carlos C. Gelardi Corp. v. Miller Brewing Corp., 502 F. Supp. 637, 653 (D. N.J. 1980) (indirect termination can be accomplished through failure to deal fairly with dealers or franchisees).

The written Agreements between the parties provide that the Agreements last until the death of each Agent, and entitles each Agent to termination review procedures upon any attempted termination.<sup>10</sup> Agent's Agreements at Section III. State Farm's implementation of its "no-new-business" policy, which restricts and eliminates the rights of the Agents to sell new insurance policies, violates each of these provisions in the written Agreements, as well as the implied covenant of good faith and fair dealing contained in the Agreements. Thus, State Farm has effected a de facto termination of the Agents' Agreements, without notice, and without any type of review procedure. State Farm has, therefore, violated the Agreements between the parties, and NASFA has again demonstrated a substantial likelihood of success on the merits, warranting the grant of an injunction that would prevent these de facto terminations from taking place.

3. Imposition of limitations on selling new policies constitutes a fundamental change to, and constructive termination of, the agreements between the parties and violates several state franchise statutes.

NASFA also has alleged in its Complaint that State Farm's conduct violates the franchise

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<sup>10</sup>SECTION III - TERMINATION OF AGREEMENT

- A. This Agreement will terminate upon your death. You or State Farm have the right to terminate this Agreement by written notice delivered to the other or mailed to the other's last known address....
- B. In the event we terminate this Agreement, you are entitled to request a review in accordance with the termination review procedures approved by the Board of Directors of the Companies, as amended from time to time.

statutes of several different states.<sup>11</sup> The Court need not reach the issue of whether State Farm and its Agents are in a franchise relationship in deciding this motion, because the required likelihood of success on the merits has been demonstrated by NASFA already on three separate and independent bases, any one of which would be sufficient (breach of express contract; breach of implied covenant; and de facto termination). Nevertheless, it is instructive, and further supportive of NASFA's position, that the parties are in a franchise relationship.

All of the relevant franchise statutes define a "franchise" in terms of the following elements:

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<sup>11</sup>California Franchise Investment Law and California Franchise Relation Act (Count V); Hawaii Franchise Investment Act (Count VI); Indiana Franchise Act and Indiana Deceptive Franchise Practices Act (Count VII); Virginia Retail Franchising Act (Count VIII); Minnesota Franchise Act (Count IX); Wisconsin Franchise Investment Law and Wisconsin Fair Dealership Law (Count X); Nebraska Franchise Practices Act (Count XI); New Jersey Franchise Practices Act (Count XII); Oregon Franchise Act (Count XIII); Arkansas Franchise Practices Act (Count XIV); Delaware Franchise Security Law (Count XV); New York Franchise Sales Act (Count XVI); Michigan Franchise Investment Law (Count XVII); Maryland Franchise Registration and Disclosure Law (Count XVIII); and Illinois Franchise Disclosure Act of 1987 (Count XIX).

1. One party (the franchisor) grants to another party (the franchisee) the right to sell or distribute a product or service;<sup>12</sup>
2. The franchise uses the franchisor's trademark or trade name;<sup>13</sup>
3. The franchisee pays the franchisor a fee for the right to enter into the business;<sup>14</sup> and
4. The franchisor either (a) prescribes a marketing plan or system for use by the franchisee or (b) there is a "community of interest" between the franchisor and franchisee in the marketing or selling of the goods or services of the franchisor.<sup>15</sup>

State Farm need not have intended to form a franchise to satisfy the statutory definition of a

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<sup>12</sup>Ark. Code Ann. § 4-72-202(1); Cal. Corp. Code § 31005(a)(1); Cal. Bus. & Prof. Code § 20001(a); Del. Code Ann. Tit. 6, § 2551(3); Haw. Rev. Stat. § 482E-2; 815 Ill. Comp. Stat. § 705/3(1)(a); Ind. Code § 23-2-2.5-1(a)(1); Mich. Comp. L. § 445.1502 (3)(a); Md. Cod Ann. § 14-211 (e)(1)(i); Minn. Stat. § 80C.01, subd. 4(a)(1); Neb. Rev. Stat. § 87-402(1)(a); N.J. Stat. § 56:10-3(a); N.Y. Gen. Bus. L. § 681(3)(a) or (b); Or. Rev. Stat. § 650.005(4)(a); Va. Code § 13.1-559(a)(1); Wis. Stat. § 553.03(4)(a)(1); Wis. Stat. § 135.02(3).

<sup>13</sup>Ark. Code Ann. § 4-72-202(1); Cal. Corp. Code § 31005(a)(2); Cal. Bus. & Prof. Code § 20001(b); Del. Code Ann. tit. 6, § 2551(1)(2); Haw. Rev. Stat. § 482E-2; 815 Ill. Comp. Stat. § 705/3(1)(b); Ind. Code § 23-2-2.5-1(a)(2); Mich. Comp. L. § 445.1502(3)(b); Md. Code Ann. § 14-201(e)(1)(ii); Minn. Stat. § 80C.01, subd. 4(a)(1); Neb. Rev. Stat. § 87-402(1)(a); N.J. Stat. § 56:10-3(a); N.Y. Gen. Bus. L. § 681(3)(b); Or. Rev. Stat. § 650.005(4)(b); Va. Code § 13.1-559(a)(2); Wis. Stat. § 553.03(4)(a)(2); Wis. Stat. § 135.02(3).

<sup>14</sup>Ark. Code Ann. § 4-72-202(1); Cal. Corp. Code § 31005(a)(3); Cal. Corp. Code § 31011; Cal. Bus. & Prof. Code § 20001(c); Cal. Bus. & Prof. Code § 20007; Del. Code Ann. tit. 6, § 2551(3); Haw. Rev. Stat. § 482E-2; 815 Ill. Comp. Stat. § 705/3(1)(c); Ind. Code § 23-2-2.5-1(a)(3); Md. Code Ann. § 14-201(e)(1)(iii); Mich. Comp. L. § 445.1502(3)(c); Minn. Stat. § 80C.01, subd. 4(a)(3); N.Y. Gen. Bus. L. § 681(3)(a) or (b); Or. Rev. Stat. § 650.005(4)(c); Va. Code § 13.1-559(a)(3); Wis. Stat. § 553.03(4)(2)(3). The Nebraska Franchise Practices Act, New Jersey Franchise Practices Act, Wisconsin Fair Dealership Law, and the Arkansas Franchise Practices Act do not require payment of a "franchise fee" to satisfy the definition of a "franchise."

<sup>15</sup>Cal. Corp. Code § 31005(a)(1) (marketing plan); Cal. Bus. & Prof. Code § 20001(a); Haw. Rev. Stat. § 482E-2 (community of interest); 815 Ill. Comp. Stat. § 705/3(1)(a); Ind. Code § 23-2-2.5-1(a)(1) (marketing plan); Md. Code Ann. § 14-201(e)(1)(i); Mich. Comp. L. § 445.1502(3)(a) (marketing plan); Minn. Stat. § 80C.01, subd. 4(a)(2) (community of interest); Neb. Rev. Stat. § 87-402(1)(a) (community of interest); N.J. Stat. § 56:10-3(a) (community of interest); N.Y. Gen. Bus. L. § 681(3)(a) or (b); Or. Rev. Stat. § 650.005(4)(a) (marketing plan); Va. Code § 13.1-559(a)(1) (marketing plan); Wis. Stat. § 553.03(4)(a)(1) (marketing plan); Wis. Stat. § 135.02(1) and (3) (community of interest). The Arkansas Franchise Practices Act and Delaware Franchise Security Law requires neither a marketing plan nor a community of interest.

“franchise.” Peter v. Stone Park Enters., LLC, 1999 U.S. Dist. LEXIS 11385 at 19, Bus. Franchise Guide (CCH) ¶ 11,750 (N.D. Ill. 1999) (“a party cannot avoid a franchise relationship merely by disclaiming its existence”). Similarly, a relationship’s legal significance “is fixed by reality, not by what [the parties] call it...” Petereit, 853 F. Supp. at 60. NASFA will very likely prevail not only on satisfying the statutory definition of a franchise, but also on its claims for State Farm’s violation of franchise statutes.

a. The Right to Sell

Under the agreements between State Farm and the Agents, the Agents are required to sell State Farm insurance products. Apart from setting underwriting standards, there is no reservation of rights to State Farm, in the agreements, to approve or accept transactions. In fact, Agents are authorized to accept premiums on behalf of policyholders for State Farm. The Franchise Agreement between each Agent and State Farm

provides:

The Agent will solicit applications for insurance, collect initial premiums, membership fees and charges, countersign and deliver policies, reinstate and transfer insurance, assist policyholders and cooperate with adjusters in reporting and handling claims, avoid conflicts of interest, and cooperate with and advance the interest of the Companies, the agents, and the policyholders.

Agent’s Agreements at Section II, ¶ B. Thus, the Agents handle a majority of the transactions involving the sale and service of insurance policies to policyholders, and, as such, are vested with the right to sell State Farm insurance products in satisfaction of the statutory requirement of such rights. See Gentis v. Safeguard Business Sys., 60 Cal. App. 4<sup>th</sup> 1294 (Cal. Ct. App. 1998) (finding that sales representatives who solicited orders and provided local customer support were franchisees despite the fact that they never entered into binding agreements with customers to sell the supplier’s goods or services or took title to, or delivered, the supplier’s goods).

b. Trademark

Here, the requirement of the right to sell using State Farm's trademark is easily satisfied. The Agents are implicitly authorized to use the State Farm name and mark. Agent's Agreements at Section I. In fact, absent an express prohibition against the use of the grantor's trademark, a right to use the mark will be inferred. See FTC Informal Staff Advisory Opinion to Permagraphics Int'l, Inc., Bus. Franchise Guide (CCH) ¶ 6,433 (Sept. 21, 1982). Additionally, even where an express grant authorizing trademark use is absent, courts will find de facto licenses based on the parties' conduct. See Cooper Distrib. Co. v. Amana Refrigeration, Inc., 63 F.3d 262, 272-73 (3<sup>rd</sup> Cir. 1995); Cassidy Podell Lynch, Inc. v. Snyder Gen. Corp., 944 F.2d 1131, 1139-40 (3<sup>rd</sup> Cir. 1991); Lobdell v. Sugar 'N Spice, 33 Wis. App. 81, 890 (Wash. Ct. App. 1983).

c. Franchise Fee

Most of the statutes require that NASFA show that the Agents paid, directly or indirectly, a franchise fee to State Farm.<sup>16</sup> The fee, however, need not have been specifically denominated a "franchise fee" between State Farm and the Agents. Rather, the statutes at issue recognize that a franchise fee may be paid indirectly. See supra n.14. Here, the indirect franchisee fee is the receipt of reduced commissions by the Agents. In order for an Agent to receive the right and privilege of being a designated State Farm Agent, an Agent agrees to forego a certain percentage of his/her commissions that would otherwise be paid if the Agent was selling State Farm insurance policies as independent agent. Swift Aff. at ¶ 28.

An indirect franchisee fee may be found where a franchisee must make payments, or as in this case, foregoes payment of commissions, throughout the life of the franchise agreement. See Pool Concepts, Inc. v. Watkins, Inc., Bus. Franchise Guide (CCH) ¶ 12,249 (D. Minn. Jan. 29, 2002) (franchise fee found where franchisee was required to pay additional charges as part of a co-op advertising fund); To-Am Equip. Co. v. Mitsubishi Caterpillar Forklift Am., Inc., 152 F.3d

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<sup>16</sup>NASFA need not prove the existence of a franchise fee under the Arkansas Franchise Practices Act, the Nebraska Franchise Practices Act, New Jersey Franchise Practices Act, or the Wisconsin Fair Dealership Law.

658 (7<sup>th</sup> Cir. 1998) (a distributor's purchases from a manufacturer of manuals for repair of forklifts constituted a franchise fee even though they might have had a value equal to what the distributor paid). Thus, NASFA has demonstrated that the Agents paid State Farm, although indirectly, a franchise fee.

d. Marketing Plan or Community of Interest

The "marketing plan" requirement is generally satisfied by the franchisor's specification of prices, pricing systems, sales requirements, sales techniques or advertising. See, e.g., People v. Kline, 100 Cal. App. 3d 587, 168 Cal. Rptr. 185 (1980) (marketing plan is satisfied by franchisor's promise of "total and continuing support" and assistance with advertising). State Farm's extensive requirements concerning advertising and marketing satisfies this requirement. The Agreement provides:

We retain the right to prescribe all policy forms and provisions; premiums, fees, and charges for insurance; and rules governing the binding, acceptance, renewal, rejection, or cancellation of risks, and adjustment and payment of losses.

Agent's Agreements, Section I, ¶ L. Additionally, State Farm furnishes the Agents with manuals, forms, and records, and additionally advertises for the Agents and provides the Agents with promotional materials. Id. at Section I, ¶¶ C and F. In fact, a franchisor's advice or suggestion, even where there is no obligation on the part of the franchisee to observe them, satisfy the "marketing plan" requirement of the franchise statutes. Blankenship v. Dialist Int'l Corp., 568 N.E.2d 503, 507 (Ill. Ct. App. 1994). Thus, NASFA has established that the franchise statutes at issue apply to the relationships between the Agents and State Farm.

e. Violations

Not only is it likely that NASFA will succeed on the merits of demonstrating that the franchise acts enumerated in the Complaint apply, but NASFA will likely succeed in showing that State Farm's conduct of limiting the number of new insurance policies that the Agents can sell each month violates these franchise statutes' prohibitions on termination without reasonable notice and good cause.<sup>17</sup> As stated earlier, State Farm is liable for the constructive or *de facto* termination of the Agents agreements because they have destroyed the ability of the Agents to successfully operate their businesses. See Carlos v. Philips Bus. Sys., Inc., 556 F. Supp. 769 (E.D.N.Y. 1983) (a manufacturer's reorganization of its distributors into dealers -- meaning that the distributors could no longer sell at wholesale, but had to sell at retail -- could amount to a termination of their distributorships); American Bus. Interiors, Inc. v. Haworth, 798 F.2d 1135 (8<sup>th</sup> Cir. 1986) (franchisee terminated in effect when information necessary to conduct business is taken away); Coast to Coast Stores, 667 P.2d at 628 (franchise agreement is terminated in fact under Washington statute when the means of continuing the franchised business are taken away); Imperial Motors, Inc. v. Chrysler Corp., 559 F. Supp. 1312, 1315 (D. Mass. 1983) (Federal Dealers' Day in Court Act allows recovery where coercion or intimidation amount to a constructive termination). The franchise statutes at issue provide that termination may only be for good cause, and then only upon reasonable notice. See supra n.18.

Here, the Agents were given no notice of the limitations imposed upon their right to sell insurance policies. Swift Aff. at ¶ 8. This, in and of itself, is sufficient to establish a violation of the franchise statutes. Furthermore, State Farm's termination was without good cause. Good cause is generally defined as failure of the franchisee to meet performance criteria. Wright-Moore Corp. v. Ricoh Corp., 908 F.2d 128, 137 (7<sup>th</sup> Cir. 1990). Here, State Farm has not limited

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<sup>17</sup>Ark. Code Ann. § 4-72-204(a)(1); Cal. Bus. & Prof. Code § 20020(b); Del. Code Ann. tit. 6, § 2552; Haw. Rev. Stat. § 482E-(H); 815 Ill. Comp. Stat. § 705/19; Ind. Code § 23-2-2.71(7)&7-3; Mich. Comp. L. § 445.1527(c); Minn. Stat. § 80C.14, subd. 3; Neb. Rev. Stat. § 87-404; N.J. Stat. § 56:10-5; Va. Code § 13.1-564; Wis. Stat. § 135.03.

the number of new insurance policies that Agents can sell due to deficiencies in the performance of its Agents. Rather, State Farm's new "no-new-business" policy is completely unrelated to the Agents' performance. State Farm has not withdrawn from the business of selling insurance policies completely, but instead has selectively (and in discriminatory fashion) limited the ability of some Agents to sell new insurance policies. This does not amount to good cause. See e.g., Wright-Moore Corp., 908 F.2d at 137 (stating that "the language and structure of the Indiana [franchise] law, along with the guidance provided by interpretation of franchise laws in other states, compel a conclusion that the internal economic reasons for the franchisor are not, by themselves, good cause for termination or non-renewal of a franchise"); Satellite Receivers, Ltd. v. Household Bank (Illinois) N.A., 922 F. Supp. 174 (E.D. Wis. 1996) ("The purely economic concerns [that is, unrelated to the performance of a particular dealer] of a grantor who remains in the marketplace cannot provide good cause for termination as a matter of law"); Sims Wholesale Co., Inc. v. Brown-Forman Corp., 468 S.E.2d 905, 909 (Va. 1996) (holding that manufacturer's desire "to consolidate its brands into fewer wholesalers over broader geographic areas" was not "good cause" within Virginia's Wine Franchising Act); Coelho & Bachetti, Inc. v. Ford New Holland, Inc., Bus. Franchise Guide (CCH) ¶ 10,923 (A.A.A. 1996) (holding that the manufacturer's elimination of a specific brand did not constitute good cause for termination of dealers associated with that brand); Kealey Pharmacy and Home Care Servs., Inc. v. Walgreen Co., 761 F.2d 345 (7<sup>th</sup> Cir. 1985) (holding there was no good cause for a termination due to manufacturer's withdrawal from the market); Petereit, 853 F. Supp. at 60 (franchisor enjoined from reallocating store assignments even though franchisor asserted it was good for business because "to permit defendant to find cause in purportedly sound business judgment is to make the relationships illusory," and as there was no failure to perform by franchisees, no good cause for termination could be found).

Additionally, State Farm has imposed its limitations in a discriminatory manner. For instance, while Agents in some states have no restrictions on their right to sell insurance, Agents in other states have had their right to sell new insurance policies completely terminated. Several

of the franchise acts prohibit a franchisor from treating similarly situated franchisees differently.<sup>18</sup> Here, while some Agents are free to continue to engage in the business of selling new insurance policies, as they are contractually entitled to do, without restriction, other Agents have had their ability to sell new insurance policies drastically reduced or entirely eliminated. This is just the sort of discrimination prohibited by the franchise acts of Hawaii, Illinois, Indiana and Minnesota. See supra n.19. Additionally, courts have recognized that such discriminatory conduct may violate the implied covenant of good faith and fair dealing. D&K Foods, Inc. v. Bruegger's Corp., Bus. Franchise Guide (CCH) ¶ 11,506 (D. Md. 1998); Venta, Inc. v. Frontier Oil & Refining, 827 F. Supp. 1526 (D. Colo. 1993) (recognizing the common-law claim for breach of the implied covenant of good faith and fair dealing arising out of discriminating practices of a supplier who practiced favoritism of certain distributors over others).

State Farm's conduct violates the franchise statutory prohibitions against termination without reasonable notice and good cause, as well as the prohibition against discrimination among franchisees prohibited by several states. As such, NASFA again has demonstrated the requisite likelihood of success on the merits of its applicable statutory claims and injunctive relief enjoining State Farm's statutorily prohibited conduct is warranted.

4. State Farm's conduct amounts to tortious interference with the contracts and business expectancies of the Agents

A claim for tortious interference lies when the following exists: (1) the existence of a valid business relationship or expectancy; (2) knowledge by the interferor of the relationship or expectancy; (3) an unjustified, intentional act of interference on the part of the interferor; (4) proof that the interference caused the harm sustained; and (5) damage to the party whose relationship or expectancy was disrupted. See, e.g., RESTATEMENT (SECOND) OF TORTS §§766-769; Alfred A. Altimont, Inc. v. Chatelain, Samperton & Nilon, 374 A.2d 284 (D.C. 1977); See

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<sup>18</sup>Haw. Rev. Stat. § 482E-6(c); 815 Ill. Comp. Stat. § 705/18; Ind. Code § 23-2-2.7-2(5); Minn. R. 2860.4400(B).

Cooke v. Griffiths-Garcia Corp., 612 A.2d 1251 (D.C. 1992); Xavier v. Bumbarner and Hubbell Anesthesiologists, 923 S.W.2d 428, 433 (Mo. Ct. App. 1996); RTL Distrib., Inc. v. Double S Batteries, Inc., 545 N.W.2d 587, 590 (Iowa Ct. App. 1996); Fulton v. Peninsula Reg. Med. Ctr., 665 A.2d 297, 313-314 (Md. App. 1995); Wiekhorst Bros. Excavating & Equip. v. Ludewig, 529 N.W.2d 33, 39 (Neb. 1995); Fisher v. Jones, 844 S.W.2d 954, 959 (Ark. 1993).

There is a strong likelihood that NASFA will succeed on the merits of its tortious interference claims against State Farm. Clearly, a contract or prospective economic advantage exists between the Agents and their customers and State Farm is clearly aware and knows of these relationships -- the very nature of the insurance business dictates that such relationships exist. State Farm's interfered with these relationships by restricting or eliminating the right of the Agents to service their customers on-going insurance needs. In fact, State Farm's constructive wrongful termination of the Agents agreements constitutes an unjustified and intentional act under the laws of some states. See, e.g., Koster v. P & P Enter., Inc., 539 N.W.2d 274, 279 (Neb. 1995) (holding that "by wrongfully terminating [the plaintiff], the [defendants] were acting in an unjustified and intentional manner. The interference with [plaintiff's] employment caused him financial damage. Therefore, the elements of tortious interference with a business relationship were satisfied"). Finally, the Agents will demonstrate that because of State Farm's tortious interference their businesses have been damaged. See Swift Aff. at ¶¶ 20-21. Thus, NASFA has raised substantial questions going to the merits of its tortious interference claims and this, in conjunction with the clear balance of hardships in favor of NASFA, warrants the grant of an injunction prohibiting State Farm from implementing its "no-new-business" policy.

**E. GRANTING AN INJUNCTION IS IN THE PUBLIC INTEREST**

An injunction, in this instance, is consistent with “the public interest in requiring parties to live up to their legal contracts” and in protecting legitimate business interests. Green Stripe, Inc. v. Berny’s Internacionale, S.A., 159 F. Supp.2d 51, 57 (E.D. Pa. 2001) (citation omitted). Thus, where the nonmoving party is alleged to be in breach of that agreement, such as through an alleged wrongful termination of the agreement, the public interest favors maintaining the status quo of the underlying agreement until a final determination on the merits can be made. Chinetti-Garthwaite Imports, Inc., 463 F. Supp. at 75, n.4 (noting that, if the public interest factor were to apply in the context of a manufacturer/importer dispute, it would “favor ... [the importer] since the public interest would not be served by allowing the termination of an ongoing and financially healthy enterprise”). Here, State Farm has breached its contractual obligations to the Agents and is effectively terminating their franchise agreements in contravention of the agreements between the parties, the covenant of good faith and fair dealing implied in those agreements, and several state statutes, all in contravention of the public’s interest in maintaining the status quo and requiring State Farm to live up to its agreements with its Agents until such time as this Court can hear this case on the merits.

#### **V. CONCLUSION**

While the harm to State Farm is negligible, the harm that is sure to befall the businesses of the NASFA member Agents as a result of State Farm’s “no-new-business” policy will be catastrophic, resulting in damage to the goodwill and reputations that the Agents have spent years developing. State Farm’s conduct, if not enjoined, will result in the failure of Agents’ businesses. In the face of this clear balance of hardships in favor of NASFA, with high likelihood that NASFA will succeed on the merits of its claims, with the public’s interest in protecting legitimate business interests, and in the interest of avoiding irreparable harm until a determination on the merits can be made, NASFA respectfully requests that this Court enjoin State Farm either from restricting the rights of the Agents to sell new State Farm insurance policies, or from restricting them from selling non-State Farm policies where State Farm has decided not to compete for the business.

DATED: January \_\_, 2003

RESPECTFULLY SUBMITTED,

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