

B-1131

IN THE SUPERIOR COURT FOR THE DISTRICT OF COLUMBIA
CIVIL DIVISION

NATIONAL ASSOCIATION OF)
STATE FARM AGENTS, INC.,)

Plaintiff,)

v.)

STATE FARM MUTUAL)
AUTOMOBILE INSURANCE)
COMPANY, *et al.*)

Defendants.)

C.A. No. 02ca004089
Calendar 7
Judge Neal E. Kravitz

DEFENDANTS' STATEMENT OF UNDISPUTED FACTS
IN SUPPORT OF THEIR MOTION FOR SUMMARY JUDGMENT

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May 6, 2004

~~Original~~
cc: WMG
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TABLE OF CONTENTS

	PAGE
I. General Background	1
II. Agents' Duties	3
III. Financial Arrangements	10
A. Independent Contractor Compensation.....	10
1. Commissions.....	10
2. "Term Pay"/AIPP.....	11
B. Trainee Agent Compensation	13
C. Agents' Costs Of Doing Business	15
1. Premium Fund Account Fees.....	15
2. Computer Lease Fees.....	16
3. Advertising Costs.....	17
4. Signage Costs.....	18
5. Remembrance Advertising Items.....	19
IV. The Partner Agent Program	20
V. The "Select Agent" Program	29
VI. The Customer Response Center.....	34
VII. State Farm's Decision To Limit The Production Of New Business.....	37
VIII. State Farm's Decision Not To Allow Agents To Produce Business For The Company's Competitors	45
IX. The Ethics/Compliance Program	53
X. Internet Sales.....	58
Personalia.....	60

I. General Background

(1) Defendants State Farm Mutual Automobile Insurance Company, State Farm General Insurance Company, State Farm Fire and Casualty Company, and State Farm Life Insurance Company (collectively "State Farm" or the "Company") are all corporations formed under Illinois law with their principal place of business in Bloomington, Illinois. (Complaint ¶ 4; Answer ¶ 4.)

(2) State Farm provides various insurance and financial services products to the public. (Complaint ¶ 4; Answer ¶ 4.)

(3) Plaintiff National Association of State Farm Agents ("NASFA") is a Washington, D.C. corporation with its principal place of business in Baltimore, Maryland. (Complaint ¶ 3.)

(4) NASFA has at least one member in 47 states and the District of Columbia. (*See* NASFA membership table attached as Ex. 26 to the Martin Aff.)

(5) Its members are all active or retired State Farm Agents. (*See* Complaint ¶ 3.)

(6) State Farm is the largest provider of auto and homeowner's insurance in the United States, and makes insurance available to residents throughout the country and in three provinces of Canada. (*See* Trosino Depo. 21/8-24, 147/5-18 (attached as Martin Aff., Ex. 19).)

(7) State Farm provides insurance to the public principally through its network of approximately 16,000 Agents located throughout the states and provinces in which it does business. (*See* Trosino Depo. 24/10-25/9.)

(8) There are currently over 50 different form agreements in effect between State Farm and its Agents (each an "Agent's Agreement"). With rare exceptions, virtually all Agents

operate under three basic forms of the Agent's Agreement known as the "AA3," the "AA4," and the "AA97." (Casino Aff. ¶ 4 (attached as Martin Aff., Ex. 23).)¹

(9) The AA3 Agreement first came into effect in 1977; the AA4 first came into effect in 1982; and the AA97 first came into effect in 1997. (Fisher Depo. 47/7-8; 183/14-15 (attached as Martin Aff., Ex. 14).)

(10) Under all forms of the Agent's Agreement, State Farm Agents are independent contractors of the Company. Section I(B) of the Agreement provides:

As a State Farm agent, you are obligated to follow State Farm procedures and processes and to provide prompt, friendly, accurate, and cost effective service. You are an independent contractor for all purposes. You have full control over your daily activities, with the right to exercise independent judgment as to time, place, and manner of soliciting insurance, servicing policyholders, and otherwise carrying out the provisions of this Agreement.

(AA97 Agreement § I(B) (attached as Martin Aff. Ex. 3).)²

(11) Neither the AA3 nor AA4 Agreement contains a choice of law provision. (*See generally* AA3 Agreement and AA4 Agreement (attached as Martin Aff., Exs. 1 & 2, respectively).)

¹ Mr. Casino's affidavit was previously submitted to the Court in connection with State Farm's February 2003 Opposition to Plaintiff's Motion for a Preliminary Injunction. Plaintiff deposed Mr. Casino on January 14, 2004.

² Unless otherwise indicated in a footnote, the language of the various forms of the Agent's Agreement reads identically.

The AA3 Agreement and AA4 Agreement do not contain the first sentence of this paragraph. Section I(A) of those agreements read: "As a State Farm agent, you are obligated to follow State Farm procedures and processes and to provide prompt, friendly, accurate, and cost effective service. You are an independent contractor for all purposes. As such, you have full control over your daily activities, with the right to exercise independent judgment as to time, place and manner of soliciting insurance, servicing policyholders, and otherwise carrying out the provisions of this Agreement."

(12) Section VI(E) of the AA97 provides:

The validity, enforceability, and interpretation of this Agreement shall be construed according to the laws of the State of Illinois.

(AA97 Agreement § VI(E).)

(13) When the AA97 was first introduced, Agents operating on earlier forms of the Agent's Agreement were given the choice of either keeping their then-current agreement, or signing the AA97. (Knapp Depo. 25/3-10; 26/21-27/11 (attached as Martin Aff., Ex. 11); Beauchamp Depo. 94/1-22 (attached as Martin Aff., Ex. 7); Nazziola Depo. 86/21-87/9 (attached as Martin Aff., Ex. 12); Mueller Depo. 165/15-20 (attached as Martin Aff., Ex. 9); Adams Depo. 5/12-21 (attached as Martin Aff., Ex. 10).)

(14) All Agents who have joined State Farm since 1997 operate under the AA97 Agreement. (Fisher Depo. 183/14-18.)

(15) At present, approximately 50 percent of all active Agents operate under the AA97 Agreement. (Casino Aff. ¶ 5.)

II. Agents' Duties

(16) Section I(A) of the Agent's Agreement states that the Agents' core duties are to:

solicit applications for insurance, collect premiums, 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, comply with all laws and regulations, and cooperate with and advance the interests of the Companies, the agents, and the policyholders.

(AA97 Agreement § I(A) (emphasis added).)³

³ Section I(A) of both the AA3 Agreement and the AA4 Agreement read: "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 interests of [State Farm], the agents, and the policyholders."

(17) In other words, it is Agents' job to present potential insureds to the Company. (Swift Depo. 178/7-179/10 (attached as Martin Aff., Ex. 5); *see also* Martin Aff. Ex. 27 (article by Plaintiff's Legal Counsel stating: "Agents present a potential insured to the company."))

(18) It is for State Farm, however, to decide whether or not to accept the customer and to enter into a contract to sell an insurance policy to him or her. (Fisher Depo. 86/14-87/1, 94/11-14; Swift Depo. 179/5-10; Wright Depo. 21/8-17, 175/19-22, 195/9-15 (attached as Martin Aff., Ex. 15); *see also* Martin Aff., Ex. 27 (article by Plaintiff's Legal Counsel.)

(19) This is because all insurance policies are a contract between State Farm, on the one hand, and the policyholder, on the other hand. Agents are not a party to the contract. (Killingsworth Depo. 117/10-12 (attached as Martin Aff., Ex. 13); Swift Depo. 183/11-22.)

(20) As Mr. David Swift, NASFA's current President, testified:

Q ... [I]t's a State Farm policy that is purchased by the insured?

A Right.

Q And you, as agent, are never owner of the policy; correct?

A Owner?

Q Yeah. You don't own the policy.

A No, I don't own the policy.

Q So as far as ownership of the policy, it goes from State Farm to the insured; correct?

A That's correct.

(Swift Depo. 183/12-22; *see also* Wright Depo. 11/10-16, 193/5-194/2; Fisher Depo. 95/7-16; Lamphier Depo. 80/19-81/1 ("No, I don't own the policies.") (attached as Martin Aff., Ex. 8).)

(21) Section I(L) of the Agent's Agreement also gives State Farm

the right to prescribe all ... rules governing the binding, acceptance, renewal, rejection, or cancellation of risks, and adjustment and payment of losses; and limitations on the submission of applications by individual agent, by market area, by line of coverage, by policy type, by Company, or by other means.

(AA97 Agreement § I(L).)⁴

(22) The Agreement gives State Farm complete control over decisions about whether or not to accept new risks (*i.e.*, customers):

[Agents] will not represent [themselves] as having any powers except those authorized by this Agreement and subject to any applicable law. Without limiting the foregoing, [Agents] shall not have the authority to extend the time of payment of any premium, or to alter, waive or forfeit any of the [State Farm] Companies' rights, requirements, or conditions in any policy of insurance, or otherwise obligate the Companies in any way except as stated in this Agreement or expressly authorized under the rules and regulations of the Companies or as otherwise authorized in writing by the Companies.

(Agreement § I(M).)⁵

(23) Consistent with these provisions, State Farm determines the underwriting rules governing the nature of the risks the Company deems acceptable. (Swift Depo. 60/3-19; Wright Depo. 21/8-17; *see also* Knapp Depo. 40/11-15 ("Q. [T]hat's strictly the right of the company to determine at any time what the underwriting rules should be? A. Well, certainly."));

(Killingsworth Depo. 119/6-8.)

⁴ Section I(L) of both the AA3 Agreement and the AA4 Agreement read: "We retain the right to prescribe all policy forms and provisions, premiums, fees, and charges for insurance; rules governing the binding, acceptance, renewal, rejection, or cancellation of risks, and adjustment and payment of losses."

⁵ Section I(M) of both the AA3 Agreement and the AA4 Agreement read: "[Agents] will not represent [themselves] as having any powers except those authorized by this Agreement and subject to any applicable law. Without limiting the foregoing, [Agents] shall not have authority to extend the time of payment of any premium, or to alter, waive or forfeit any of the [State Farm] Companies' rights, requirements, or conditions in any policy of insurance, or otherwise obligate the Companies in any way except as stated in this Agreement or expressly authorized under the rules and regulations of the Companies or as otherwise authorized in writing by the Companies."

(24) Agents solicit customers for insurance and/or financial services provided by the Company, and submit applications to State Farm. (Swift Depo. 179/1-10; Wright Depo. 21/8-17.)

(25) After an application is submitted, State Farm reviews it for accuracy and to ensure that it meets its underwriting guidelines. Only after the application passes State Farm's review is a decision made by the Company to sell insurance to the applicant and issue a formal policy of insurance. (Fisher Depo. 138/20-139/2; Swift Depo 178/7-179/10; Wright Depo. 21/8-17.)

(26) At deposition, Mr. Swift testified:

Q As part of your job, you don't -- you can't promise the policyholder or potential policyholder who walks into your office that they will receive the insurance for the quoted rate. It's all dependent on whether State Farm underwrites --

A If they qualify, that's correct.

Q But State Farm makes that decision?

A That's correct.

...

Q What do you do when you get the application? Do you give it to State Farm?

A Yes.

Q And then you await State Farm's approval of the application?

A That's correct.

(Swift Depo. 178/7-179/10.)

(27) At all times, State Farm reserves the right to reject applications submitted by Agents. (Fisher Depo. 138/3-139/2; Wright Depo. 175/19-22.)

(28) Agents have no power to set or vary any of the terms or conditions of the insurance policies that State Farm sells to policyholders. (Beauchamp Depo. 179/21-180/19; Wright Depo. 11/10-16; Mueller Depo. 81/13-20; Killingsworth Depo. 116/4-117/3.)

(29) Because the Company, not the Agents, is the actual party to the policy contract with the insured, State Farm alone bears the risk of loss on the policies it agrees to issue. (Killingsworth Depo. 118/5-7.) When an insured submits a covered claim, State Farm pays, not the Agents. (Mueller Depo. 156/16-22.)

(30) State Farm, not the Agents, sets the premiums policyholders pay. (Wright Depo. 174/8-16; Mueller Depo. 81/13-17; Killingsworth Depo. 116/13-17.)

(31) All premium monies belong exclusively to State Farm, and are paid to it by policyholders. (Swift Depo. 179/11-16; Lamphier Depo. 81/14-82/1; Beauchamp Depo. 178/21-179/5.)

(32) On occasion, policyholders give premium monies to their Agents in the first instance. Yet, in such cases, the money is still State Farm's. (Mueller Depo. 120/8-16.) Agents are not only required to give all policyholder payments to State Farm, but to keep them in a separate trust account for State Farm's benefit. (Swift Depo. 179/17-180/3; Lamphier Depo. 81/21-82/10.)

(33) The Agent's Agreement states

All funds collected on behalf of the Companies shall be held in trust by you as *the absolute property of the Companies*, and you will be responsible for these funds until they are safely transmitted to the Companies. You agree to maintain a premium fund account for State Farm's benefit in a bank or similar financial institution, which we may audit at any time, in which you will promptly deposit all funds collected for State Farm premiums, fees or charges. You further agree to transmit all such funds and all insurance applications promptly as directed by State Farm.

(AA97 Agreement § I(I) (emphasis added).)⁶

(34) State Farm provides temporary coverage to certain applicants for insurance, to protect them from loss from the time they submit an application to State Farm until the time State Farm approves or rejects their application, and an insurance policy is sold (or not sold). State Farm, like most insurers, is required by law in most states to provide such temporary coverage. (Fisher Depo. 133/16-22, 138/3-16; Wright Depo. 21/18-22; Trosino Depo. 91/3-14.)

(35) Applicants in this category are advised by Agents that a “binder” has been issued by the Company, so that they are temporarily protected while their applications are pending, and before any sale of an insurance policy occurs. If an application contains fraudulent or otherwise false information, however, State Farm may decline to cover any losses which occur after an application is nominally bound. (Fisher Depo. 133/16-22, 138/3-16; Wright Depo. 21/18-24/10.)

(36) Under current prevailing practice for auto insurance, Agents input policyholder applications electronically. Upon submission of the application, the Agent receives an electronic instruction through the computer informing him or her whether or not the application is bound. (See Beauchamp Depo. 178/11-20 (“Q. So that decision is made by State Farm? A. Yeah.”).)

(37) Under current prevailing practice, homeowners insurance applications are completed on paper. Paper applications contain the following wording:

[State Farm] of Bloomington, Illinois, hereby binds as of the requested effective date for a period of 45 days from such date, the Insurance applied for, subject to all the terms and conditions of the [] policy and applicable endorsements in current use by such Company....

⁶ Section I(I) of both the AA3 Agreement and the AA4 Agreement read: “All monies collected on behalf of the Companies shall be held in trust by you as the absolute property of the Companies, and you will be responsible for these moneys until they are safely transmitted to the Companies. You agree to maintain a premium fund account in a bank or similar financial institution, which we may audit at any time, in which you will promptly deposit all cash collected for premiums, membership fees, and charges. You further agree to transmit promptly to the Companies the moneys so deposited, through checks drawn upon this premium fund account, along with all insurance applications received and checks collected on behalf of the Companies.”

(Thomas Depo., Ex. 1 (attached as Martin Aff., Ex. 16).)

(38) On all "bound" applications, as with everything else, it is the Company that is bound, not the Agent. It is also State Farm that bears fully the risk of loss.

(39) Mr. Clifford Mueller, NASFA's Vice President for Chapter Relations, testified:

Q When you bind the company, it is the company that is bound, right, the company is bound to certain commitments towards the policyholder?

Q And any risk of loss is the company's, it is not your risk of loss?

A Yes, that's true.

(Muller Depo. 156/16-22.)

(40) State Farm reserves the right to, and in some cases does, withdraw Agents' authority to submit bound applications. In those circumstances, State Farm does not give policyholders even the temporary coverage afforded by a binder, but rather will only provide coverage after a full review of the relevant applications. (Fisher Depo. 134/1-8, 171/20-172/5.)

(41) Mr. Mueller testified:

Q The binding authority that you get is given to you by State Farm?

A Yes.

Q And they can take it away?

A Yes.

Q They can also, when they give it to you, prescribe rules and regulations and conditions?

A Underwriting guidelines.

Q Subject -- well, including underwriting guidelines, that, as well as other conditions or rules that apply to your binding authority, in other words, they set the limits on the binding authority or any conditions that exist?

A Yes.

(Muller Depo. 118/19-119/10.)

III. Financial Arrangements

A. Independent Contractor Compensation

1. *Commissions*

(42) Agents' compensation under all forms of the Agent's Agreement is a percentage of the premiums policyholders pay State Farm. (Casino Aff. ¶ 6.)

(43) Although State Farm sells many lines of insurance and financial services products to the public, its core business is auto and fire (homeowner) insurance. (See Trosino Depo. 21/8-24.) Consequently, Agents' compensation is dominated by commissions on auto and fire insurance. (See generally Casino Depo., Ex. 1.)

(44) Under the AA3 Agreement and the AA4 Agreement, Agents receive a 15% commission on auto policy premiums paid to State Farm, and a 10% commission on fire policy premiums. (Swift Depo. 191/20-22.)

(45) Under the AA97 Agreement, Agents receive a 10% commission on auto policy premiums paid to State Farm, and an 8% commission on fire policy premiums. (Swift Depo. 191/20-22.)

(46) These commissions rates apply to "personally produced" business; that is, to policies for which the Agent him or herself has solicited the initial application. (Fisher Depo. 34/21-35/2.)

(47) Agents sometimes also receive "assigned business;" that is, customers formerly assigned to another Agent who has retired or passed away. (Fisher Depo. 33/20-34/2.) On such business, Agents receive a 7% commission on both assigned auto and fire policies. (Swift Depo. 203/4-204/3.)

(48) After ten years, policies that were originally categorized as assigned business are re-classified as personally produced, and Agents receive commissions on such policies at the higher rate. (Fisher Depo. 44/10-16.)

2. "Term Pay"/AIPP

(49) Upon termination of their Agreement, and upon satisfaction of certain contractually specified contingencies, AA3 and AA4 Agents are eligible to receive "termination payments" ("term-pay"). (Fisher Depo. 49/7-15, 63/17-64/3.)

(50) In essence, eligible AA3 and AA4 Agents receive roughly 20% of the amount of their last year's auto and fire commissions each year for a period of five years. (Fisher Depo. 51/3-15; Knapp Depo. 31/20-32/17.)

(51) Term pay is not, and legally cannot be, a pension program. (Fisher Depo. 65/10-12; Knapp Depo. 35/10-15.)

(52) AA97 Agents do not receive term pay. Instead, they receive Annual Investment Plan payments ("AIP" payments). (Fisher Depo. 45/3-10, 46/14-21; Swift Depo. 189/13-18.)

(53) Beginning on January 1 after the end of their fifth year and continuing for twenty years, AA97 Agents receive an extra annual payment (the AIP payment) equaling roughly 5% of their previous years' compensation. (AA97 Agreement § V.)

(54) Agents do not receive AIP payments during their first five years. During this time, no money is set aside on an Agent's behalf. (See Fisher Depo. 62/18-63/9 ("There isn't any 'that money'").)

(55) Mr. Swift testified:

Q So you have to be an AA97 agent for five years before your rights to AIPP payments vest?

A Well, until you start getting them as a percentage of your salary, so that's correct, they give that up, that's correct.

Q Well, their right to them doesn't begin until five years after they have signed the contract?

A No, they don't get them, they don't get paid them for five years. They don't get them and they're not held, and then they're vested and they get them until five years. They don't get them until ...

Q They don't start collecting any AIPP payments for the first five years; is that correct?

A That's right.

Q So its not that -- I understand what you're telling me. It's not as if the money is put aside and then they collect it all in five years?

A That's correct.

(Swift Depo. 192/16-193/18; *see also* Fisher Depo. 62/18-63/9.)

(56) The purpose of transitioning from term pay under the AA3/4 Agreement to AIP payments under the AA97 Agreement was several fold. First, as its name suggests, the AA97 Agreement was introduced in the late 1990s when the stock market was rising rapidly, and when many Agents asked the Company to make their "term pay" available earlier in their careers, instead of after retirement, so that they could invest it themselves. By giving Agents AIP payments commencing after only five years as an Agent, instead of "term pay" commencing after retirement, State Farm was responding to the desires of many of its Agents. (Fisher Depo. 50/7-51/8; *see also* Knapp Depo. 33/8-34/1.)

(57) Also, by giving AIP payments after only five years, State Farm was attempting to eliminate the inherent insecurity associated with a contingent future payment like term pay. (*See* Knapp Depo. 30/18-31/5 ("There's always an opportunity for there to be no State Farm, period.").)

(58) Commencing AIP Payments after the fifth year (instead of even earlier in an Agent's career) was conceived as a benefit to Agents. As stated, the payments are a percentage

of the previous years' compensation. And because Agents' compensation tends to increase as the number of policyholders assigned to them increases over time, beginning after year five as opposed to year one results in a substantial increase in the total compensation paid to each Agent over his or her entire career. (*See* Nazziola Depo. 83/8-20.)

B. Trainee Agent Compensation

(59) Prior to the time they become independent contractors, State Farm Agents are required to go through a period as "Trainee Agents," typically around two years. Trainee Agents are State Farm employees, not independent contractors. (*Fisher* Depo. 22/17-23/10, 29/22-30/5; *Wright* Depo. 209/12-16; *Nazziola* Depo. 4/6-10; *Mueller* Depo. 6/20-22; *Swift* Depo. 188/1-7.)

(60) Even before prospective Trainees start as State Farm employees, the Company gives them free training in the insurance and financial services business. Much of this training -- for example, in marketing skills -- is of general application in the insurance business; it has value and utility outside the State Farm context. (*See Fisher* Depo. 20/21-22/16.)

(61) Not all Trainee Agents succeed in becoming independent contractor Agents. To become independent contractors, Trainees must meet certain production thresholds that demonstrate their ability to survive as independent business people. (*See Killingsworth* Depo. 48/17-22.)

(62) To assist them in becoming successful independent business people, the Company gives Trainees types of compensation and support that it does not give independent contractor Agents. (*See Wright* Depo. 206/6-207/1.)

(63) The compensation arrangements under which Trainees operate have been in place since June 1, 1995. (*See* TA8 Agreement (attached as Martin Aff., Ex. 4).)

(64) Trainees receive three categories of direct compensation: (a) a Specified Monthly Payment ("SMP"); (b) reimbursement for their office expenses, including staff salaries; and (c) commissions on certain categories of Company products. (Fisher Depo. 32/17-22; Wright Depo. 206/6-207/1.)

(65) The SMP is a guaranteed monthly sum Trainees receive regardless of their production numbers. The amount of each Trainee Agent's SMP varies by region. (Fisher Depo. 32/17-33/3.)

(66) Independent contractor Agents do not receive an SMP, or, indeed, any form of guaranteed compensation at all. (*See generally* Agent's Agreement.)

(67) State Farm also pays a substantial portion of every Trainee's office expenses, including rent, staff salaries, the cost of equipment and fixtures, *etc.*, up to a designated maximum amount per month. (Fisher Depo. 68/15-69/6.)

(68) Independent contractor Agents must pay all their own expenses. (*See* Killingsworth Depo. 126/20-127/15.)

(69) In addition to SMPs and expense reimbursements, Trainees also receive commissions on certain categories of Company products. Under the most recent Trainee Agent Agreement (the "TA8"), they receive 7.5% on personally produced fire insurance, and 5% on personally produced auto insurance. (*See* TA8 Agreement.)

(70) Taking account of the SMP and other support they receive, Trainee Agents are financially better off under the compensation arrangements applicable to them than they would be under the compensation schedule applicable to independent contractor Agents. (Wright Depo. 207/10-208/22.)

(71) The net cost to the Company of developing each Trainee Agent, and supporting him or her through the process until he or she becomes an independent contractor Agent is over \$250,000. (Wright Depo. 208/8-17.)

(72) The Trainee Agent program has always represented a net cost to the Company. State Farm spends money setting up its Trainees in business with the hope that the investment will pay off in the form of more productive independent contractor Agents down the road. (See Wright Depo. 208/8-11.)

(73) The Trainee Agent program has become increasingly generous over time. (Adams Depo. 119/2-21.) As Mr. Steven Knapp, NASFA's Vice President for Legal Issues, testified:

Q Would it be fair to say that the compensation provided to trainee agents has continued to increase with each successive change in the contract?

A I think that would be fair, yes.

(Knapp Depo. 18/5-9.)

C. Agents' Costs Of Doing Business

(74) As independent business people, State Farm Agents incur costs and fees in the course of soliciting business for the Company.

(75) Some of these costs and fees are paid to unaffiliated third parties, and some are paid to State Farm. In no case, however, are Agents required to pay any fees to State Farm.

1. *Premium Fund Account Fees*

(76) Under their Agreement, Agents are required to maintain a separate bank account into which they deposit policyholder premium payments and other State Farm monies. (See Agreement § I(I).) The account is held by the Agents in trust for State Farm. (*Id.*)

(77) In some, but not all, cases, Agents' banks charge them a service fee for maintaining this account. (Fisher Depo. 74/22-75/9.)

(78) Two of Plaintiff's witnesses, for example, testified that they were able to negotiate with their banks to eliminate the fee on the premium fund account altogether. (Nazziola Depo. 177/13-178/21; Adams Depo. 97/13-19.)

(79) In those cases when Agents do incur a cost associated with maintaining a premium fund account, the fee is always paid to the bank with which the Agent has the account, not to State Farm. As Mr. Mueller testified:

Q And the premium fund account is with which bank?

A I believe my premium fund account is with First Virginia but I think they just changed the name to BB&T over the weekend or something.

Q And does the bank, whether it is First Virginia or whatever, charge you a fee for that?

A Oh, yes.

Q How much do they charge you?

A It varies but it is about \$25 a month, sometimes more.

Q And you pay that to the bank?

A Yes, I pay that to the bank.

(Mueller Depo. 120/17-121/9.)

2. *Computer Lease Fees*

(80) To enable them to do business, State Farm provides all Agents with a basic equipment package of computer hardware and software free of charge: "You get a laser printer, two staff workstations with printers, and one scanner, and then the agent gets a laptop IBM computer with a printer." (Adams Depo. 11/1-7; *see also* Wright Depo. 211/11-14, 212/4-7; Fisher Depo. 71/15-19.)

(81) If Agents want to lease additional equipment from State Farm, they may do so. They are not required to do so, however. (Knapp Depo. 87/3-21; Adams Depo. 13/10-18; Wright Depo. 211/15-17, 212/8-11.)

(82) Those Agents who choose to procure additional equipment pay a monthly lease fee to State Farm. (Knapp Depo. 87/3-21.)

(83) According to Mr. Stephen Adams, NASFA's Secretary/Treasurer/Vice President for AA97 Contracts:

Q Now, if you want more than that [the basic package], you obtain it from the company?

A Right.

Q And you lease the equipment?

A Correct.

Q But you're not obligated to take that; it's up to you whether you want it?

A Right.

Q And if you want it, then you lease it from the company?

A Right.

(Adams Depo. 11/22-12/10; *see also* Mueller Depo. 135/12-13 ("As far as I know, I don't pay for the computer equipment now."); Nazziola Depo. 173/22-174/12.)

(84) Thus, in some cases Agents may incur computer lease costs that they pay to State Farm, but in no case are they required to do so.

3. *Advertising Costs*

(85) State Farm Agents are free to advertise, if they so desire. They are also free not to advertise. The decision is exclusively that of the Agent. Mr. Swift testified:

Q Does the company require you to advertise in the yellow pages, or are you free to say you don't want to advertise?

A No, you don't have to.

Q Does the company require you to advertise anywhere, or are you free to do it or not to do it?

A You don't have to advertise.

(Swift Depo. 196/3-9; *see also* Fisher Depo. 72/20-73/1; Mueller Depo. 134/8-10 (“Q. And State Farm does not require that you advertise? A. No.”).)

(86) Agents may choose to list themselves in the Yellow Pages in what is referred to as the “trademark ad,” an alphabetical listing of all area State Farm Agents under a general State Farm logo. State Farm pays the cost of placing the Company's trademark in the advertisement; Agents pay the cost of including their individual names. (Fisher Depo. 274/9-18.)

(87) For administrative convenience, the Agents' portion of the cost of participating in the trademark ad is sometimes paid to State Farm in the first instance. The Company then passes all monies on to the advertising vendor. In those cases, the Company makes no money on the transaction. (*See* Adams Depo. 101/5-14; Killingsworth Depo. 146/14-20.)

4. *Signage Costs*

(88) Most State Farm Agents choose to have a State Farm sign outside their offices. If they do not want to have a sign for any reason, however, they are not required to have one. (Fisher Depo. 194/14-16; Wright Depo. 213/3-6; *see also* Swift Depo. 195/19-22.)

(89) Mr. Mueller testified:

Q You are not required by State Farm to put a sign out in front of your office, are you? You could put one there or not?

A No, I don't believe I am.

Q And State Farm does not require that you advertise?

A No.

Q You can if you want?

A No, they don't require it.

(Mueller Depo. 134/4-12; *see also* Adams Depo. 100/14-16 (“Q. Similarly, you are not required to have a sign; that’s up to you if you want to have a sign? A. Yes.”))

(90) Those Agents who choose to have a sign purchase it from third-party vendors.

(Fisher Depo. 194/10-13, 341/9-12; Wright Depo. 213/3-214/9.)

(91) In many cases, State Farm refers Agents to authorized vendors with which it has standing arrangements. These arrangements enable State Farm to (1) negotiate reduced costs for the Agents, and (2) ensure that the signs conform with the Company’s trademark. (Wright Depo. 213/7-214/9.)

(92) In all cases, the cost of Agents’ signage is paid directly from the Agents to the outside vendors. (Wright Depo. 213/7-214/9; Fisher Depo. 194/9-13.)

5. *Remembrance Advertising Items*

(93) State Farm makes available to Agents a variety of “remembrance advertising” items bearing the Company’s logo, such as golf balls, pencils, calendars and the like. (Fisher Depo. 191/8-17, 341/5-9; Lamphier Depo. 76/20-77/17.)

(94) If Agents want to, they may purchase these items from the Company. (Fisher Depo. 341/5-9; Lamphier Depo. 76/20-77/17.)

(95) They are, however, under absolutely no obligation to do so. (Wright Depo. 211/3-7; Lamphier Depo. 76/20-77/17.)

(96) As Mr. Lamphier testified:

Q Now, you also mentioned that you have to purchase from the company supplies with State Farm logos, and you gave examples of golf balls and road atlases that you give to policyholders; correct?

A Right, correct.

Q You're not obligated to obtain those materials or to distribute them to your policyholders?

A No.

Q This is something that you have made your free choice to do, as part of your sales promotion, marketing practice, care and feeding of the policyholders; correct?

A Correct.

Q And State Farm makes these materials available to you and you're free to accept them or not?

A Purchase them or not, correct.

Q You are free to purchase them or not?

A Right.

(Lamphier Depo. 76/20-77/17.)

IV. The Partner Agent Program

(97) State Farm has traditionally been an insurance company, and has a particularly strong presence in the auto and fire insurance markets. (See Trosino Depo. 24/10-25/9, 26/12-27/1.)

(98) During the 1990s, however, changes in federal law for the first time permitted financial services companies to provide insurance products to the public. By the same stroke, insurance companies were given broader access to the financial services market. (See Wright Depo. 32/11-33/2.)

(99) Faced with the prospect of competition from increasingly full-service companies, State Farm made the strategic choice to begin providing a broader array of financial services products. (Wright Depo. 45/18 - 46/7, 47/5 - 48/19.)

(100) Among the new products State Farm decided to provide were mutual funds. (Wright Depo. 32/11-33/2.)

(101) NASFA's witnesses testified that State Farm has the right to provide mutual funds, through its Agents, to potential customers. (*See, e.g.,* Nazziola Depo. 224/19-226/5.) NASFA's in-coming President (as of June 2004), Mr. Jerry Beauchamp, testified:

Q Let me ask you, was that a legitimate goal to bring in customers for the financial services?

A I'm sure it is.

(Beauchamp Depo. 98/16-18.)

(102) NASFA's current President, Mr. Swift, testified that State Farm was well-advised to provide mutual funds:

Q So to take care of the agents -- I'm sorry, to take care of the policyholders, it's important to service all of the changing needs of the policyholders?

A That's correct.

Q And those needs could include banking and financial products too?

A Yes.

(Swift Depo. 126/3-10; *see also* Mueller Depo. 53/16-18 ("Q. Do you believe the company has the right to offer mutual funds to the public? A. Yes.").)

(103) The prospect of providing mutual funds, however, presented new challenges to the Company. In particular, federal and state securities laws only permit registered securities representatives to solicit mutual funds business from customers. (*See* Mueller Depo. 53/19-54/5.)

(104) Registered representatives are required by federal securities laws to hold a "Series 6" license; state securities laws require the to hold "Series 63" licenses. (Sikora Depo. 8/24-9/14 (attached as Martin Aff., Ex. 21).) Because State Farm had not traditionally provided securities to the public, few Agents possessed the requisite licenses.

(105) NASFA's witnesses described the issues presented by State Farm's entry into the mutual fund business. Mr. Mueller testified:

Q Do you believe the company has the right to offer mutual funds to the public?

A Yes.

Q And you are aware that the law requires that mutual funds can only be offered to the public through registered agents; correct?

A Yes.

Q So that for the company to sell mutual funds and to do that through its agents, the agents have to become licensed or registered in compliance with federal law; is that right?

A Correct.

(Mueller Depo. 53/16-54/5; *see also* Swift Depo. 236/12-22.)

(106) Having made the decision to enter the mutual fund business, State Farm encouraged all of its Agents to acquire Series 6 and 63 licenses. It did not, however, require them to do so. (Mueller Depo. 32/10-33/5; *see also* Knapp Depo. 53/21-54/5; Swift Depo. 231/17-232/10.)

(107) At present, approximately 61% of State Farm Agents are licensed to solicit customers who may be interested in purchasing mutual funds from State Farm. (*See* Sikora Depo. 54/11-13.)

(108) Because a significant portion of its Agents did not have Series 6 or Series 63 licenses, the Company was faced with the question of how to reach customers serviced by Agents who chose not to obtain licenses and become registered representatives.

(109) The Company's answer was to initiate a "partnering" program (the "Partner Agent Program") whereby nonregistered Agents could team with registered Agents to whom they could

refer policyholders interested in mutual funds. (Fisher Depo. 176/1-177/7; Sikora Depo. 14/15-24; Wright Depo. 49/19- 51/14.)

(110) The Program was designed to be, and always has been, entirely voluntary. (*See* Fisher Depo. 177/2-4; Sikora Depo. 16/15-17/18; Swift Depo. 231/17-232/10; Wright Depo. 53/9-18.)

(111) Nonregistered Agents are encouraged (but not required) to select a registered Agent to whom they will refer customer inquiries about mutual funds. They may change their selection at any time simply by informing the Company. (Sikora Depo. 19/20-20/4, 29/1-16, 30/24-31/3; Wright Depo. 51/15-51/20, 53/9-53/18, 54/20-56/13.)

(112) Agents are also free to refuse to nominate their own Partners. No adverse action is taken against any Agent who has refused to do so. (*See* Beauchamp Depo. 100/19-101/3; Lamphier Depo. 64/15-66/3; Mueller Depo. 61/20-62/2.)

(113) Seven of NASFA's trial witnesses were deposed by State Farm. Six testified that they refused to nominate their own Partners. State Farm took no adverse actions against them. (Beauchamp Depo. 96/10-12, 99/21-100/6; Swift Depo. 231/17-19; Lamphier Depo. 64/15-66/3; Mueller Depo. 61/20-62/2; Adams Depo. 48/1-3; 49/3-7; Nazziola Depo. 153/8-9.)

(114) During his deposition, Mr. Beauchamp testified:

Q So that aspect of the program where you were asked to make referrals of people who were interested in mutual funds to other State Farm agents who were licensed to deal in mutual funds, you had no problem with that, that aspect of it?

A I didn't, it's just like I said here. You know, I have some friends who are agents that I trust that they would not try to raid [*i.e.*, poach insurance customers from] my business or try to get them enticed into going to their office.

Q The key was you had control over to whom you could refer the people?

A I think that's the way it should be.

...

Q. So if you had control over the referrals, who you referred people to, that was acceptable to you?

A That's right.

(Beauchamp Depo. 114/3-115/9.)

(115) Similarly, Mr. Swift testified:

Q What was it that you just said you had no objection to?

A I said I had no objection for us to refer it to another agent but not a particular agent, but we could refer it to whatever agent we wanted to.

Q As long as you had the choice --

A That's correct.

Q -- of which agent to refer it to?

A That's correct.

Q And as long as you had the choice of which State Farm agent to refer your policyholder to for the mutual fund or other financial product business, you had no objection?

A That's correct.

(Swift Depo. 239/21-240/12.)

(116) In fact, this is the policy. (Sikora Depo. 29/1-16, 30/24-31/3.)

(117) Mr. Robert Lamphier, NASFA's President at the time this lawsuit was filed, testified that the program is voluntary:

Q Essentially it's a voluntary program that you have chosen not to participate in; correct?

A That is correct

(Lamphier Depo. 67/11-13; *see also* Knapp Depo. 51/12-17.)

(118) Mr. Nazziola testified that because the voluntary nature of the Partner Agent Program meant it did not violate anyone's rights:

Q If there were some agents who for whatever reason saw no problem with this and voluntarily signed on to it, that's their right and that's the company's right?

A Absolutely, entrepreneurial.

Q Nobody's rights are being violated?

A No.

(Nazziola Depo. 156/11-17 (emphasis added).)

(119) Nonregistered Agents are not required to refer customers who ask them about mutual funds back to the Company, or to anyone else, for assistance. They may choose to do so if they wish, or they may not, as their judgment dictates. (Sikora Depo. 17/1-18.)

(120) On those occasions when the customer of a nonregistered Agent who has not selected a partner contacts the Company independently to ask about mutual funds (for example, through State Farm's call-center), State Farm will refer that customer to a registered agent. (Sikora Depo. 30/19-23; Wright Depo. 53/9-18.)

(121) The Agent to whom the customer is referred is selected on a rotation basis from a database of registered representatives. (Wright Depo. 54/9-19.)

(122) State Farm has and always has had a very strong prohibition against "raiding," the poaching of customers assigned to one Agent by a different Agent. (See Swift Depo. 242/13-243/3.)

(123) By contract, Agents have the following obligation:

You will respect the rights and interests of your fellow agents in policies credited to their accounts by refraining from raiding or otherwise diverting policies from their accounts to your account. You shall neither directly nor indirectly attempt to divert policies to your own account from unassigned accounts or from those of

other State Farm agents, or from your own account to the accounts of other State Farm agents.

(AA97 Agreement § I(H).)⁷

(124) State Farm was aware that any program by which some Agents might be brought into contact with policyholders assigned to another Agent might generate concerns about possible raiding. (Fisher Depo. 177/8-13; Swift Depo. 242/13-243/3.)

(125) The Partner Agent Program was designed to prevent raiding. Agents were given an opportunity to nominate their own "Partner Agent" precisely in order to address concerns about raiding, and to prevent it from occurring. (Fisher Depo. 177/8-178/1.)

(126) The purpose was to give nonregistered Agents control over the identity of their Partner; to help them feel comfortable with and about the person to whom they would be referring customers; and to give them comfort that their Partner was someone they could trust to refrain from raiding customers. (Fisher Depo. 177/8-178/1.)

(127) Registered Agents who agree to Partner with nonregistered Agents were reminded of their contractual obligation to refrain from raiding, and were warned not to violate this obligation. (Wright Depo. 73/1-74/6.) Agency field management was also instructed to monitor the situation closely and ensure that none of the Partner Agents engaged in raiding. (Wright Depo. 64/16-65/9, 74/7-75/14.)

(128) State Farm assured Plaintiff's President it would not allow any raiding to take place through the Partner Agent Program. Mr. Swift testified:

Q Did you say anything about the no raiding provisions of your contract, to Chuck Wright [State Farm's Executive Vice President for Agency and Marketing]?

⁷ Section I(H) of both the AA3 Agreement and the AA4 Agreement read: "You will respect the rights and interests of your fellow agents in policies credited to their accounts by refraining from raiding or otherwise diverting policies from their accounts to your account."

A We talked about that [possible raiding].

Q What did you say?

A We told him that we -- we're concerned that that was going to happen.

Q What did he say?

A He said well, we're going to make sure that that doesn't happen. That was his comment.

Q Chuck Wright told you that State Farm was going to make sure that your business would not be raided by these partner agents?

A That's what he said, right.

(Swift Depo. 242/13-243/3.)

(129) At deposition, NASFA's witnesses testified that Plaintiff originally had two principal fears about the Partner Agent Program: (a) the possibility that Partner Agents might directly market mutual funds to policyholders assigned to nonregistered Agents; and (b) the possibility that the Program could be used as a model for marketing insurance policies, as well as mutual funds. (*See, e.g.*, Nazziola Depo. 150/6-151/20.)

(130) In implementing the Partner Agent Program, State Farm admonished Partner Agents not to directly market mutual funds to policyholders assigned to nonregistered Agents. State Farm has never contemplated using the Partner Agent Program as a model for marketing insurance policies. (*See* Sikora Depo. 41/18-24; Lamphier Depo. 66/18-67/10; Mueller Depo. 57/3-16; Adams Depo. 49/17-50/6; Nazziola Depo. 154/10-18.)

(131) State Farm's efforts to prevent raiding of policyholders assigned to nonregistered Agents have been successful. There has not been a single instance of raiding occasioned by the Partner Agent Program. Mr. Swift testified:

Q Are you aware of any other State Farm agents, not registered or licensed to sell mutual funds or other financial products, who have

lost business to other State Farm agents as a result of this partner agent program?

A No, not really.

(Swift Depo. 246/20-247/3.)

(132) Mr. Beauchamp agreed:

Q. So you have no knowledge of any [raiding] that took place as a result of the Partner Agent program?

A. No, I don't. I don't have any knowledge of that.

Q And you have no knowledge that any agent, any non-registered agent lost any business, lost any of its policy holders because of the Partner Agent program?

A I haven't heard. I don't know.

(Beauchamp Depo. 122/1-10; *see also* Mueller Depo. 63/10-64/11; Wright Depo. 214/10-22.)

(133) Plaintiff's President at the time this lawsuit was testified that the Partner Agent was the motivating force behind this lawsuit:

Q ...[W]hat were the specific things that caused you to ... sue State Farm?

A Mine was just one issue, and that was the partnering issue.

Q Would you say that was the major issue for most people?

A I believe it was.

(Lamphier Depo. 155/12-19.)

(134) Yet, NASFA's witnesses have now testified that the "program" that they originally objected to "was never implemented" and thus is "not a problem," and a "non-issue" in this lawsuit.

(135) Mr. Mueller testified:

Q Do you know of any occasions under the partner agent program where clients have been diverted?

A In my area, I do not believe that the partnering agent situation or policy has been actively pursued by State Farm.

Q Do you know whether it's been actively pursued in other areas?

A No, I don't.

Q But in your area, you believe it has not been actively pursued?

A That's my understanding.

Q So it is not a problem as of today?

A As of today, it is not a problem.

(Mueller Depo. 66/21-67/12; *see also* Knapp Depo. 69/15-20.)

(136) Mr. Swift, NASFA's President, testified:

Q So there's no longer an issue, as far as the partner agent program is concerned?

A Right now it's kind of gone away....

Q So it's a non issue, as of today?

A As of -- right now it's a non issue.

(Swift Depo. 247/18-248/2.)

V. The "Select Agent" Program

(137) The Agent's Agreement provides that

[State Farm] reserves the right to fix and determine the amount, extent, and conditions of any bonuses, awards, prizes, and allowances.

(AA97 Agreement § II(D).)⁸

(138) NASFA's witnesses have recognized this right. Mr. Lamphier, for example, testified:

⁸ This provision is found in Section II(C) of both the AA3 Agreement and AA4 Agreement.

Q The contract that you signed authorizes the company to have the exclusive right to make decisions about bonuses and rewards; correct?

A Yes.

(Lamphier Depo. 58/6-9; *see also id.* at 59/8-21; Adams Depo. 64/9-65/5; Swift Depo. 230/16-231/16.)

(139) Pursuant to Section 2(D), State Farm has historically had a variety of award programs to reward Agents for meeting objectives the Company deemed important. Examples of past bonus or reward programs include the Chairman's Club, Legion of Honor, the Millionaire Club, and the Extended Millionaire Club. (Killingsworth Depo. 140/17-141/23; *see also* Adams Depo. 27/13-17.)

(140) Starting in approximately 1998, State Farm instituted a new bonus program known as the "Select Agent" Program. (Fisher Depo. 82/4-6; Swift Depo. 223/16-20; Wright Depo. 157/3-4.)

(141) The purpose of the Program was to reward Agents who met certain criteria the Company deemed important. (Fisher Depo. 81/8-13.)

(142) Although the specific details of the Program have varied somewhat from year to year, its basic structure has remained constant. Agents who meet certain criteria are eligible to receive bonuses and rewards from the Company. (Fisher Depo. 77/9-18, 80/15-81/6; Wright Depo. 77/11-19; 157/7-17.)

(143) The current bonuses and rewards Select Agents receive are: (a) the Company contributes to the cost of some of their advertising; (b) the Agents may identify themselves as "Select Agents" in Yellow Pages display advertisements; (c) they receive bonus monies calculated according to a Select Agent "scorecard;" and (d) they are eligible to receive

assignments of accounts from Agents leaving the business. (Fisher Depo. 77/19-78/8; 274/8-275/1; Wright Depo. 157/7-17.)

(144) The Select Agent program was designed to be and is inclusive. Every Agent is capable of taking the steps necessary to become a Select Agent. In principle, 100% of Agents could be Select Agents. (See Fisher Depo. 81/13-14, 99/3-13; Swift Depo. 222/13-22; Wright Depo. 166/19-167/12.)

(145) Currently, 76% of Agents nationwide are Select Agents. (Fisher Depo. 98/12-17; Wright Depo. 166/15-18; *see also* Lamphier Depo. 60/16-61/4 (testifying that in the Albuquerque, NM area 47 or 48 of 60 Agents were Select Agents).)

(146) None of the benefits Select Agents receive are guaranteed to Agents under the Agent's Agreement. (*See generally* Agent's Agreement.)

(147) The Agreement, for example, does not guarantee Agents assigned business. (*See generally* Agent's Agreement.) Mr. Nazziola testified:

Q Now, did the AA3/4 contract guarantee that the company would assign business to you, or did it leave it in the company's discretion whether or not to assign business to you?

A Company's discretion.

(Nazziola Depo. 98/11-15.)

(148) The Agreement also gives State Farm discretion to determine whether or not to give Agents a co-op advertising allowance. The Agreement states:

[State Farm] will advertise, provide promotional materials, and participate in the cost of advertising, *in accordance with policies determined from time to time by us.*

(Agreement § I(F) (emphasis added); *see also* Fisher Depo. 75/19-76/11, 76/19-20, 77/6-8.)

(149) Mr. Nazziola testified:

Q But the company did reserve to itself the right to decide when and in what circumstances to provide co op advertising funds for agents' advertising?

A Yes.

(Nazziola Depo. 144/8-12.)

(150) The Select Agent Program is a bonus program that does not violate the rights of Agents who choose not to participate. Plaintiff's President, Mr. Swift, testified:

Q So select agent status is really another form of bonus that the company provides to certain agents?

A That's correct, they put them in the phone book, or they'll give them listings in the phone book that the regular agent wouldn't get, and he'll be there as a select agent.

Q So again, it's the company's choice to provide bonuses to certain agents, even though it's not contractually obligated to do so?

A Yes.

Q And you would agree that State Farm has the right to provide bonuses to agents that meet certain criteria, even though it's not obligated to do that?

A Yes.

Q And by providing these bonuses to certain agents, based on meeting certain criteria, whether it's sales or other criteria that the company establishes, the company isn't violating your rights?

A They're not violating my rights?

Q That's right.

A By providing --

Q Bonuses to others.

A That's fine, yeah.

Q It's not?

A No, it's not.

Q It's not violating?

A It's not violating.

(Swift Depo. 230/9-231/16; *see also* Beauchamp Depo. 151/20-152/1; Lamphier Depo. 58/6-59/21; Mueller Depo. 35/22-36/20.)

(151) In addition to being inclusive, the program is and always has been voluntary. If an Agent decides that the benefits of being a Select Agent merit making the effort to achieve the Select Agent criteria, he or she is free to participate. If, on the other hand, the Agent decides the benefits of participation are not worth the effort, he or she is also free not to. (Fisher Depo. 283/15-284/2, 285/2-7; Lamphier Depo. 55/8-57/10; Mueller Depo. 35/22-36/11; Adams Depo. 22/15-22; Knapp Depo, 66/10-67/11.)

(152) As Mr. Knapp testified:

Q Are there other company programs where you made a decision, a business decision, as you said, to pass on them because you felt that the benefits to you would not outweigh the costs?

A Yes.

Q And what were they?

A In the last three years I have decided to pass on being a select agent. I didn't see any benefit to that to me, and I saw that it had perhaps some significant costs to it.

(Knapp Depo. 54/6-15; *see also* Swift Depo. 222/13-226/9.)

(153) Mr. Lamphier testified:

Q Are you a select agent?

A No, sir.

Q You chose not to be one?

A Yes, sir.

Q And you were free to make that choice?

A Absolutely.

Q And the company has not threatened you with termination because of your decision not to become a select agent; correct?

A No.

(Lamphier Depo. 55/8-17; *see also* Adams Depo. 22/15-22.)

(154) Only one of NASFA's seven proposed trial witnesses is currently a Select Agent. (See Beauchamp Depo. 144/18-20; Lamphier Depo. 55/8-9; Mueller Depo. 30/19-20; Adams Depo. 22/15-22; Knapp Depo. 54/6-15.)

(155) State Farm took no adverse action against Agents as a result of their decision not to become a Select Agent. (See, e.g., Swift Depo. 226/5-14, 230/1-15; Lamphier Depo. 55/8-17; Mueller Depo. 35/15-21.)

VI. The Customer Response Center

(156) In approximately 1997, State Farm initiated an after-hours call service for Agents and policyholders known as the Customer Response Center ("CRC"). (See Wright Depo. 155/4-11.)

(157) The CRC takes calls from policyholders when Agents' offices are closed in the evening and during weekends. (See Fisher Depo. 278/20-279/6; Adams Depo. 16/9-17.)

(158) The purpose of establishing the CRC was to meet the insured public's increasing demand for 24/7 access and responsiveness. (See Defendants' Answers to Plaintiff's First Set of Interrogatories, No. 11 (attached as Martin Aff. Ex. 24); *see also* Fisher Depo. 278/20-279/6.)

(159) The CRC was created after the AA3 and AA4 forms of the Agent's Agreement came into being. Thus, the cost of it is not reflected in the compensation structure of Agents who operate under those forms of the Agreement. (Beauchamp Depo. 15/2-16; Lamphier Depo. 70/8-16.)

(160) AA3 and AA4 Agents are, however, given the option of participating in the service if they so choose. (Swift Depo. 331/12-332/6.)

(161) For those who do, the cost of participation is \$1.75 per household per year. (Adams Depo. 16/21-17/15.) For those who choose not to participate, there is no cost. (See Fisher Depo. 279/7-16; Swift Depo. 333/22-334/4.)

(162) All AA97 Agents receive the CRC free of charge. (Lamphier Depo. 70/22-71/8; Adams Depo. 16/18-20; Knapp Depo. 78/17-21.) This is one of the benefits those Agents receive in return for their acceptance of lower commission rates than AA3 and AA4 Agents. (Fisher Depo. 280/8-15; 283/1-4; Wright Depo. 155/4-11.)

(163) The money State Farm receives from AA3 and AA4 Agents who participate in the CRC does not cover the ratable percentage of the total cost of the CRC attributable to them. In other words, even for those Agents who voluntarily join and pay an annual fee to use the CRC, State Farm subsidizes the cost of participation for them. (Fisher Depo. 283/7-10.)

(164) State Farm is within its contractual rights charging AA3 and AA4 Agents for the use of the CRC:

Q So the company has a right to charge you for the use of the CRC under the contract, but you think it's not a wise decision to do that; correct?

MR. HILLMAN: Object to the form. You may answer.

THE WITNESS: Yes.

(Lamphier Depo. 71/15-20.)

(165) Of NASFA's seven Board members who have been designated as "trial witnesses," five operate under either the AA3 or AA4 form of the Agent's Agreement. All five testified that the decision whether or not to participate in the CRC was one they freely undertook. Four of those five declined to participate; State Farm took no adverse action against them as a

result of their decision. (Lamphier Depo. 56/19-57/10; Mueller Depo. 32/2-9; Swift Depo. 331/9-332/6; Nazziola Depo. 74/10-18; *see also* Beauchamp Depo. 17/19-18/9, 19/4-12.)

(166) Mr. Swift testified:

Q Do you use that [the CRC]?

A No.

...

Q But you've chosen not to join the CRC?

A Sure. I don't want to pay the money for doing that, that's correct. I have an answering machine that tells them that they can call my -- they can call a number if they have a claim or they have my phone number that they can call.

Q So you are free to make that decision?

A Right.

Q And the company hasn't threatened you with termination over that?

A Nope.

(Swift Depo. 331/14-332/9; *see also* Lamphier Depo. 57/3-10; Beauchamp Depo. 53/21-54/5 (testifying that Agents are free to give out their home numbers and/or use an answering machine in place of using the CRC.))

(167) State Farm does not, and never has, required Agents to participate in the CRC to be able to advertise in the Yellow Pages. (Defendants' Answers to Plaintiff's First Set of Interrogatories, No. 11(d).) NASFA's designated "trial witnesses" -- four of seven of whom do not participate in the CRC -- testified that they may nonetheless advertise in the Yellow Pages if they so desire. (*See, e.g.*, Mueller Depo. 49/19-21; Swift Depo. 334/5-11; Wright Depo. 156/9-19.)

(168) David Swift, NASFA's President, testified that NASFA actually has no complaint about the CRC:

Q Okay. But there's no complaint about the CRC?

A At this current time, no.

(Swift Depo. 333/11-13.)

VII. State Farm's Decision To Limit The Production Of New Business

(169) Like any insurance company, State Farm must manage the risks that it is willing to assume by establishing underwriting criteria. (*See* Thomas Aff. ¶ 4 (attached as Martin Aff., Ex. 22).)⁹

(170) Unlike many other enterprises, volume and profitability are sometimes at odds with each other in the insurance industry. The financial health of State Farm is premised on extending insurance coverage to potential policyholders only where the risks warrant. (*See* Swift Depo. 58/9-17, 59/13-20, 60/3-8, 138/6-11; Lamphier Depo. 24/3-19.)

(171) This is because "every time a new policy is sold, it represents income on the one hand but it also represents additional expenses for the company and it also represents increased risk of loss for the company..." (Lamphier Depo. 24/14-19.)

(172) Experience has shown that new policies are inherently more risky than existing policies; the claim rate on new business is invariably higher. (Thomas Aff. ¶ 11.)

(173) Thus, a business model in which State Farm agreed to extend insurance coverage to all comers would not be viable, and would undermine the Company's ability to guarantee risks for its existing policyholders. (*See* Thomas Aff. ¶ 4; *see also* Lamphier Depo. 24/3-19.)

⁹ Mr. Thomas' affidavit was previously submitted to the Court in connection with State Farm's February 2003 Opposition to Plaintiff's Motion for a Preliminary Injunction. Plaintiff subsequently deposed Mr. Thomas on January 13, 2004.

(174) NASFA's President, Mr. Swift agreed:

Q [reading from an exhibit]... "But unbridled growth or excessive concentration of risk are not sustainable courses for an organization whose core values include protecting its financial strength." Do you agree with that statement?

A I agree with that.

(Swift Depo. 138/6-11.)

(175) State Farm specifically reserves to itself the right to make all determinations concerning the nature of the risks it will assume in the Agent's Agreement. Section I(L) provides that State Farm retains

the right to prescribe all ... rules governing the binding, acceptance, renewal, rejection, or cancellation of risks, and adjustment and payment of losses; and limitations on the submission or applications by individual agent by market area, by line of coverage, by policy type, by Company, or by other means.

(AA97 Agreement § I(L).)¹⁰

(176) From time to time in the past, State Farm has imposed specific limitations on the number of new applications Agents may submit in order to minimize the Company's risk exposure. (Thomas Aff. ¶ 4.)

(177) Historically, these previous limitations were occasioned by unforeseen or unforeseeable events like natural catastrophes or economic downturns. (*See id.* ¶¶ 5-10.)

(178) For example, State Farm Fire and Casualty Company (the "Fire Company") limited the production of new business in certain hurricane-prone areas in response to severe losses suffered as a result of Hurricane Andrew in August 1992. (Thomas Aff. ¶ 5.) By itself,

¹⁰ Section I(L) of both the AA3 Agreement and the AA4 Agreement read: "We retain the right to prescribe all ... rules governing the binding, acceptance, renewal, rejection, or cancellation of risks, and adjustment and payment of losses."

Hurricane Andrew caused policyholder loses of approximately \$3.7 billion, more than the entire surplus of the Fire Company at the time. (*Id.*)

(179) Absent a \$3 billion contribution to capital from Defendant State Farm Mutual Automobile Insurance Co., the Fire Company (in business since 1935) would have been insolvent. (*Id.*)

(180) The catastrophe caused by Hurricane Andrew also strained the Fire Company's human resources. In 1992, claims representatives spent more than one million days on catastrophe duty. (*Id.* ¶ 6.) Between 1990 and 1994, the Fire Company added more than 3,000 people in claims to service the needs of policyholders. (*Id.*)

(181) As a result of these developments, the Fire Company announced limitations on production of new business in 1993 and placed limits on the growth of the Company. (*Id.* ¶ 7.) The programs involved quantitative limits on new risks the Company was willing to insure in certain areas, including Texas, Florida and Louisiana. (*Id.*)

(182) The purpose of the limitations on new business production was to reduce the Fire Company's exposure to catastrophic loss so as to guarantee that it would continue to be able to meet its obligations to existing policyholders. (*Id.*)

(183) Even as the limitations on new business production were being announced, the Northridge Earthquake occurred in southern California in January 1994. (*Id.* ¶ 8.) The earthquake itself cost over \$3 billion in policyholder losses. (*Id.*)

(184) In response, State Farm developed a more comprehensive program intended to better manage exposure to catastrophic losses throughout the United States. (*Id.* ¶ 9.) In September 1994, the Fire Company implemented an exposure management program, designed to

reduce the Company's exposure in catastrophe-prone areas so that it could remain viable and honor its commitments to existing policyholders. (*Id.*)

(185) A chief tool towards achieving this goal was the imposition of limitations on the number of new applications Agents in exposure management areas could submit. (*Id.*)

(186) In addition, in 1996 (and lasting until 2001), the Fire Company adopted a plan which again placed quantitative constraints on Agents' ability to submit new insurance applications. (*Id.* ¶ 10.)

(187) The plan applied broadly in jurisdictions throughout the country depending on the Fire Company's "rate adequacy" in the relevant jurisdiction. (*Id.*) ("Rate adequacy" refers to the issue of whether or not premiums paid to State Farm, plus investment income, are sufficient to cover the cost of losses and expenses, and allow for a reasonable rate of return. (*Id.*))

(188) At least four of NASFA's seven Board members designated as "trial witnesses" testified that during their careers prior to 2001, State Farm had limited in some way their ability to submit new fire and/or auto applications. (*See* Beauchamp Depo. 184/9-20; Nazziola Depo. 9/3-18; Adams Depo. 72/19-73/20; Knapp Depo. 39/17-21; 43/7-44/5.)

(189) Beginning in 2001, State Farm and the insurance industry as a whole began feeling the effects of a convergence of negative trends, including:

(i) *Unprecedented Claim Severity*. The amount paid on each claim has increased significantly;

(ii) *Rising Costs Coupled with Rate Inadequacy*. Generally speaking, rates had not kept pace with rising costs. State Farm was (and in some cases still is) incurring losses and expenses that are far greater than the amount received in premiums;

(iii) *Reduced Investment Income*. Above average investment returns in the 1990s meant that the cost of insurance coverage remained relatively stable even when insurers incurred underwriting losses. The recent economic downturn and reduced investment income, however, have magnified the impact of cost

increases and rate inadequacies. In 2001, for every \$1 that State Farm brought in, it paid out \$1.25; and

(iv) *Rapid Growth*. Rapid growth in insurance policies produces significant initial expenses, but a much smaller amount of initial income. Industry statistics show new insurance customers are more likely to make claims than long-term customers. The problem is exacerbated when a company is experiencing operating losses and does not have adequate rates in place.

(Thomas Aff. ¶ 11.)

(190) NASFA's Board members acknowledged the severity of the problem confronting the Company. Mr. Lamphier, Plaintiff's President at the time this lawsuit was filed, testified:

Q So it's your understanding that in 2001-2002 combined, the company suffered losses of between 7.8 and \$8 billion; is that right?

A Yes, yes.

Q You would agree, wouldn't you, that when a company loses \$8 billion in two years, that some changes are required?

A Yes.

Q And it's the responsibility of State Farm's senior management to determine what changes are required and to implement them; correct?

A Yes.

Q [reading from an exhibit] "In order to help the company...", as you put it, "...Return to its profitable ways." Correct?

A Correct.

(Lamphier Depo. 29/2-17; *see also* Muller Depo. 88/12-13 ("[W]e were losing money hand over fist."))

(191) In response to this unprecedented financial problem in January 2002, State Farm began to implement a managed growth plan that limited the number of new fire and auto applications Agents could submit. (Thomas Aff. ¶ 12.)

(192) The limits adopted under these managed growth plans varied considerably by jurisdiction and across time. A chart setting forth the various limitations and effective dates by state is attached to the Martin Affidavit as Exhibit 17.

(193) The limitations on new business production varied from state to state. In some states, Agents were limited to providing accommodations to existing policyholders only. (*See id.*) In others, growth was targeted at a percentage of the number of policyholders assigned to the Agent. (*Id.*) In still others, the growth rate was set at a specified number of net new applications. (*Id.*)

(194) At their maximum, limitations on new business production were in place in 42 states and the District of Columbia. (*See Martin Aff., Ex. 17.*)

(195) Under Section I(L) of the Agreement, State Farm is authorized to impose limitations on an Agent's submission of new applications. Mr. Lamphier testified:

Q So you agree it is to the mutual interest of the company and yourself, as an independent contractor agent, to maintain the company's operations on a profitable basis, in order to assure the necessary financial strength to protect the policyholders' interests; correct?

A Yes.

Q Now, ultimately, the responsibility for the profitability of the company, that is the responsibility to maintain the company's operations on a profitable basis, ultimately that's State Farm's responsibility, isn't it?

A Correct.

Q And the way -- or at least one of the principal ways in which State Farm does this is by making judgments about which risks to underwrite and which risks not to underwrite; correct?

A Correct.

Q Because every time a new policy is sold, it represents income on the one hand but it also represents additional expenses for the

company and it also represents increased risk of loss for the company; correct?

A Correct.

Q And in this contract the company retains the right, with respect to each and every new policy, to determine whether that policy should be sold, based on the company's determinations of the potential profitability or risk of loss; correct?

A Correct.

Q And do you know where in the contract it provides that the company shall make these determinations on whether or not to sell policies based on its own determinations of potential profitability? Can you find that?

A Section 1.L.

(Lamphier Depo. 23/18-25/9.)

(196) Mr. Knapp, Plaintiff's Vice President for Legal Issues, testified:

Q Under the contract, the company has the right to decide to impose restrictions on writing new business in either auto or fire or to lift those restrictions when it considers the circumstances justify that?

A Well, *I don't think there is any doubt that the company has the right to have those restrictions.*

...

Q I think you already have agreed, but I just want to make sure that we are being accurate here, that the contract, and particularly this provision [Section I(L)], does give the company the right to impose restrictions on the submissions of applications or the writing of new business by individual agents.

A That seems to be fairly clear to me.

(Knapp Depo. 44/12-19; 47/5-11 (emphasis added); *see also* Mueller Depo. 89/13-19; Adams Depo. 81/3-6 (“Q. So that under this contract the company had the right to impose restrictions on growth of new business and to remove them? A. Right.”); Beauchamp Depo. 188/12-14

(“Well, if [State Farm] can't be make [sic] a profit on a product, they either have to raise the rate or quit writing it.”.)

(197) State Farm has not exercised its right to limit the submission of new applications unreasonably. Regarding an article that appeared in the December, 2002 issue of NASFA's membership magazine, THE MIRROR, Mr. Swift testified:

Q [reading] Next sentence, “Therefore, all agents need to be reminded that the clause [Section I(L)] exists, and although *management has not abused it until now*, agents should still be aware that the potential for mischief remains.” Do you agree with that?

A Right.

(Swift Depo. 210/7-13 (emphasis added).)

(198) The limitations imposed on new business production were always intended as temporary measures to see the Company through until its financial situation improved. (*See* Fisher Depo. 119/6-11; *see also* Swift Depo. 91/13-18, 128/7-11.)

(199) State Farm has sought rate increases in states throughout the country where existing rates were not adequate, and has adjusted its underwriting criteria to reduce exposure to losses and ensure greater profitability. (*See* Thomas Aff. ¶ 12; *see also* Lamphier Depo. 40/1-6 (agreeing that “the current pricing and underwriting changes should have been implemented sooner”).)

(200) After State Farm succeeded in raising its rates in many jurisdictions, and as the Company's financial situation improved, the Company ended almost all of the limitations on new business production adopted in the managed growth plans. (*See* Martin Aff., Ex. 17; *see also* Swift Depo. 128/21-129/2; Adams Depo. 78/22-79/13; Mueller Depo. 92/9-18.)

(201) As of January 2004, limitations on new business production formerly in place had been ended in 34 states and the District of Columbia. (*See* Martin Aff., Ex. 17.) Limitations

remained in only eight (8) states. (*See id.*) Only in three (3) states were simultaneous limitations in place with respect to both auto and fire insurance. (*See id.*)

VIII. State Farm's Decision Not To Allow Agents To Produce Business For The Company's Competitors

(202) For at least half a century, State Farm Agents have been exclusive agents who, except in rare circumstances, solicit business only for State Farm. (*See Agreement § I(G).*) There are no insurance agents other than State Farm exclusive Agents who solicit business for and receive commissions from the Company. (*See Casino Aff. ¶ 23; Swift Depo.129/19-130/15.*)

(203) Agents' exclusivity is governed by Section I(G) of the Agent's Agreement, which provides:

[Agents] 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.

(Agreement § I(G).)

(204) The Company has spent decades and invested hundreds of millions of dollars in developing its marketing network of exclusive Agents. They are the core of State Farm's marketing system. (Fisher Depo. 121/11-16.) Mr. Swift testified:

Q How important are the agents to State Farm?

A How important are they?

Q Yes. In your opinion.

A Well, I think they're probably one of the most important parts of the company.

Q Why?

A Because without them, there is no new business. We service the policyholders, we take claims, we handle a lot of expenses....

Q You're essential to the business?

A Right.

Q You are the marketing and distribution system for State Farm insurance?

A Right. We're the goodwill portion of the company. That's correct.

(Swift Depo. 75/17-76/13.)

(205) Mr. Beauchamp testified:

Q All right. Mr. Beauchamp, how important are the agents to State Farm's business?

A 100 percent.

Q What do you mean?

A Well, if they don't write the business, we don't have a business.

Q You would say that the agents are State Farm's marketing and distribution system?

A Yes.

(Beauchamp Depo. 177/12-20; *see also* Lamphier Depo. 18/2-14.)

(206) The Company invests considerable resources on a daily basis nurturing its brand identity through Agents, including State Farm's frequent national television advertisements highlighting the qualities of its "good neighbor" Agents, a fact of which the Court can take judicial notice.

(207) Based on decades of experience, it is State Farm's business judgment that allowing Agents to solicit insurance for other carriers would cause a number of serious problems, including:

- (i) The possibility of confusion regarding who the policyholder believes is insuring him or her;
- (ii) Complications with respect to claims handling;
- (iii) Potential liability to State Farm and/or its Agents in the event that business is placed with a company that fails to pay on claims;
- (iv) Difficulty in protecting trade secrets;
- (v) Competing companies gaining the benefit of the State Farm name and reputation;
- (vi) Competing companies gaining the benefit of State Farm's training of its Agents; and
- (vii) Strained Agent loyalty.

(Affidavit of J. Gregory Fisher ("Fisher Aff.") ¶ 14 (attached as Martin Aff., Ex. 21;¹¹ *see also* Defendants' Answer to Plaintiff's First Set of Interrogatories (explaining the basis of these judgments.)

(208) Mr. Clifford Mueller, Plaintiff's Vice President for Chapter Relations and Development, testified that policyholders are prone to confusion about who their insurer is:

Q So what you are saying is the policyholders don't know one kind of insurance from the other or who is handling it?

A Yes. If you walked out on the street and started a poll and asked 10 people, I have people that call me who I have written their auto insurance for 20 years and I don't have their homeowner's insurance and they say, "Well, Cliff, I thought you handled my homeowner's insurance." "Well, no, I don't and I have tried to for years." "Oh." I said, "Do you know who your homeowner's insurance is with?" "Well, no, I really don't." "Well, do you know who your agent is? What company is it with?" And on many occasions, seriously, they don't. They seriously don't know.

...

¹¹ Mr. Fisher's affidavit was previously submitted to the Court in connection with State Farm's February 2003 Opposition to Plaintiff's Motion for a Preliminary Injunction. Plaintiff subsequently deposed Mr. Fisher on June 4-5, 2004.

Q Do [policyholders] even know which company is insuring them?

A Probably not. It is -- more than likely, they do, okay? More than likely they do but in many cases not. I told you about the people that call me that I have insured their auto insurance for years and for whatever reason they have fire insurance with another company and they are calling me as their fire agent because they are in and out of my office all the time.

Q So they are confused about who their insurer is?

A Precisely.

(Mueller Depo. 126/8-22; 152/11-153/4.)

(209) The exclusive relationship between State Farm and its Agents benefits the Agents as well as State Farm. Mr. Swift testified:

Q There are certain advantages, however, that State Farm agents have over independent agents, namely that they sell State Farm insurance; correct?

A That's correct.

Q And that is an advantage?

A Right.

Q Because you're dealing with a nationally known brand and a company that -- although there may be a few dissatisfied agents, at least in terms of the population at large, to potential policyholders, has a wonderful reputation?

A That's correct.

(Swift Depo. 187/1-12.)

(210) Mr. Mueller testified:

Q Did -- why did you choose to become a State Farm agent as opposed to an agent for another company or an independent agent?

A Because my dad used to play golf with Ed Rust, Senior [State Farm's former Chairman] ... and I said, "Dad, I want to be a multi-line agent. What do you think, since you have only been in the business 40-odd years, would be the best company to go with?"

And he said, in his opinion, State Farm would be the best company to go with.

Q Why?

A His idea at the time was, number one, the training that they gave the agents and the support vis-à-vis the billing and issuance of policies, which independent agents at that point in time they had to bill out of their offices and stuff, he said it will [save] you hours and hours of work so that's why....

Q Now, during the -- I guess it is about 26 years, I guess, that you have been --

A Almost 28.

Q Counting the trainee --

A If you count the trainee period.

Q 26, 28 years, at any time did you consider becoming an independent agent, that is giving up the State Farm contract, becoming an independent agent or becoming an agent for another company?

A No, I really did not.

Q Even though commissions are generally hire [sic] for independent agents?

A Uh-huh.

Q You chose to be a State Farm agent?

A Yes.

Q Why?

A The billing support, the training, the accident service for the clients, that type of thing. You know, it is my understanding even to this day that State Farm's claims service is without peer and that's what's important to a client when the yogurt hits the fan.

Q I suppose does it add anything to you and to your potential income that State Farm is a nationally known brand, a name?

A I would say probably so.

Q Does State Farm's name help sell insurance?

A I would say so. I would say so, yes. I think you would be unrealistic to say otherwise.

(Mueller Depo. 153/5-156/8; *see also* Lamphier Depo. 17/1-18/1; Nazziola Depo. 26/13-27/19.)

(211) Pursuant to Section I(G) of the Agent's Agreement, State Farm has expressly permitted Agents to place business that does not meet its underwriting requirements through governmental or insurance industry plans or facilities known as joint underwriting associations or state FAIR plans. (Fisher Aff. ¶ 15.)

(212) In addition, in very rare circumstances, such as when no state FAIR plan or industry association plan is available, the Company has allowed Agents to write business for other private insurance companies. (*Id.* ¶ 16.) In these situations, State Farm consented because it did not provide competing products, and had no long term plans to provide competing products, in the markets served by these entities. (Casino Aff. ¶¶ 18-21.)

(213) For example, State Farm has consented to Agents in Alabama placing business for Baldwin Mutual Insurance Co. Alabama does not have a state FAIR plan that would cover the specific risks covered by Baldwin Mutual. Therefore, State Farm Agents have no outlet to place high-risk business. In all cases, the policies Agents place for Baldwin Mutual are ones that State Farm would not write, and will not write in the future. (Casino Aff. ¶ 18; Fisher Depo. 104/1-4, 116/20-117/4.)

(214) Similarly, State Farm has consented to Agents in Maine placing workers' compensation business through Maine Mutual Employers' Insurance Company. While State Farm formerly wrote workers' compensation policies in Maine, changes in the regulatory environment in that state caused State Farm to withdraw from the market. Because Maine also does not have an assigned risk plan, State Farm has consented to Agents writing workers'

compensation policies through Maine Mutual. (Casino Aff. ¶ 19; Fisher Depo. 104/4-10, 117/5-9.)

(215) State Farm has also given consent to Agents who have signed a separate Agreement with a State Farm subsidiary known as IPSI (the "IPSI Agreement") to solicit applications for Fortis Insurance Company and Phoenix Mutual Life Insurance Company through IPSI. (Lamphier Depo. 22/10-22; Mueller Depo. 108/13-18; Fisher Depo. 101/7-16; Fisher Depo. 103/11-22.)

(216) Each of these companies provides products that State Farm does not provide. Fortis, for instance, provides health products that State Farm does not, including short term medical and student select health policies. Phoenix Mutual provides high-end life insurance products that State Farm does not provide. (Fisher Depo. 101/7-14, 101/22-102/20, 117/10-118/6, 133/1-8.)

(217) Thus, State Farm has consented to Agents soliciting business for other insurance providers only when the Company has made a long-term strategic decision that it will not provide competing products. (Fisher Depo. 103/11-104/15.)

(218) On November 25, 2002, NASFA President David Swift wrote State Farm asking the Company to permit Agents subject to limitations on their production of new business to solicit business for all other insurers, including competitors of State Farm. (Swift Depo. 13/22-14/5, 16/18-18/14 & Ex. 4 (attached as Martin Aff., Ex. 6).)

(219) State Farm denied Mr. Swift's request. (Swift Depo. 16/18-18/8.)

(220) Mr. Mueller and Mr. Adams both testified that it was reasonable for State Farm to refuse to allow Agents to solicit business for the Company's competitors:

Q And -- but you would consider it understandable, indeed, reasonable, for State Farm to refuse you permission to write insurance for direct competitors like Allstate or Nationwide?

A For direct multi-line companies such as Allstate and Nationwide, yes.

(Mueller Depo. 97/14-19.)

* * *

Q I see. So State Farm would have a business justification for not granting its consent to an agent such as yourself to broker business for Allstate, Nationwide, Farmers, the ones that State Farm generally competes with?

A Yes, with the big carriers that are in the same market with captive agents.

(Adams Depo. 86/14-20.)

(221) In his letter to State Farm, Mr. Swift asked the Company to allow Agents to solicit business for any other insurer because the then-existing limitations on new business production:

have drastically disabled, or entirely eliminated, the ability of Agents to operate profitably. Without the ability to service the needs of new customers or to sell new policies to existing customers, the ability of each Agent's business is severely impaired.

(Swift Depo., Ex. 4.)

(222) State Farm figures show that, as a whole, Agents' incomes actually increased considerably throughout the period the limitations on new business production were widely in place. Nationally, average compensation was up 13.3%, from \$272,788 in 2001 to \$309,158 in 2002. (Casino Depo., Ex. 1.) In 2003, they were up another 10.1%, to \$340,483. (*Id.*) Thus, between 2001 and 2003, average agent compensation increased by 24.8%. (*See id.*)

(223) In Texas, average agent compensation was up 15.7% in 2002 over 2001. (*See* Casino Depo., Ex. 1.) In California, commissions per agent were up 19% in 2002 over 2001. (*See id.*) In Florida, commissions per agent were up 8.5% in 2002 over 2001. (*See id.*)

(224) Incomes for all seven of NASFA's Board members deposed in this case increased during the years 2001, 2002, and 2003. (*See* Casino Depo., Ex. 1.) The income of NASFA's current President, Mr. David Swift, went from \$282,668 in 2001, to \$309,576 in 2002, to \$323,466 for just the first 11 months of 2003. (*See id.*) The income of its incoming President, Mr. Jerry Beauchamp, went up from \$244,079 in 2001, to \$275,961 in 2002, to \$276,443 for just the first 11 months of 2003. (*See id.*) And the income of its President at the time this litigation was brought, Mr. Lamphier, went from \$185,479 in 2001, to \$198,986 in 2002, to \$222,734 for just the first 11 months of 2003. (*See id.*)

IX. The Ethics/Compliance Program

(225) During the 1990s, the insurance industry endured a considerable amount of adverse publicity. Lawsuits and mass media stories eroded the public's confidence in the ethics of many insurers and their agents. (Wright Depo. 104/17-105/8.)

(226) In response to these developments, a number of insurers came together and formed "IMSA," the Insurance Marketing Standards Association. Among other things, IMSA was formed to promote ethical business practices among insurers. (*See* Wright Depo. 100/19-101/19; Fisher Depo. 241/4-13.)

(227) As part of its mission, IMSA offers certification that member insurers are "compliant" organizations if they can demonstrate their commitment to ethical business practices. (Wright Depo. 101/4-102/14, 103/9-13.)

(228) In approximately 1998, State Farm sought IMSA certification for the first time. (*See* Fisher Depo. 240/9-13, 241/4-13.)

(229) As part of its effort to demonstrate its commitment to ethical business practices, and more generally to make sure all Agents were fully informed about recent legal and regulatory developments in the industry, State Farm instituted a mandatory, once-yearly ethics/compliance program for Agents. (Fisher Depo. 234/16-22; Swift Depo. 336/12-18; Beauchamp Depo. 101/12-18; Lamphier Depo. 53/21-54/1; Mueller Depo. 67/15-20; Wright Depo. 100/7-101/3, 104/14-105/16.)

(230) The first such program was conducted in 1998; it has been held every year since. (See Fisher Depo. 234/16-22, 240/9-13.) The topics covered vary from year-to-year, depending, *inter alia*, on changes in legal requirements. (Lamphier Depo. 51/14-54/8, 55/1-7.)

(231) The program lasts for half a day, typically the morning hours. (Fisher Depo. 246/8-11; Swift Depo. 337/8-12; Beauchamp Depo. 101/12-20; Lamphier Depo. 53/21-54/1; Mueller Depo. 67/21-68/1.)

(232) Personal attendance by all Agents is required. Agents who do not attend risk having State Farm terminate their contracts. (Swift Depo. 336/12-14; Beauchamp Depo. 101/14-16; Lamphier Depo. 54/2-8.)

(233) State Farm does not require Agents to attend at any other meeting. (Swift Depo. 344/12-14.)

(234) The Company decided that matters of ethical, legal and regulatory compliance are of sufficient importance to require Agents' attendance (once a year, and for half a day) in this exceptional case. (Fisher Depo. 239/7-240/1; Wright Depo. 117/11-15; 124/17-126/5.) Mr. Wright, State Farm's Senior Executive Vice President for Agency and Marketing, testified:

Q Why did State Farm make the decision to require agents to attend a compliance class in person once a year?

A We had never done anything like this prior to that point in time. It was this was all happening, this IMSA certification and, indeed,

IMSA, grew out of tremendous concern in the industry over the lawsuits that were occurring during that period of time. There was a great deal of adverse press relating to the insurance industry. It seemed as though every week another company was accused of some sort of wrongdoing or there was another class action lawsuit filed and we felt, given the kind of thing going on in the marketplace, that we needed to make a strong statement for the benefit of all of our agents, for the benefit of the company, indeed, for the benefit of our brand and that the only way in which we could do that was to ask all of our agents to come to a compliance training and to do that in person. Indeed, the reason for doing that in person was to give agents an opportunity to talk with other agents to really get into the fabric of this issue and have an opportunity to discuss with other agents problems and situations that came about in their in their offices.

(Wright Depo. 104/14-105/16.)

(235) The Agent's Agreement emphasizes the importance of ethical business practices.

The very first paragraph of the Preamble states: "It is to our mutual interest to serve the insuring public [and] to comply with all applicable laws ..." (Agreement, Preamble (1st para.)) The next paragraph states:

Insurance is a closely regulated business. The Companies and the agents must deal equitably with policyholders as to rates and claims, be trustworthy in handling money, avoid false advertising and unfair practices, and otherwise act in a lawful manner.

(AA97 Agreement, Preamble (2d para.))¹²

(236) After this language was read to him, Mr. Mueller testified:

Q Do you agree with that?

A Yes.

Q And you would agree that from the company's standpoint, good ethics is also good business?

¹² The second paragraph of the Preamble to both the AA3 Agreement and the AA4 Agreement read: "Insurance is a closely regulated business. The Companies and the agents must deal equitably with policyholders as to rates and claims, be trustworthy in handling money, avoid false advertising and unfair practices, and refrain from any action that would result in violation, by State Farm or any agent, of any applicable law or regulation."

A Absolutely.

Q And the company has an interest in assuring -- without implying anything negative about the agents, which I would never do, but the company has an interest in insuring that its agents in their relations with policyholders, customers, clients, behave ethically and in strict conformity with the law?

A Absolutely.

(Mueller Depo. 71/13-72/3.)

(237) Following the Preamble, the first operative provision of the Agreement states that Agents will:

solicit applications for insurance ... avoid conflicts of interest, *comply with all laws and regulations, and otherwise cooperate with and advance the interests of the Companies, the agents, and the policyholders.*

(Agreement § I(A) (emphasis added).)¹³

(238) Mr. Lamphier testified that it is not abusive for State Farm to require its Agents to attend a once-a-year meeting to discuss ethical and legal matters:

A [reading from an exhibit] "They in the contract clearly state that we are free to decide how we will run our business as long as we comply with all laws and are fair, honest and ethical in our dealings."

Q You agree with that statement?

A Yes.

Q So your contract in particular states that you are free to decide how you will run your business, but it also obligates you to comply with all laws that are fair, to be honest and to be ethical in your dealings with policyholders and others; correct?

A Absolutely.

¹³ Section I(A) of both the AA3 Agreement and the AA4 Agreement read: "The Agent will solicit applications for insurance ... avoid conflicts of interest, and cooperate and advance the interests of the [State Farm] Companies, the agents, and the policyholders."

...

Q ... [T]he contract obligates you to deal equitably with policyholders as to rates and claims, to be trustworthy in handling money, to avoid false advertising and unfair practices, and to refrain from any action that would result in a violation by State Farm or yourself of any applicable law or regulation; correct?

A Correct.

Q And State Farm has the right to hold you to those obligations; correct?

A Absolutely.

Q And to make sure you comply with them; correct?

A Absolutely.

Q And one way that the company attempts to assure that you are complying with your ethical obligations, your obligations to deal equitably, is to hold meetings on ethics and compliance once a year; correct?

MR. HILLMAN: I object to the form. You may answer.

THE WITNESS: Yes.

...

Q And the company, in carrying out its obligations to assure you act equitably and ethically, requires your attendance at these meetings; correct?

MR. HILLMAN: Object to the form. You may answer.

THE WITNESS: Requires, yes.

...

Q And [they] cover[] compliance requirements with law and regulations and other ethical issues?

A Correct.

Q Do you consider it abusive by State Farm to require you once a year for half a day to listen to the latest news and information on ethics?

A No, sir.

(Lamphier Depo. 51/14-55/7.)

X. Internet Sales

(239) Beginning in approximately 1996, the Company began exploring the possibility of providing insurance to the public over the internet. State Farm did so as a result of the increasing prevalence of the internet, and in response to efforts by competitors such as GEICO and Progressive to sell insurance on the web. (See State Farm Int. Answer No. 11; *see also* Trosino Depo. 125/22-126/6.)

(240) At various times, and in various jurisdictions, State Farm has provided a selection of insurance products directly to consumers over the internet. The Company conducted a limited experiment in providing auto insurance directly over the internet, but stopped doing so when it proved ineffective. (Swift Depo. 76/14-18, 77/7-19.)

(241) State Farm does not currently provide either auto or homeowner's insurance directly over the internet. Products now sold over the internet in some jurisdictions include renter's insurance and other secondary insurance products. (Swift Depo. 77/7-19.)

(242) In some jurisdictions, State Farm does allow potential customers to submit inquiries for auto and/or fire insurance over the web. When State Farm receives such inquiries, they are referred to local Agents for follow-up. If a policy ultimately issues, the Agent receives commissions on the relevant product. Even with the products State Farm sells directly over the internet, the business is assigned back to a local agent after the policy is issued. The Agent to whom the business is assigned receives annual commissions on the policy. (Wright Depo. 148/7-149/14.)

(243) Thus, all internet activities lead in one way or another back to State Farm's Agents. (Wright Depo. 150/8-151/2.)

(244) There is nothing to indicate that any Agents have been adversely affected by State Farm's internet activities. Mr. Beauchamp testified:

Q Have you been adversely effected in any way by State Farm's practices on the internet?

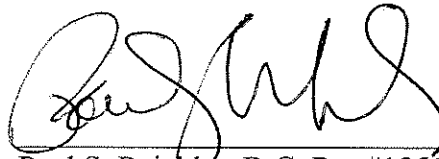
A I really don't know if I have or not.

Q Do you know of any other agents who have been adversely effected by any of State Farm's practices on internet?

A I don't know of any.

(Beauchamp Depo. 151/3-9; *see also* Swift Depo. 77/11-18.)

Respectfully submitted,



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May 6, 2004

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David Swift	President, NASFA
Jerry Beauchamp	President Elect/ Vice President for Government Affairs, NASFA
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Clifford H. Mueller	Vice President for Chapter Relations/Development, NASFA
Steven P. Adams	Secretary/Treasurer/Vice President for AA/97 Contracts, NASFA
Stephen R. Knapp	Vice President for Legal Issues, NASFA
Gabriel Nazziola	Vice President for Conventions/Past Presidents Council, NASFA
John Killingworth	former State Farm Agency Field Executive (currently in litigation against State Farm)

State Farm

Vincent J. Trosino	President, Chief Operating Officer, State Farm
Charles R. Wright	Executive Vice President for Agency and Marketing, State Farm
J. Gregory Fisher	Vice President, Agency, State Farm
Mary Bitzer	Senior Vice President, State Farm
Leon Maxwell	former Vice President, Agency, State Farm
Barry Thomas	Director of Property and Casualty Underwriting, State Farm
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