

IN THE SUPERIOR COURT FOR THE DISTRICT OF COLUMBIA
CIVIL DIVISION

NATIONAL ASSOCIATION OF)	
STATE FARM AGENTS, INC.,)	
)	
Plaintiff,)	
v.)	C.A. No. 02ca004089
)	Calendar 7
STATE FARM MUTUAL)	Judge Neal E. Kravitz
AUTOMOBILE INSURANCE)	
COMPANY, <i>et al.</i>)	
)	
Defendants.)	

PLAINTIFF'S REPLY MEMORANDUM IN SUPPORT
OF ITS MOTION FOR SUMMARY JUDGMENT

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I. INTRODUCTION

Plaintiff NASFA submits this Reply Memorandum in Support of its Motion for Summary Judgment. A proverbial forest of trees has succumbed to the parties' efforts in their motions for summary judgment, but this is the Memorandum for which the Interior Department has long pined: the final word.

In this Reply Memorandum, NASFA addresses State Farm's arguments in opposition to NASFA's motion. Where appropriate, reference is made to "Plaintiff's Memorandum of Law in Opposition to State Farm's Motion for Summary Judgment and in Support of NASFA's Motion for Summary Judgment" ("NASFA's First Memo").

NASFA confirms here that:

(1) the relationship between State Farm and its independent contractor agents is that of franchisor-franchisees.

(a) The argument that the state insurance regulatory framework would be upset if a court correctly ruled on this issue is meritless, because there is no such inexorable tension and because, were there any, a court decision would make clear the controlling principles;

(b) The prior decisions on the franchise issue (most now abandoned by State Farm) are either distinguishable or incorrect;

(c) State Farm independent contractor agents sell, distribute, market, offer and dispense (the various terms used disjunctively in the franchise statutes) State Farm insurance; and

(d) State Farm independent contractor agents pay a franchise fee to State Farm.

(2) The issues presented here are live controversies appropriate for declaratory relief.

They are not moot. State Farm's efforts to convince the Court that the termination issue, in

particular, is moot by misquoting a NASFA proposed statement of fact is a metaphor for the invalidity of State Farm's position.

(3) In the implementation of its right to approve or disapprove agent requests to broker insurance of other companies, State Farm, by its documented and complete refusal to treat any of these requests seriously, and its bald refusal to grant even the most reasonable of them, has violated the covenant of good faith and fair dealing by exercising its discretion unreasonably and unfairly.

(4) State Farm has breached the Agents' Agreements in several ways, as alleged by NASFA.

NASFA's claims merit Summary Judgment in NASFA's favor.

II. STATE REGULATION OF THE INSURANCE BUSINESS IS CONSISTENT WITH FRANCHISE LAWS

State Farm's argument that there is a fatal conflict between state insurance laws and state franchise laws is not only incorrect, but it is also premised upon a serious mischaracterization of the law. There is nothing in state insurance laws to suggest that those laws are intended to be exclusive of other legislation; State Farm cites no law to that effect; countless counter-examples abound; and State Farm's blanket characterization of state insurance law is wrong.

At the outset, State Farm's statutory citations, in this latest Memorandum and its prior Memorandum, do not stand for the proposition that state insurance laws exclude the operation of other state laws. And indeed, they could not. If state insurance laws excluded other laws, then State Farm agents could not possibly be licensed to sell securities, as they do, nor could State Farm operate a bank, as it does. Similarly, if State Farm's argument were valid, real estate agents, who are licensed by the state, would not be subject to franchise laws, *see, e.g., Century 21 Real Estate Corp. v. Hometown Real Estate Corp.*, 890 S.W.2d 188 (Tex. App. 1994) and health care services, also regulated by the state, would not be subject to franchise laws, *Interim Healthcare of Northern Illinois v. Interior Healthcare, Inc.*, 1999 WL 571005 (N.D. Ill. 1999).

State Farm also has misstated the law in asserting that the insurance laws in all fifteen states make insurance agents terminable at will. (State Farm’s Memorandum at 2-3, 21.) First, various statutes cited by State Farm do not expressly “make insurance agents terminable at will.” At most, they provide that if an agent is terminated, the state commissioner of insurance must be notified. An example is the Delaware statute, Del. Code Ann. § 1716:

(b) Termination without cause. - An insurer or authorized representative of the insurer that terminates the appointment, employment or contract with a producer for any reason not set forth in § 1712 of this title shall notify the Insurance Commissioner within 30 days following the effective date of the termination, using a format prescribed by the Insurance Commissioner. Upon written request of the Insurance Commissioner, the insurer shall provide additional information, documents, records or other data pertaining to the termination.

It expressly contemplates, moreover, termination for cause:

(a) Termination for cause. - An insurer or authorized representative of the insurer that terminates the appointment, employment, contract or other insurance business relationship with a producer shall notify the Insurance Commissioner within 30 days following the effective date of the termination, using a format prescribed by the Insurance Commissioner, if the reason for termination is one of the reasons set forth in § 1712 of this title or the insurer has knowledge the producer was found by a court, government body or self-regulatory organization authorized by law to have engaged in any of the activities in § 1712. Upon the written request of the Insurance Commissioner, the insurer shall provide additional information, documents, records or other data pertaining to the termination or activity of the producer.

Moreover, both Maryland and Minnesota affirmatively require cause for termination.

Maryland law states:

“Notwithstanding any other provision of this section, an insurer may not cancel or amend a written agreement with an insurance producer or refuse to accept business from the insurance producer if the cancellation, amendment, or refusal is arbitrary, capricious, unfair or discriminatory....” Md. Ann. Code, Insurance, § 27-503.

Minnesota law provides that an insurance company writing fire or casualty loss insurance

may not terminate an agency after it has been in effect for three years without attempting to rehabilitate the agent—a lengthy process pursuant to which the agent avoids termination. Minn. Stat. 60A.171. Minnesota law also provides that there must be a termination review process for any agent involuntarily terminated. This procedure requires a termination review board to determine if the termination is justified. Minn. Stat. 60A. 177. Thus, State Farm’s argument is not only wrong, it is premised upon misleading representations of law to the Court.¹

Finally, insurance agents’ businesses are regulated by a whole host of statutes, of course, as are virtually all businesses which are also deemed franchises. If and when a legislature determines that there is tension between laws affecting the same business, it has the power to and does reconcile those laws. Until then, it is a hornbook principle that the law is as stated in a Court’s decision interpreting the law or interpreting the legal status of a business or business-person. There is no tension and no confusion.

III. THE PURPOSE, SPIRIT AND LETTER OF FRANCHISE STATUTES CALLS FOR THEIR APPLICATION TO THE INSURANCE BUSINESS

State Farm’s argument that the franchise laws should not apply to the insurance business is principally based upon the proposition that this Court should ignore the purpose and language of those statutes and instead adhere to narrow, poorly reasoned and, in some cases, unreported decisions from jurisdictions that are not controlling here. State Farm once again puts the emphasis on the quantity, not quality, of decisions.

The purpose of state laws regulating franchises is to protect small business people from the disproportionate bargaining power of their franchisors; franchisees are usually locked into long-term

¹ State Farm’s citation of *McNeill v. Security Benefit Life Insurance Co.*, 28 F.3d 891 (8th Cir. 1994) for the proposition that the Arkansas Insurance Code makes agency contracts terminable at will is predicated upon a provision of Arkansas law (Ark. Code Ann. § 23-64-221) that does not stand for the proposition cited. (In fact, the citation authorizes an insurance company to sell insurance through vending machines, nothing else.) And its statement that, under Maryland law, insurance agents’ contracts are “presumptively terminable at will” is squarely contradicted by the provision noted above.

arrangements in which their entire livelihood and a considerable personal investment are tied up in the franchise business:

The New Jersey Act, for example, was

intended to reach the inherently unfair inequality of bargaining power between a licensor and licensee that is peculiar to a business arrangement under which one party loses his bargaining power because the arrangement causes a licensee to become economically dependent on a licensor who can then unilaterally deprive the dependent licensee of a substantial investment that has little or no utility once the license is terminated.

Cassidy, Podell Lynch Inc. v. Snyder General Corp., 944 F.2d 1131, 1143-44 (3rd Cir. 1991).

Unlike employees, franchisees have a substantial investment in the business that must be forfeited if they choose to leave; unlike independent business people, franchisees cannot simply decide to cease doing business with one supplier and switch to another. Franchisees are dependent upon the franchisor for the supply of goods and services, the right to do business under the franchisor's trademark and their franchisor's system of doing business. In light of these realities, state legislatures passed laws to ensure that prospective franchisees obtained full and complete information when they purchased franchises, and that franchisors were not able to abuse their power by terminating franchise without cause or otherwise changing the terms of the relationship, so as to leave the franchisees economically disadvantaged. See, e.g., Ill. Comp. Stat. § 705/2(1) ("The General Assembly finds and declares that the sale of franchise is a widespread activity. Illinois residents have suffered substantial losses when the franchisors or their representatives have not provided full and complete information regarding the franchisor-franchisee relationship.") So it is with State Farm agents: They make a substantial investment in the business that is not readily portable; they are dependent entirely upon State Farm for their business; and they have virtually no bargaining power when dealing with the company. Franchise laws exist precisely to redress the imbalance of power that enables a company like State Farm to make the types of unilateral changes that it has made

here.

In light of these broad purposes, courts construing and applying the definition of “franchise” have applied two overarching principles of construction. First, virtually all of the franchise laws are remedial laws and therefore are to be construed broadly so as to achieve their purpose. For example, in *To-Am Equip Co. v. Mitsubishi Caterpillar Fork Lift Am., Inc.*, 152 F.3d 658 (7th Cir. 1998), the Seventh Circuit noted that Illinois law “vigorously” protected franchisees because franchisors could otherwise terminate them “at will” and “franchisees tend to be weak and in need of a legislative boost in bargaining power.” Second, the franchise laws are written so as to be inclusive-unless the putative franchisor can show that its arrangement should be excluded from the scope of franchise law, it is included. See Cal. Corp. Code Ann. § 31153 (stating that in any proceeding under this law, the burden of proving an exemption or an exception from a definition is upon the person claiming it); Ill. Comp. Stat. § 705/42 (stating that in any proceeding under this Act, the burden of proving an exemption or an exception from a definition is upon the person claiming it); Md. Bus. Reg. Code Ann. § 14-227(a)(2) (stating that when determining liability under this subsection, the person who sells or grants a franchise has the burden of proving that the [franchisee] did not know and, in the exercise of reasonable care, could not have known of the untruth or omission); Mich. Comp. Laws § 445.1503(10) (stating that in any proceeding under this act, the burden of proving an exemption or an exception from a definition is upon the person claiming it); Wis. Stat. § 553.24(5) (stating that in any proceeding under this chapter, the burden of proving an exemption or an exception from a definition is upon the person claiming it). Most franchise laws place the burden of proof upon the putative franchisor-to show that the arrangement is not included within the definition of a franchise.

IV. STATE FARM HAS FAILED TO SHOW THAT ITS CASES ARE CONTROLLING

State Farm seems to have abandoned the six non-State Farm cases concerning insurance agents as franchisees, failing to respond to NASFA's showing that they are either distinguishable or fatally flawed. As to the three State Farm decisions, State Farm's effort to revive them after NASFA placed them on life support (NASFA's First Memo at 41-44.) is unavailing.

State Farm's reliance on the Court's observation in *Vitkauskis v. State Farm*, 509 N.E.2d 1385 (Ill. App. Ct. 1987) that the legislative history of the Illinois Franchise Act made it clear that it was intended to apply to the "relatively new business phenomenon" of franchising as opposed to the (older) "insurance business" ignores the express language of the statute as well as the legion of cases decided in the 17 years since *Vitkauskis* that have applied the Illinois Franchise Act to a wide variety of long-established businesses. See, e.g., *To-Am Equip. Co., Inc. v. Mitsubishi Caterpillar Forklift Am., Inc.*, 152 F.3d 658 (7th Cir. 1998)(forklifts); *Salkeld v. V.R. Bus. Brokers*, 548 N.E.2d 1151 (Ill. App. Ct. 1989)(business brokerage); *ECC Computer Ctr. Of Illinois, Inc. v. Entre Computer Ctr. Inc.*, 597 F. Supp. 1182 (N.D. 111. 1984)(computers). In *Vitkauskas*, the plaintiffs' status as a trainee agent, i.e., an employee, not an independent contractor agent, was the Court's rationale for denying the applicability of each prong of the Illinois Franchise Disclosure Act.

State Farm does not seriously take issue with NASFA's demonstration that *Hartman v. State Farm*, Case No. 93-8084 (S.D. Fla. 1993), aff'd, 77 F.3d 496 (11th Cir. 1996) is inapposite because it reflects a Florida law not involved here, and because the court did not carefully analyze the franchise issue. State Farm's only point, that "under Florida law, insurance is not an item of commerce" (State Farm Mem. at 18) is just that – a ruling which has nothing to do with this case. Indeed, *Hartman* was grounded on the antique premise that insurance services are not commercial activity, a relic of jurisprudence rejected by the United States Supreme Court sixty years ago in *U.S. v.*

Southeastern Underwriters Assn., 322 U.S. 533 (1944). Florida’s decision to ignore that rule is Florida’s embarrassment, but it need not be this Court’s.

State Farm’s attempt to distinguish between the services that agents provide and the business of insurance as a service (State Farm Brief at 18) does not advance its argument. If agents did not provide a service, there would be no need for them. In fact, however, the State Farm Agent Agreement requires that agents provide services to customers. Therefore, there can be little doubt that agents are engaged in the business of providing services—a point that *Hartman* ignored. Finally, State Farm’s contention that the *Hartman* court actually considered the “distribute” and “offer” prongs of the franchise definition elevates form over substance. The court may have mentioned those portions of the definition in a quote to the statute, but it did not consider them at all.

State Farm’s argument with respect to *Mazziotti v. State Farm*, No. C33-98 (NJ Super CH Div. 2002), an unreported, lower court decision, is almost incomprehensible. The *Mazziotti* court, which ruled that the New Jersey Act did not apply because agents did not “sell” insurance, apparently did not have the evidence this Court has that State Farm admits its agents sell insurance, nor did it have the legion of cases, cited in the next section, in which *State Farm* has argued expressly and Courts have concluded that State Farm agents do sell insurance.

As noted above, State Farm essentially concedes that the Plaintiff has effectively distinguished the non-State Farm cases; it does not even attempt to refute Plaintiff’s arguments. Indeed, as State Farms says, there is no real dispute about the current state of the law: No decision has been issued by the highest court of any state; some of the decisions State Farm cites are unreported; some are distinguishable; none of them consider the arguments in any sort of any comprehensive manner; and the courts in those cases clearly did not have the evidence that is before this Court.

State Farm goes to great lengths to eat its own words, i.e., its description of a State Farm agency as a “franchise.” Playing the same game that it plays with the word “sell,” it contends that “franchise” really does not mean “franchise” since State Farm issued an official policy disclaiming the use of the word “franchise” on the eve of state franchise regulation. The significance of State Farm’s discontinuance of that term is obvious: the arrangement was considered a franchise, even by State Farm – to the point that its agency managers continued to use the term after its official “discontinuance.” (Interestingly, State Farm does not offer any proof to refute the testimony of Plaintiff’s witnesses that agency recruiters compared the State Farm opportunity to a “McDonald's franchise.”) In any event, the point is that State Farm admits that its agencies were franchises at least some time in the past. State Farm has changed that usage, but has not explained it. State Farm tells us that its legal department concluded that the use of the word was inaccurate – but has produced no witness with knowledge to tell us how it was inaccurate or what conclusions State Farm reached at the time. Was the relationship changed in any way? Once again, as it does on so many other occasions, State Farm demands that this Court accept its word-simply because State Farm says so. That is hardly good law or persuasive evidence.

V. STATE FARM’S ARGUMENTS THAT AGENTS DO NOT “OFFER,” “DISTRIBUTE” OR “SELL” INSURANCE ARE PALPABLY FALSE: STATE FARM HAS AFFIRMATIVELY ARGUED BEFORE OTHER COURTS THAT ITS AGENTS SELL INSURANCE

“In this case, Schmeiser is an Iowa resident. He is seeking coverage under an umbrella policy with State Farm that was sold and delivered to him in Iowa by an Iowa agent. The policy was negotiated in Iowa and could reasonably have been expected to be performed in Iowa.”

Brief of Intervening Defendant-Respondent State Farm Fire & Casualty Co., in *Trombello v. Blue Sky Harbor Limited Partnership*, Wis. Ct. App. No. 01-0195, April 18, 2001, 2001 WL 34352608, annexed to the Affidavit of Allan P. Hillman, dated August 18, 2004, as **Exhibit 1** (Emphasis added.)

Now we know: Agents not only sell and deliver policies, but they also negotiate them.

Just in case State Farm's lawyers in the *Trombello* case were wrong, let us consider what other courts have said in cases where State Farm was represented by counsel: "Defendant Ruby Shields ("Shields") was the State Farm agent who sold the policy to Roland." *Roland v. State Farm Fire & Cas. Co.*, 2003 WL 22779071 (Va. Cir. Ct. Oct. 14, 2003). "...Milam County is the location of State Farm's local insurance agent, Lloyd Curington, who sold the policy." *Chiriboga v. State Farm Mutual Auto Insurance Co.*, 96 S.W.3d 673 (Tex. App.-Austin, Jan. 6, 2003). "The independent contract agent is paid commissions on policies sold from his or her local office..." *Gardner v. State Farm Mutual Auto Insurance Co.*, 842 So.2d 1 (AOA Civ. at Jan. 18, 2002). "State Farm argues that Nebraska is where the insurance policy was sold and issued, where the parties live, and where the Bechlers' State Farm agent does business." *Bechler v. State Farm Mutual Auto Insurance Company*, 195 Ariz. 282, 987 P.2d 768 (Ariz. App. Div. 1, April 22, 1999). "These policies were issued by State Farm and had been sold to the Bailey's by State Farm agent, Tom Metzger." *Bailey v. State Farm Fire & Cas. Co.*, 267 Ill. App.3d 653, 642 N.E.2d 1323 (Ill. App. Aug. 31, 1994). "State Farm offers only the deposition of Teddy D. Schaefer, the State Farm agent who sold the insurance policy to the Plaintiffs." *Cornwell v. State Farm Fire and Cas. Co.*, 527 F. Supp. 310 (E.D. Pa. Dec. 10, 1981). Significantly, as exemplified in the *Trombello* case, State Farm has argued repeatedly that the law of the place of contracting – i.e., where the agent sold the policy-where the contract was made-was the place whose law should govern disputes as to the obligation to provide coverage. See *Bechler*, supra. *Trombello v. Blue Sky Harbor Limited Partnership*, 250 Wis.2d 353, 639 N.W.2d 801, (unpublished disposition Wisc. Apr. 4, 2001).

The doctrine of judicial estoppel precludes State Farm from asserting, in this case, that its

agents do not “sell” insurance. In *New Hampshire v. Maine*, 532 U.S. 742, 121 S. Ct. 1808 (2001), the Supreme Court endorsed this doctrine in holding that the State of New Hampshire was judicially estopped from claiming that the state border with Maine ran along the Maine shore of the Piscataqua River when, in prior litigation, it had entered into a consent decree providing that the border was the mid-point of the river. Justice Ginsburg observed that the doctrine of judicial estoppel was intended to protect the integrity of the judicial process by prohibiting parties from changing positions “according to the exigencies of the moment.” Thus, the Court held that a party will be estopped from taking a position when it is “clearly inconsistent” with an earlier position it has taken in litigation and that it has succeeded in having a court adopt.² Absent estoppel, a court’s acceptance of a contrary position in the later proceeding would create “the perception that either the first or second court was misled.” 532 U.S. at 750, 121 S. Ct. at 1815. Applying the doctrine, the court in *Kale v. Obuchoski*, 985 F.2d 360 (7th Cir. 1993) held that a bankruptcy court had properly invoked the doctrine in holding a party could not claim an interest in a real estate development when, in a prior divorce proceeding, he had testified that he had no such interest. The court further penalized the party and his lawyers under Fed. R. Civ. P. 11. Likewise, in *Rissetto v. Plumbers and Steamfitters Local*, 343, 94 F.3d 597 (9th Cir. 1996) the Court estopped an employee from pursuing claims to recover back pay for age discrimination when she had previously obtained workers compensation based on her assertion that she could not work.

Is State Farm any different? Hardly. It has repeatedly taken the position in litigation that its agents “sell” insurance – positions that the courts have accepted, and reiterated, as demonstrated above. Now it seeks to play fast and loose, and shamelessly tells this Court that agents *never* sell

² The Court stopped short of requiring that the party *prevail* in the earlier proceeding; it required only that the court accept the party’s position.

insurance. The Court should not permit this inexcusable conduct to be successful; agents do exactly what State Farm has told courts over and over around the country: they sell insurance.

While State Farm’s judicial admissions should be enough to dispose of the “sale” issue, we will briefly address the balance of its arguments. State Farm still does not grapple with the fact that franchise laws define franchisees as those “who offer, distribute or sell” a good or service of the franchisor. These are not technical terms nor are they “simply additional ways to describe the action of selling” (State Farm Mem. at 27), a proposition for which there is absolutely no authority.³ They are distinct concepts, to be understood in their ordinary sense; they ensure that franchisees who do not “sell,” but indeed “offer” or “distribute” the franchisor’s goods or services-are covered by the franchise laws. Additionally, Arkansas, Wisconsin and New Jersey do not even require that the franchisees “sell.”

Significantly, State Farm virtually ignores the “offer” prong of the definition – for the obvious reason that it has no counter-argument. If State Farm agents do anything, they offer policies to the public. Franchise statutes do not define “offer” in the sense of a contract offer (e.g., offer and acceptance) but simply in the ordinary sense of the term.

State Farm devours five pages of paper contending that agents do not “distribute” insurance. Its argument stumbles upon awkward propositions – that “distribute” only refers to wholesalers of goods, or that state franchise statutes, which are plainly in the disjunctive, may in some alternative

³ Since State Farm weds its arguments to the propositions contained in Mr. Garner’s treatise, we are confident that State Farm will embrace the most recent supplement of the Treatise (written before State Farm’s Memorandum), which State Farm conveniently has ignored, and which unequivocally states that a franchisee may “offer” or “distribute” a product or service as well as sell. A copy of the latest supplement of the (updated) sections cited by State Farm is annexed to the Affidavit of Allan P. Hillman as **Exhibit 2**.

universe, be conjunctive.⁴ State Farm's citation of *Zentner v. Farmers Group, Inc.*, No. B133011 (Cal. Ct. App. 2000), which it apparently exhumed from the graveyard of unreported decisions, is bizarre indeed; State Farm tells us that *Zentner* "compels a conclusion that State Farm agents are sales representatives." Indeed, they must, therefore, sell.

State Farm does not refute in any way Plaintiff's showing that agents "deliver" and therefore "distribute" policies. Indeed, agents not only deliver insurance policies, but they deliver a wide variety of services, including advice, information, assistance with claims, reinstatement, delivery of documentation and the like. In the words of franchise statutes, agents "deliver" services of the franchisor.

Unable to overcome this reality or the fact that there are no cases that support its position, State Farm cites *Kenebrew v. Connecticut General Life Insurance Co.*, 882 F. Supp. 749 (N.D. Ill. 1995) which deals not with a franchise statute but with the Illinois Sales Representative Act. It is simply inapposite.

State Farm's arguments that it is not possible to "distribute" a service or "an intangible item like insurance" is simply an academic exercise in trying to count angels on a pinhead. The reality is that the word "distribute" means, among other things, to make available. State Farm agents deliver and make available insurance policies, insurance services and services that go along with insurance. If they were not there to make those services available to the public, State Farm would be out of business. State Farm's arguments that it is "simply incorrect" that agents distribute insurance is "simply disingenuous."

State Farm's remaining argument that its agents do not "sell" insurance is premised upon a

⁴ State Farm oddly claims that plaintiff cites only *Gentis v. Safeguard Business Systems, Inc.*, 71 Cal.Rptr2d 122 (Cal.App. 1988) for the proposition that "offer" "sell" or "distribute" are disjunctive, and then proceeds to try to bash that case. Quite simply, the statutes are written in the disjunctive; the words are clear and unambiguous, and no case authority is necessary.

wholesale abandonment of reams of its own executives' admissions that agents "sell" insurance, as detailed as in NASFA's First Memo. These are not off hand, ill-considered or casual uses of the term "sell" or "sale." They are, among other things, statements by a Vice President in written columns in an edited magazine that is published to all 16,000 State Farm agents and they are terms that are used in official programs adopted by the company to train its agents to "sell." The Court is told it must ignore this crucial evidence, however; told by a party (StateFarm) which itself also seeks summary judgment.

State Farm would like this Court to believe that there is some magical, narrow definition of the word "sell" under the franchise laws. Unfortunately, it cannot find that definition because it does not exist. And there is nothing, absolutely nothing, under the franchise laws that requires that the franchisee "set the terms and conditions of the sales, to set prices, to receive and/or convey title, to bear the risk of loss, etc." (State Farm Mem. at 33.) Under the franchise laws, State Farm agents sell State Farm insurance.

VI. STATE FARM AGENTS PAY FRANCHISE FEES.

A. Fees for Premium Fund Accounts are Franchise Fees.

State Farm's prolix argument that fees paid by agents to maintain premium fund accounts for State Farm's benefit are not franchise fees deliberately ignores what is not disputed on this motion:

1. Agents must have a premium fund account in order to do business.
2. The account is not for the agents but is for State Farm.
3. Agents incur fees for maintaining these accounts.

As shown previously, State Farm bears the burden of proving that these fees are not franchise fees, and State Farm has failed to do so. Specifically, State Farm has failed to show that all agents, or agents generally, do not have to pay fees to maintain this account for State Farm's benefit. Perhaps

most tellingly, State Farm does not suggest that its company-owned bank offers these account services at no charge.⁵ What State Farm has offered as its “proof” is the inconclusive testimony of two agents that they do not pay fees for their State Farm accounts. This testimony falls short: What is missing is why these agents do not pay a fee for that particular account—is it because they keep all of their business at that bank? Because they maintain a minimum balance? Are the terms and conditions under which they maintain their accounts available to all State Farm agents? State Farm has completely failed to address these issues.

State Farm ignores the law that has established that payments made to parties other than the franchisor can be franchise fees. *Boat & Motor Mart v. SeaRay Boats*, 825 F.2d 1285 (9th Cir. 1987); *California Guidelines*; *Tractor and Farm Supply v. Ford New Holland, Inc.*, Bus. Franchise Guide (CCH) ¶ 10,643 (W.D. Ky 1995). *Implement Serve, Inc. v. Tecumseh Product Co.*, 726 F. Supp. 1171 (S.D. Ind. 1989) (a putative franchisee’s rendering of services at no cost may be a “franchise fee”). State Farm’s citations are not on point; *Peter v. Stonepark Enterprises*, 1999 WL 543210 (N.D. Ill. 1999) concerned purchases of goods or services from third parties, not payment of fees on behalf of the franchisor. *In Re Matterhorn Group, Inc.*, 2000 WL 1174215 (Bankr. S.D.N.Y. 2000) merely held that the complaint had failed to properly plead a franchise fee. And that case cited *Sea Ray* and recognized that franchise fees may well be indirect.

State Farm’s attempt to diminish or distinguish the California Attorney General’s definitive *Guidelines* is simply wishful thinking. The *Guidelines* plainly and explicitly recognize that payments made on behalf of a franchisor to a third party are considered franchise fees. The alleged “omitted” “key language” from the *Guidelines* is not even meaningful; that language refers to

⁵ It is interesting on this motion that State Farm, with its vast expertise in financial services, has not offered this Court comprehensive information – or even a list – of banks that offer to maintain custodial accounts such as this at no charge.

payments made to third parties that are not on behalf of the franchisor, but here the payments are made on behalf of the franchisor.

The facts, then, are not in dispute: Plaintiffs must maintain a premium fund account on behalf of State Farm in order to be in the business of being State Farm agents. The payments are made for the benefit of State Farm. State Farm has failed to show that agents do not have to pay these fees. They are franchise fees.

B. Payments for Signs Are Indeed Franchise Fees

State Farm does not contest that case law and regulations recognize that the cost of advertising and promotional materials is a franchise fee. *Sea Ray*, 825 F.2d at 1290 (“films, floats, banners, posters and brochures arguably constituted a fee in terms of the Act”); California Guidelines (“Charges for ... displays”); *Tractor and Farm Supply v. Ford New Holland*, Bus. Franchise Guide (CCH) ¶ 10,643 (W.D. Ky.) (“payments for ... advertising ... sales materials ... constitute a franchise fee”).

State Farm does not argue that agents need not have signs as a practical necessity. State Farm has not disputed the factual statements of Plaintiff (PSOF ¶ 31) that as a matter of custom and practice, for at least 35 years, State Farm has required agents to have signs and that agents cannot serve the interests of policyholders without a sign. Rather, State Farm makes the artful, but ultimately futile, argument, that agents are not required by contract to have signs. This is a fine distinction that leaves the key facts undisputed: agents must have signs as a practical necessity; agents must pay for the signs, the signs, like advertising, benefit State Farm. If they are a “practical necessity,” then, under the FTC Franchise Rule, they are franchise fees (see citations in NASFA’s First Memo, p. 70)

State Farm mischaracterizes the affidavit and deposition testimony of David Swift. Mr. Swift’s affidavit states that as a practical necessity, agents are required to have signs. As State

Farm knows, this point is completely different from and distinct from what State Farm “requires” or what its current policy is.

C. The Computer Expenses of Agents are Franchise Fees

State Farm’s argument that expenses for computers are not franchise fees is premised upon the misleading observation that because some agents may not require additional computer equipment, or that some agents chose, before 1996, to work without computers, that payments for computers are not required payments. What is undisputed is that agents were required to pay for computers and that they still must make such payments if, as a practical necessity, they need additional equipment. The payments they make for computer equipment are franchise fees.

D. Payments for Advertising Are Franchise Fees

The State Farm Agent Agreement requires that agents advertise, and they must advertise as State Farm agents. State Farm does not take issue with the proposition that, as a practical necessity, agents must advertise. It is, moreover, undisputed that franchisees make cooperative advertising payments to State Farm.

State Farm’s argument that advertising is only a franchise fee if required in the franchise agreement is satisfied in this case by the requirement in the franchise agreement that agents advertise. Plaintiffs have cited above the authorities holding that advertising expenses may be franchise fees. While some isolated jurisdictions have held to the contrary, those decisions are limited to the jurisdictions in which those decisions have been made.

E. Sales Brochure Expenses Are Franchise Fees

State Farm does not dispute that sales brochures are a practical necessity for its agents, and that they must purchase them from State Farm. The fact that a small percentage of the agents have not purchased them within the last 18 months or that State Farm distributes some brochures for free is not dispositive. Likewise, State Farm's subsidy of the cost of brochures is of no

consequence: franchisor's subsidy is not the measure of a franchise fee.

State Farm also attempts to create a distinction – without success – between sales brochures and “manuals,” and on this basis seeks to distinguish the *To-Am* case. *To-Am* is fatal to State Farm, and did not turn on the distinction between a “manual” and a “brochure.” The critical point *To-Am* was that the supplier required the distributor to purchase written materials in order to do its job. Here, the same is true with respect to the sales brochures that agents must purchase in order to do their job. The cost of those expenses is a franchise fee. *To-Am; Sea Ray; Tractor and Farm Supply; California Guidelines*.

F. The Cost of Promotional Items is a Franchise Fee

State Farm's only argument with Plaintiff's showing that the cost of promotional items constitutes a franchise fee is to quibble with the credibility of Mr. Swift's affidavit. Once again, State Farm attempts to confuse Mr. Swift's testimony about what State Farm legally requires in its documents with what State Farm agents must do and have as a practical necessity. Thus, while State Farm may not “force [the promotional items] down [agents'] throats” agents are required as a practical necessity to use them.

The further attack on Mr. Swift's credibility is ludicrous. He has been an agent for some 35 years and is President of NASFA, a position in which he obviously is in touch with thousands of agents throughout the country on a regular basis. He is, by any standard, qualified to state what an agent requires as a “practical necessity” in order to do business. See Fed. R. Evid. 701 (allowing lay opinion testimony based on personal knowledge or experience); *Western Industries, Inc. v. Newcor Canada Ltd.*, 739 F.2d 1198 (7th Cir. 1984)(business people should have been permitted to testify that there was a custom in the trade of not permitting consequential damages); *S.E.C. v. Singer*, 786 F. Supp. 1158 (S.D.N.Y. 1992)(attorney permitted to testify with respect to nature of relationship with client).

G. There is No Dispute that Trainee Agents Receive Reduced Commissions, a Form of Franchise Fee

Trainee Agents receive less compensation than regular agents in two ways: the commissions are less and they must sell minimum quotas of insurance or be liable for deficiency payments. Significantly, State Farm has not disputed the fact (PSOF #28) that trainee agents receive either no commissions (i.e., first and second year assigned fire policies) or reduced commissions. Nor does State Farm contest the fact that agents must pay the entire cost of servicing these accounts. State Farm admits that “it is easy to conceive how forfeiting compensation to which one would otherwise be entitled might be a ‘fee.’” (State Farm Brief at 53.) This essentially concedes the point. There is no argument that trainee agents receive less commission compensation than regular agents. And they must accept these lesser commissions, giving up the regular commission schedule, to take the next step, i.e., become independent State Farm agents. This alone compels the conclusion that the agents are paying franchise fees, and the case of *Koellen v. Snap-On Tools Corp.*, Bus. Franchise Guide (CCH) ¶ 11,426 (E.D. Wash. 1998) supports that conclusion by analogy. *Koellen* stands for the proposition that when a person who is paid on commission does not receive the full commission, the difference may constitute a franchise fee. Whether it is characterized as a withheld commission or a reduced commission does not make a difference: The person has given up consideration.

State Farm’s contention that because it makes other payments to the agents to “make up” for what it has taken away from them or that it subsidizes trainee agents is simply inapposite. It does not matter whether State Farm – or any franchisor – makes payments to franchisees. That is not the test of a franchise fee. Accordingly, State Farm's argument that its largess eliminates the franchise fee is simply wrong.

VII. THERE IS AN ACTUAL CONTROVERSY WITH RESPECT TO STATE FARM'S COMPLIANCE WITH THE FRANCHISE LAWS

A. There is an Actual Controversy with Respect to State Farm's Rights to Terminate

Arguing that there is no dispute concerning State Farm's termination policies, State Farm engages in what some would criticize as "sleight of hand"; others, perhaps the court, may react more vigorously. Thus, State Farm writes:

... Plaintiff itself takes the position that "State Farm never terminates/anyone arbitrarily or capriciously; it always does so for a reason... for cause." (PSOF ¶ 77.)

State Farm Memo at 56. There is just one problem with this citation. Let's us see what Plaintiff actually stated in its Proposed Statement of Fact 77, which speaks for itself:

With respect to this provision, State Farm's witness with knowledge, Gregory Fisher, testified that State Farm never terminates anyone arbitrarily or capriciously; it always does so for a reason ... for cause.

(Emphasis added.) This bring to mind the song Lord Cornwallis ordered played as his forces stacked their arms in surrender at Yorktown: "The World Turned Upsidedown."

State Farm's Agreements all give it the right to terminate without cause; indeed, State Farm argues that vociferously in propounding its view that the insurance laws and franchise laws cannot co-exist. NASFA contends that State Farm, as a franchisor, cannot terminate for cause in states here at issue. Hence, for State Farm to assert that there is no dispute over State Farm's obligation to terminate its agents only for cause, and therefore no case or controversy, is simply disingenuous. There is, indeed, a live controversy. *Maryland Casualty Co. v. Pacific Coal & Oil Co.*, 312 U.S. 270, 272, 61 S. Ct. 510 (1941). For a controversy to exist, the court looks "to the state of affairs as of the filing of the complaint." *International Harvester v. Deere & Co.*, 623 F.2d 1207, 1210 (7th Cir. 1980). The plaintiff must show that at the time the complaint was

filed, he suffered an actual or faced potential, threatened injury from the defendant's conduct, traceable to the defendant's action, and that the injury is likely to be redressed by favorable court action. *Valley Forge College v. Americans United*, 454 U.S. 464, 472 (1982). The Complaint, in fact, alleges that State Farm is subject to franchise laws and that those laws require good cause for termination, (see, e.g., Complaint at ¶¶ 28, 32, 36, 40, 44, 48, 52, 56, 64, 68 and 84, all of which allege that State Farm is subject to certain franchise laws “and may not lawfully act contrary to such statute, i.e., it may not terminate the Agents' contracts without notice, good cause and an opportunity to cure.”) State Farm has denied those violations in its Answer and in its pleadings since.

The Complaint further alleges that there is an actual controversy between the parties. (Complaint ¶ 13.) The agents have alleged and have produced evidence that State Farm has unilaterally adopted a host of programs that threaten agents' futures. (Complaint ¶ 1.) These include the partnering program, the discontinuance of sales of certain lines of the insurance in some jurisdictions, refusal to permit brokering in violation of the duty of good faith, sales of insurance over the Internet, the “Select Agent” program and other policies. There is indeed a live controversy, and the constitutional requirement of a concrete case or controversy is satisfied. State Farm's citation of *Smith v. Smith*, 310 A.2d 229 (D.C. 1973) is inapposite; what the plaintiffs sought in that case was an interpretation of an existing divorce decree, not a concrete dispute. Here, what is at issue is the scope of obligations that State Farm has upon termination.

State Farm's contention that its limitations on the number of new applications agents may submit is “largely moot” misses the point. State Farm has the power to impose the restrictions; it has imposed them in the past, and it provides the agents (and this Court) with no assurance that it would not impose them in the future – quite the contrary. This is, therefore, a classic situation of offenses

that are “capable of repetition.” Not only should the court look to the state of affairs at the time of filing the Complaint, *International Harvesters*, but it should recognize that, as here, the dispute is ongoing and “capable of repetition but prone to evading review.” *Employers Resource Management Co. v. James*, 62 F.3d 627, 631, n.8 (4th Cir. 1995) (Emphasis added).

Thus, the dispute is not moot.

State Farm has made much of the fact that Agents’ incomes generally (but not always) have increased year-to-year in recent years, as “proof” that State Farm’s policies could not have been harmful. But State Farm admitted that rate (premium) increases were widespread during this period (DSOF 199-200). And the AA3-AA4 Agents’ retirement under the Agreements are based on their books of business, i.e., their customer bases. (PSOF-133.) These bases generally have declined.

State Farm argues that “Plaintiff not only fails to dispute this ... fact [concerning agent incomes], it ignores it entirely.” (SF Memo, p. 9.) This is odd. In “Plaintiff’s Response to Defendants’ Statement of Undisputed Facts,” in responding to this very point about agents’ incomes, NASFA stated:

Plaintiff disputes the statement contained in paragraph 222. State Farm admitted that it had done no study or calculation of what the average earnings of agents would have been if the limitations and restrictions had not been in place. *Casino Depo. at 24/15-18*. Furthermore, State Farm did not consider the long-term effect on such restrictions given lapse/cancellation rates or account for the role of premium increases. *See Garner Aff. Exs. 48, 49*.

The law is consistent with the above logic. The rule is well stated in *Lee-Moore Oil Co. v. Union Oil Co.*, 599 F.2d 1299, 1305 (4th Cir. 1979). *Lee-Moore* was an antitrust case, but the principal is universal. Stating that the injury is “relative” in nature, the Court held:

No matter how thriving [Plaintiffs’] business may be, no matter how large his rate of profit may be, no matter how impressive his annual report may be, the substance of his claim is that he would have been

even better off if the defendant's alleged misdeeds had never taken place.⁶

In short, the issue is concrete, the controversy is concrete and alive.

B. In Wisconsin, There Is a Live Controversy About Changes in Competitive Circumstances

Once again, State Farm attempts to avoid the consequences of its restrictions of business under Wisconsin's Fair Dealership law by claiming that the dispute is "moot" because it has removed the restrictions in Wisconsin. Is State Farm giving an assurance that it will not impose restrictions on sales of homeowners' insurance in Wisconsin again? Quite the contrary – the Defendants make no such representation. There is, therefore, a live controversy. State Farm's argument that it had "good cause" is likewise incorrect. Under Wisconsin law, there is only good cause for a change in competitive circumstances if the company is withdrawing from the market in a non-discriminatory manner. *Morley-Murphy Co. v. Zenith Electronics Corp.*, 142 F.3d 373 (7th Cir. 1998). State Farm has not shown this in the least.

C. The Restrictions in Hawaii and Indiana Violate Those States' Franchise Laws.

As before, the fact that State Farm has withdrawn restrictions on insurance that agents can sell (in the very states that impose limitations on its ability to do so) does not make this controversy moot.

State Farm's argument that the Indiana and Hawaii statutes do not apply because agents do not "purchase" insurance from State Farm misses the mark. Construing the statutes liberally,

⁶ Compensation also may have increased because agents worked overtime in light of State Farm's threats to cut back their available products for sale or because Agents were fortunate. And it is not unusual for franchisors to terminate franchisees when their incomes are at their zenith – so that the franchisor can reap the profits the franchisee is making. In any event, agent compensation is not a panacea for wrongful conduct, nor does it eliminate the threat of termination or render State Farm's other policies lawful.

State Farm is the only source of supply of the goods or services that the agents can sell.⁷ State Farm has not even purported to show that the restrictions are reasonably necessary for a lawful purpose or justified on business grounds.

D. As Recognized By Its Executives, State Farm's Restrictions On Sales Are Discriminatory

In its First Memorandum, Plaintiff showed that State Farm's decisions to restrict the ability of agents in various states to sell business was arbitrary, based upon the testimony of Mary Bitzer, who unequivocally testified that State Farm does not follow any standards or regular procedures in making these decisions.

Now State Farm attempts to back and fill by quoting Ms. Bitzer for the admitted proposition that the decision to take away the ability to do business is “not an exact process,” that it involves “conversations among ourselves” and that it involves, at best, “looking at” a number of factors. Ms. Bitzer, however, was unable to specify exactly what she looked at, what standard was applied in “looking at” these factors and was unable to articulate any basis on which these decisions were not arbitrary. Moreover, her testimony is uncontradicted (and not even mentioned by State Farm in its Memorandum) that State Farm did not solicit the agents’ points of view.

State Farm’s attempt to limit the disaster of Ms. Bitzer’s testimony to a good portion, but not all, of the United States, is undercut by the fact that State Farm offered Ms. Bitzer as a witness qualified to testify about the national process of how it limits business. It is interesting that while State Farm has undertaken to submit additional affidavits with these papers, it has not attempted to “correct” Ms. Bitzer’s testimony or to tell how State Farm decides to take business away from agents in other parts of the country. The implication is that things are as bad – or worse elsewhere.

⁷ Indeed, State Farm’s position in other litigation that agents “sell” insurance in their jurisdictions supports the view that agents effectively purchase it from State Farm and resell it.

State Farm has, once again, failed to carry its burden of showing that the restrictions are not discriminatory.

E. State Farm Has Failed to Show That The Select Agent Program is Not Discriminatory

State Farm does not effectively dispute Plaintiff's showing that the Select Agent program discriminates against agents who cannot meet its requirements for production because of geographic and economic circumstances or that the program is administered in a discriminatory fashion. Instead, State Farm merely contends that it is an "incentive" program, and offers the conclusory testimony of its witnesses that the Company has these rights under an agreement and the Select Agent Program is a bonus and incentive program authorized by the Agreement. This shows nothing. The program is not available to all agents, and State Farm has failed to show that its administration of the program is not arbitrary and capricious. It is, therefore, in violation of the franchise laws of states that prohibit discrimination.

VIII. STATE FARM HAS BREACHED THE AGENT AGREEMENT OR BREACHED THE IMPLIED DUTY OF GOOD FAITH AND FAIR DEALING IN EXERCISING ITS DISCRETION UNDER THE AGREEMENT

A. The Undisputed Facts Show That State Farm's Limitations on New Business are a Violation of Its Contract

State Farm's attempt to contend that Plaintiff has "admitted" the relevant facts concerning the Company's history of imposing restrictions on sales of business is disingenuous. State Farm's Statement of Undisputed Facts states that "from time to time" State Farm has limited business. It then cites two specific examples of this occasional restriction – Hurricane Andrew in Florida and the Northridge Earthquake in California. Neither of these isolated, catastrophic events is inconsistent with State Farm having a general custom and practice of consistently using agents to sell as much insurance as possible and making insurance products available to meet the demand. Indeed, if there was no such custom or practice, why did State Farm not put in another affidavit to

say that? On this record, then, it is undisputed that (1) State Farm had a consistent custom and practice of encouraging agents to sell as much insurance as they would; (2) making products available to them for this purpose; and (3) construing the Agent Agreement's language consistently with its custom and practice. It has made a couple of exceptions to this custom and practice "from time to time" in unusual circumstances.

Mr. Swift's testimony harmonizes the otherwise apparently conflicting provisions of the Agent Agreement so that they can be read together: While State Farm reserves the right to "limit policies," it does so in the context of maximizing sales, and making insurance products available to the agents.

State Farm's citation of *Hartman v. State Farm Mut. Auto. Ins. Co.*, Case No. 93-8084 (S.D. Fla. 1993), aff'd (table), 77 F.3d 496 (11th Cir. 1996); *Hemmans v. State Farm Ins. Co.*, 653 So.2d 69 (La. Ct. App. 1995) and *Appling v. State Farm Mut. Auto. Ins. Co.*, No. C97-1569 MJJ (N.D. Cal. 1999), aff'd, 340 F.3d 769 (9th Cir. 2003) are not controlling. *Appling* and *Hartman* concerned restrictions growing out of Hurricane Andrew, with which plaintiffs have no argument; *Hemmans* involved restrictions upon a limited number of specific *agents*, not wholesale statewide limitations of the ability to do business.

What is not at issue on this record, then, is that State Farm has had a policy, custom and practice of requiring its agents to sell as much insurance as possible and of making the product available to them: State Farm does not dispute this. State Farm has, "from time to time" in the past, limited sales of insurance in the wake of major natural disasters. What it has *not* done in the past, and what is squarely at issue here is that it has not promulgated wholesale restrictions on sales of insurance by agents where there was no natural disaster or similar circumstance.

It may be that State Farm had good, documentable reasons for imposing these restrictions. We do not know. All we know is that it "looked at" various unspecified "factors." State Farm has

failed to carry the burden of showing that it in fact exercised its discretion to limit sales in a reasonable manner.

B. State Farm Has Ignored Its Obligation to Be Reasonable in Exercising Its Discretion In Curtailing Sales, Thus Demonstrating Its Breach of Good Faith

As demonstrated in Plaintiff's opening memorandum, State Farm must administer its policies in a reasonable manner. *Interim Healthcare of Illinois v. Interim Healthcare*, 225 F.3d 876 (7th Cir. 2000). Additionally it must do this with a proper motive and not arbitrarily. Instead of introducing evidence that its curtailment of sales was reasonable, State Farm quotes a section from the deposition of Mr. Robert Lamphier in which he states that State Farm would have to make "some changes" when it loses \$8 billion dollars in a year. This proves naught. And, once again, State Farm rehashes the testimony of Ms. Bitzer, which shows only that the company "looks at" various factors in determining to curtail business—none of which involve input from agents. It is striking that State Farm has offered no – absolutely no – documentation of the reasonableness of its decision.

State Farm's attempt to distinguish *Carvel Corp. v. James Baker*, 79 F. Supp.2d 53 (D. Conn. 1997) is inapposite. State Farm contends that *Carvel* does not apply because it does not compete with the agents; that was not the point of *Carvel*. The point was that the court in *Carvel* held there was a violation of the implied covenant because Carvel frustrated the franchisees' legitimate expectations that Carvel would not compete. The emphasis was on the expectations, not on the competition. Here, State Farm has created legitimate expectations that it would not curtail business –that it would permit agents to sell as much insurance as they could for the foreseeable future. State Farm's curtailment of their ability to sell frustrates that purpose.

In the last analysis, State Farm has not shown that its curtailment of business is in any way consistent with the agents' reasonable expectations, nor has it shown that this

curtailment is otherwise reasonable. It has exercised its discretion unreasonably, which is a violation of the implied covenant of good faith and fair dealing. *Interim, supra.*

C. State Farm has Failed To Show that Its Total Denial Of Agents' Ability To Solicit Business From Other Insurers Is Either Reasonable Or Consistent With Expectations Of The Agents; Its Arbitrary, Unfair Exercise Of Discretion Concerning Such Brokering Requests Violates The Implied Covenant Of Good Faith.

State Farm once again relies on increases in agent compensation to excuse its failure to permit agents to sell products of other insurers in discrete, limited circumstances. State Farm merely asserts that because agents' incomes increase, it should be excused from wrongdoing. This argument cannot in any way be supported, as set forth above.

State Farm's prolix argument merely attempts to confuse the record. The facts are simple: When agents have made requests to sell insurance of other carriers, State Farm responded either with a flat denial or with a form letter that recites factors it supposedly takes into account. When State Farm's 30(b)(6) witness on this subject was questioned, he testified that there was virtually no basis for any of these factors. (PSOF ¶ 129.) State Farm's interrogatory answers, quoted at length in its further memorandum, add nothing to this; they are simply a reiteration of the conclusions that State Farm states in its form letter.

State Farm has again glided past the true issue presented by NASFA's challenge to its "brokering" procedures: It is not disputed by State Farm that brokering is permitted with State Farm's approval. (Agreements, Section 1-G.) NASFA contends that State Farm's policy, as implemented, violates the covenant of good faith and fair dealing, because State Farm has refused to allow agents to market to their insureds coverage furnished by another insurer (1) even when State Farm has restricted agents' marketing of that line of insurance, (2) even when the alternate insurer is not a full line competitor of State Farm, and (3) even when the agent seeks to do so to retain the entire patronage of the insured, rather than lose all of that insured's business to a full line competitor

of State Farm's, because the agent cannot accommodate the insured temporarily with State Farm insurance in this one line. (See NASFA's First Memo, pp. 32-35; 93-98.)

State Farm's argument that agents would breach a fiduciary duty by shifting business from another carrier to State Farm is balderdash. State Farm cites no authority for this proposition; it cites no evidence that agents would act unethically; it cites no facts to show any sort of breach of fiduciary duty. The Court should declare that State Farm's brokering policy, as applied, violates the covenant of good faith.

D. State Farm Does Not Eliminate the Breach of Contract of Its "Partnering" Program By Playing a Shell Game

State Farm attempts to avoid the adverse consequences of its "partnering" program by contending that it no longer exists or is "not voluntary." But State Farm's own Memorandum concedes that it is involuntary: [I]f the Company receives an inquiry from a potential mutual fund customer who would ordinarily be served by an Agent who happens to be non-registered, . . . State Farm refers the policyholder to a Registered Agent on the same geographic area . . . (State Farm Brief at 79.) In other words, the non-registered agent has no choice – his book of business is sent to someone else.

Thus, there is still a problem: The independent agent is still not independent – he must turn his clients over to another agent; he cannot "exercise independent judgment as to time, place and manner of soliciting insurance, servicing policyholders and otherwise carrying out the provisions of this agreement."

State Farm does nothing to dispute the concerns of agents that they would lose business as a result of this program. Plaintiff has demonstrated these concerns in the testimony of Mr. Adams, Mr. Swift, Mr. Nazziola and Mr. Killingsworth, who used to work for State Farm testified about the actual losses of business that were threatened or had taken place.

The program is not voluntary and the real possibility of loss of substantial business by non-participating agents exists.⁸

State Farm argues that, as to certain contract claims, some of NASFA's Board Members have stated in deposition that State Farm's actions were not, at that moment, "a problem" for them, or were at that moment, a "non-issue" for them. State Farm urges that this lay witness testimony is significant evidence proving the legality of State Farm's policies. NASFA has addressed this already ("NASFA's First Memo, pp. 1-2), but it should be reaffirmed that (a) the overwhelming authority from Wigmore forward is to the effect that lay witnesses cannot admit the legality of a policy, and (b) State Farm's chief counsel expressly told NASFA witnesses that, e.g., they were "not giving a legal opinion that's binding on anybody." (NASFA's First Memo, p. 2.) State Farm cannot retreat from that pledge and engage in bait and switch now, especially since its counsel stated the rule correctly at the deposition, albeit when it suited his convenience.

E. State Farm Has Failed Adequately To Address Plaintiff's Arguments With Respect To The Select Agent Program

State Farm literally ignores the fact that Plaintiffs have shown that under the Select Agent Program, agents who are not "select agents" are deprived of the customer response center, of a "life specialist" and other benefits. This denial cannot be dismissed, as State Farm attempts to do, by arguing that State Farm has "discretion" to specify the services, including life specialists or technical support, that it will provide to agents. If State Farm is going to furnish "such materials, supplies and services" as it specifies, then it must do so on an even-handed basis. It has not shown any rational basis for the distinction between Select Agents and other agents in these respects, nor has it shown that the Select Agent Program is reasonably available to all agents. State Farm has not

⁸ State Farm rejoins (Memo, p. 81) that damning documentary evidence of admissions by a key executive was merely a "planning" document. Again, and on summary judgment, no less, the Court is asked to trust what State Farm tells it and, as the saying goes, to "ignore [its] lyin' eyes." But the eyes do not lie, and the admissions cannot be obscured by State Farm's placing blinders on the Court.

disputed Plaintiff's proof that the program is not available to all agents. It is simply offered conclusory testimony that most of the agents meet the criteria. But Mr. Swift's testimony that the program is not even available to all is based upon his 35 years as a State Farm agent and his position as President of NASFA. His testimony is amplified by that of former State Farm manager Mr. Killingsworth, who testified that it was a program that divided agents from agents and created hostility.

Finally, State Farm does not address the uncontested fact that the Select Agent Program deprives "non-select agents" of the tools that Select Agents are given to perform under their agents' agreement and therefore interferes with their ability to perform it fully. Instead, State Farm returns to its off-recited but-in this context meaningless-mantra that agents' compensation has gone up. As we have shown, this hardly addresses the argument.

F. State Farm Agents Do Not Object To Being Ethical. They Do Object To Agents Being Terminated Or Threatened With Termination If They Decline To Attend Meetings Not Authorized By Their Agreement

State Farm (naturally, because it is an "easy shot") tries to paint the agents as so unconcerned with ethical matters that they refuse to devote a day to an ethics class. It should be noted that there is no evidence that State Farm executives, whom we are to assume are like Caesar's wife, attend any ethics class applicable to their jobs, much less are required to do so. And it is of course their misconduct, not that of isolated agents, that could threaten the viability of the company.

Be that as it may, the issue presented is simple. It is undisputed that (1) the Agreements permit State Farm to invite agents to attend these meetings, but not to require them to attend, and (2) that failure to attend is an offense State Farm deems worthy of termination.

The breach of the Agreements could not be more straightforward.

G. The Agreements Do Not Permit State Farm To Administer An Internet Program As It Has Done

If one presses forward through the thicket into the clearing, one discerns the simplicity of this issue. Agents from State Farm's futile cartwheels attempting to deny that agents have territorial

protection, there is another independent reason why the Internet program as administered violates the Agreement: if an agent does not sign on, the agent cannot obtain the business from the Internet, even if the customer is two blocks from the agent's office. Hence, the agent must sign on. But if the agent signs on, it is undisputed that the commission the agent receives from the Internet transaction is substantially reduced from the normal schedule. Whether or not State Farm has an economic rationale to support that – and none has been presented – it would not matter. There is no contractual right in the Agreement to erect a system in which the agent must participate or lose business which otherwise would be his or hers, but in which participation means significantly lowered commissions.

IX. CONCLUSION

For the foregoing reasons, NASFA's Motion for Summary Judgment should be granted, and summary judgment for State Farm should be denied. The proposed Order submitted by NASFA should be entered.

RESPECTFULLY SUBMITTED,

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Dated: August 19, 2004

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on this ____ day of August, 2004, a true and correct copy of the “Plaintiff’s Reply Memorandum in Support of Its Motion for Summary Judgment and Affidavit of Allan P. Hillman, Esquire,” were served upon the following attorney of record for Defendant herein, by federal express to: Lawrence H. Martin, Esquire, Foley Hoag, LLP, 1874 K Street, N.W., Suite 800, Washington, D.C. 20006.

Allan P. Hillman