

**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 Leonard Braman
AUTOMOBILE INSURANCE)	
COMPANY, <i>et al.</i>)	
)	
Defendants.)	

**PLAINTIFF’S POST TRIAL MEMORANDUM IN REPLY TO THE POST TRIAL
MEMORANDUM OF DEFENDANT STATE FARM**

Plaintiff, National Association of State Farm Agents (“NASFA”) submits this memorandum to reply to the post trial memorandum of Defendant State Farm and to argue certain points of law raised in Defendant’s Proposed Findings of Fact and Conclusions of Law.

I. THE PARTNER AGENT PROGRAM

The entire premise of Defendant’s contention with respect to the Partner Agent Program—that it has ceased to exist—is undercut by its own witnesses’ actions—the ubiquitous demand to all AFEs that they go out and “update a list of agents (who currently do not have a partner registered agent)” (DX 68-email to all AFEs dated July 1, 2005). Unable to explain this, unable to explain State Farm’s apparently deliberate refusal to investigate whether agents unwillingly appointed partner agents and to give them the opportunity to undo those involuntary choices, State Farm relies upon out-of-context snippets of testimony of Plaintiff’s witnesses to create the impression that the PAP ended.¹ As amply demonstrated in our proposed findings and in our Comments on Defendant’s Proposed Findings and Conclusions, Defendant’s evidence of

¹ See Def. Mem. at 1. Moreover, this testimony is from 2003 and has little bearing on the state of affairs today.

the “demise” of the program and its conversion to the RRRD amounts, in short, to nothing more than self-serving testimony of people in the executive suite that have virtually no contact with agents. Indeed, not a single actual communication with agents on either the termination of the Partner Agent Program, the conversion to the RRRD, the cessation of marketing to unregistered agents’ clients or the admonitions against “raiding” appears anywhere in the record; in fact, most of the documentation was not voluntarily produced by State Farm but had to be demanded by the Court (*see, e.g.*, Court Exs. 2 & 3). Likewise, the assertion that participation by non-registered agents was voluntary is based on Mr. Sikora’s testimony. Mr. Sikora, on this record, has never uttered or heard as much as a syllable, verbally or in writing, to or from an agent.

Defendant’s argument that the July 2005 emails produced by Plaintiff at trial represent a *de minimus* error by State Farm (Def. Mem. at p. 3) is both disingenuous and cynical. There is no dispute that these emails had fallen into Plaintiff’s hands fortuitously. Plaintiff has no way of monitoring every communication that State Farm has with its AFEs or that its AFEs have with their agents. State Farm, however, does. If State Farm sincerely wanted to show that the 20 July emails were *de minimus* or were atypical, then it had the means to canvas its AFEs and find out. It did not. Moreover, it had the means to in fact tell AFEs that selecting an agent was entirely optional. Despite its self-serving argument that the RRRD “is entirely optional” State Farm took no steps to ensure that agents who might have selected partners because they were directed to by their AFEs—or whose AFEs selected partners for them—were an option to undo those selections.

State Farm’s argument that no doctrine of contract law prohibits one party to an agreement from requesting the voluntary cooperation of another simply misses the point. The RRRD and the PAP were not voluntary: Agents either had to pick a partner or have one picked

for them, and that is true today. As shown in our comments, agents must refer business to these partners.

State Farm argues strenuously that there was no duty breached here. State Farm indeed has breached a duty: The duty to honor the Agent's independence; the duty to allow the Agent to perform his or her job as an independent agent selling insurance, free from raiding, free from demands to "appoint" someone to be a "partner" or free from having the Company "appoint" someone for him. The assertions on Page 5 of Defendant's Memorandum that Section I (B) was not impinged on by the PAP because participation was voluntary is completely undercut by the facts showing that it was not; and the assertion that non-registered agents' interests were respected by the Company is completely undercut by the undisputed evidence that the Company did allow business to be transferred without appropriate or proper requests.

There is absolutely no support for the proposition that "the door to raiding was sealed shut." There is not a shred of evidence that any agent was ever told not to raid business. Rather, the evidence, which was undisputed, given by Mr. Killingsworth, who actually did work with agents, was that there was going to be raiding; that was one purpose of the program. (PPFC 33, 35.) The fact that there is no raiding on this record does not mean that it cannot occur in the future. Similarly, the fact that the Company did not pursue direct marketing efforts to clients of unregistered agents does not mean that it will not do so in the future.

State Farm says that the "key fact" is that State Farm never required non-registered agents to refer business to their partners. The documents, however, tell a different story. *See* PX 8 ("The partner agent will become involved with the referrals"); PX 14 ("This registered agent will handle referrals from the non-registered agent.")

All of the infrastructure and mechanisms to put the PAP into high gear, as it was originally conceived, are currently in place—certainly there is no evidence that PAP was ever dismantled. And, indeed, the July 2005 emails show that the PAP is in place and that State Farm endorses it.

Finally, State Farm completely ignores the ample evidence of bad faith—Mr. Killingsworth’s testimony that the program was a scheme by the Company to marginalize older agents who were on the AA97 and that he was told by his Vice President that the program was intended to push older agents out by raiding their business or otherwise threatening them. State Farm has utterly failed to controvert this evidence, which shows that the entire program was adopted in bad faith.

II. SELECT AGENT PROGRAM

State Farm’s contention that the Select Agent Program is not a violation of the contract is premised upon its position that “the entirety of the Select Agent Program is directly authorized by Section II(B) because it is a bonus designed to reward those agents who go the extra mile” (Def. Brief at 10.)

The “entirety of the Select Agent Program” is not a bonus, prize, award or allowance, as we demonstrate at length in the comments. It gives agents benefits that are the meat of the subject matter of the contract—block assignments of insurance, referrals of insurance business, advertising for insurance.² To characterize the Select Agent Program as a “bonus or award” is, moreover, inconsistent with the parties’ historical construction of the agreement. Historically, the parties have understood and construed the “bonus and awards” provision as referring to

² Defendant’s contention that Mr. Knapp refuted the assertion that Select Agents would be eligible to broker policies for Phoenix and AON is not supported by the cited testimony. Mr. Knapp understood the Court’s question on page 138, which was “Would any benefit include underwriting benefits?” to mean that he could “provide more coverage more liberally than some other agent.”

bonuses that are given over the short term for performance, without being tied to other requirements such as making referrals to other agents. For this reason, the bonus and award provision does not authorize the Select Agent Program.

Contrary to Defendant's contention, the competent evidence was undisputed that the requirements of the Select Agent Program do not make it available equally to all agents. Mr. Knapp's testimony about the unavailability of the program to agents who worked in low income neighborhoods was undisputed, and Mr. Knapp had first-hand experience as an agent working in such an area. To the contrary, State Farm offered no first-hand evidence, and its "statistical data" was unpersuasive.

State Farm avoids the real issue here: How can it deny the subject matter of the contract, insurance, to a quarter of its agents—agents who have not breached the agreement? Instead, State Farm veers off to try to relitigate the issue of NASFA's right to represent these agents. This issue has been litigated and decided.

The issue of "representativeness" moreover, is not germane. First, might does not make right. The fact that many agents are Select Agents tells us nothing about whether the program is lawful or not. Second, there is no provision in any of these agreements that says State Farm can change the agreement if a majority, or two-thirds, or three-quarters of the agents agree to make it different. Finally, State Farm failed to show that any of its existing Select Agents would be affected in one way or another if the Court were to dismantle it, on the one hand, or make it available to all, on the other.

The Court has broad equitable powers. Among other things, it can extend the benefits of the Select Agent Program to all agents, which would be consistent with the historical meaning of the contracts. This would take absolutely nothing away from those who are Select Agents now.

The Restatement of Agency and the cases that State Farm cites simply do not support its claims. We have argued those points in the comments and will not repeat them here. Nothing in the contract and nothing in agency law says that a party to a contract may create two classes of agents.

Legally, the question is whether a contract that was written for all agents can be changed so that it means one thing for one class of agents and another for another class of agent. State Farm has cited no authority for that proposition. The contract means only one thing and, the contract must be construed as of the time the parties entered into it. When State Farm first offered these contracts, the Select Agent Program did not exist. Accordingly, State Farm cannot offer one set of benefits to one class of agent and another set of benefits to another category. Had it wished to create a second class of agent, it could have so provided in the contract, and the agents could have, at the time of signing the contract, decided whether to accept that condition. State Farm did not, and it is foreclosed now from remaking the agreement.

State Farm's argument that it has not violated the implied covenant of good faith is countered by Mr. Killingsworth's testimony that the SAP (along with the PAP) was adopted in bad faith -- for the purpose of driving out agents who were on the AA3 and AA4, which had higher commissions than the AA97. (PPFC 33-36). The structure of the SAP bears this out: Non-Select Agents have higher operating costs because they lose co-op advertising benefits; and have to pay higher costs of for display advertising in the Yellow Pages; agents on the AA3 or AA4 have to bear the cost of participating in the CRC (\$1.75 per household); non-Select Agents lose the income from referrals, block assignments and brokerage opportunities.

State Farm's argument with respect to good faith are inapposite. The heart of the implied covenant of good faith is that it protects the reasonable expectations of the parties when the

express provisions of a contract do not address unanticipated situations or situations that the parties did not bargain over. Thus, it has been said that the covenant imposes a duty upon parties "to avoid taking advantage of gaps in a contract in order to exploit the vulnerabilities that arise when contractual performance is sequential rather than simultaneous." *Original Great American Chocolate Chip Cookie Co, Inc. v. River Valley Cookies, Ltd.*, 970 F.2d 273, (7th Cir. 1992). Here, State Farm admits that it is exploiting a "gap" -- it claims it may offer all of these SAP benefits to agents because they are not specifically mentioned in the contract. Viewed another way, the implied covenant prevents a party from "unfairly recouping an opportunity foregone at the time of contracting." Burton, "Breach of Contract and the Common Law Duty to Perform in Good Faith," 94 Harv. L. Rev. 369, 370 (1980). That, too, is what is happening here.

The Select Agent Program takes the subject matter of the contract -- insurance -- that for years was available to all agents and makes it available only to a class of agents who agree to conditions that are not part of the contract. Agents who do not agree to those conditions are penalized by being deprived of such benefits. *Interim Health Care of Northern Illinois v. Interim Health Care, Inc.*, 225 F.3d 876 (7th Cir. 2000) presented a situation analogous to that presented by the SAP. In that case, a franchise agreement provided that the franchisor would cooperate with the franchisee "in obtaining contracts for its services from government or industry ... [and furnish] national account leads." The franchisor had ceased furnishing account leads to the franchisee, ostensibly because customers were dissatisfied with the franchisee. The Court held that the franchisee had stated a claim for violation of the covenant of good faith, particularly since the agreement did not condition the furnishing of leads upon franchisee performance.

Here, State Farm has made the subject matter of the agreement -- insurance -- available to all agents for decades; the agents have had a reasonable expectation that it would be available to

all. There is nothing in the agreement that gives State Farm the power to withhold insurance -- in the form of referrals, block assignments or brokerage -- from any category or class of agent. State Farm's creation of the SAP is, therefore, a violation of the implied covenant of good faith and fair dealing.

III. RESTRICTIONS ON THE SUBMISSION OF NEW BUSINESS.

State Farm's reliance on *Hartman v. State Farm Mut. Auto Ins. Co.*, Case No. 93-8084 (S.D. Fla.), aff'd 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) is inapposite. *Hartman* and *Appling* concerned State Farm's imposition of restrictions on sales in the wake of catastrophic natural disasters -- Hurricane Andrew or the Northridge Earthquake. *Hemmans* concerned a completely different issue: the imposition of restrictions on *specific agents who had high loss ratios*. None of these cases concerned the issue here: the Company's discretion to withdraw the right to sell insurance when it is the result of the Company's own foreseeable actions. Moreover, none of those cases discusses the decision-making process, which was shown here to be haphazard, unrelated to the agent's agreement and done in bad faith.

Another significant difference between the restrictions imposed in *Hartman* and *Appling* and this case is that the restrictions in those cases were restrictions imposed *in the jurisdictions where the catastrophes had occurred* -- *Hartman* in Florida in the wake of Hurricane Andrew; *Appling* in California in the wake of the Northridge Earthquake. In this case, there was no demonstrated connection between the cause of the losses and the imposition of the restrictions -- another indication that the decision-making process was without rational foundation.

With respect to good faith, State Farm concedes that Ms. Bitzer testified that “no pre-codified procedures were followed, [and] there was no rigid set of pre-ordained criteria”—directly contrary to Mr. Wright’s testimony. Rather, State Farm contends that, without any support, that its executives “used their informed business judgment.” State Farm's failure to show in any specific way how its decisions to restrict the sale of new business, or to produce a single document illustrating the criteria it used or how those criteria were applied, is further evidence of its lack of good faith and absence of any actual application of "informed business judgment."

IV. BROKERING BUSINESS FOR OTHER INSURERS.

State Farm’s position with respect to brokering is untenable. On the one hand, it now argues, contrary to what it told agents that “agents are not permitted to compete with State Farm by brokering business for the Company’s competitors.” (Def. Brief at 23.) But in fact, State Farm does permit brokering with other companies, and it offered no cogent or logical reason why brokering with those companies is permitted and brokering requests from agents are denied.

The arguments about brokering in State Farm's memorandum are duplicative of the material in its proposed findings, to which we have responded; we will not burden the Court by repeating ourselves here. The legal principle that applies here is that a party cannot exercise discretion under a contract when it does so without a basis, or does so on a false basis. Thus, for example, in *Dunkin' Donuts of America, Inc. v. Minerva, Inc.*, 956 F.2d 1566, 1570 (11th Cir. 1992), the Court found that a franchisor's termination of a franchisee for underreporting sales had been made in bad faith because the franchisor had used auditing procedures different from those that it had informed the franchisee that it would use: "the yield and usage test used by plaintiff to audit the stores had not been disclosed in the franchise agreements as a measure which plaintiff

would utilize to enforce its contractual rights and was not an appropriate and reasonably accurate accounting tool in the trade to detect underreporting." Similarly, in *Carvel Corp. v. Baker*, 79 F. Supp. 2d 53 (D. Conn. 1997), the court held that when a franchisor of ice cream parlors began selling the same ice cream through supermarkets, it could have violated the implied covenant (as a jury later found). Even though the contract did not specifically prohibit the supermarket sales, and even though the sales were made outside the franchisees' exclusive territories, the court found a potential violation. The court relied, in part, upon the franchisor's prior representations to the franchisees that it would not sell the ice cream through channels other than the parlors, and that this representation created a reasonable expectation on the part of the franchisees. Similarly, where a franchisor failed to follow its own guidelines for selecting a site for a franchisee, the court found a violation of the implied covenant. See *TCBY Systems, Inc. v. RSP Co., Inc.*, 33 F.3d 925 (8th Cir. 1994). The lesson of all of these cases is the same: where a party fails to follow its announced procedures or guidelines for decision-making in a particular area of relevance to another contractual party, it violates the implied covenant of good faith and fair dealing. In this case, there is no dispute that State Farm did not follow its own guidelines or procedures in making brokerage decisions. Accordingly, it, too, violated the implied covenant.

V. MANDATORY MEETINGS.

State Farm's main argument with respect to mandatory meetings is that a principal is allowed to give an agent lawful directions even if there is a contract that permits the agent to act independently. The Restatement's direction, however, is within the scope of the contract. That is, State Farm may direct agents on how to fill out policies, and State Farm may even direct them to follow ethical policies in their day-to-day activities. What the contract says, however, is that State Farm will not direct their daily activities or tell them how to use their time. The contract,

moreover, says that it will only invite them to meetings. It does not say that it will compel them to go to meetings. Once again, this is an example of State Farm attempting to remake the contract that it made years ago. It cannot do that and the Court should not permit it.

RESPECTFULLY SUBMITTED,

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