

**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 PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW

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Plaintiff National Association of State Farm Agents, Inc. (“NASFA”), pursuant to the Court's August 1, 2005 direction, respectfully submits these proposed findings of fact and conclusions of law. References to the record are abbreviated as follows:

Transcript References	(Witness TR MM/DD/YY page)
Pre-Trial Order Stipulations	(PTOS #)
Joint Pre-Trial Statement, as Modified by the Court	(JPS[section], as modified by the Court's Pretrial Order of July 12, 2005.)
Plaintiff's Exhibit	(PX #)
Defendant's Exhibit	(DX #)
Plaintiff's Deposition Designations	(PDD p. #)
Supplemental Joint Pretrial Statement	(SJPS ¶ #)

I. GENERAL BACKGROUND AND PARTIES

- (1) NASFA is a District of Columbia corporation composed of active or retired State Farm Agents in at least 47 states and the District of Columbia. NASFA's principal place of business is in Baltimore, Maryland. (PTOS 1.)
- (2) NASFA's members are all active or retired State Farm agents. (PTOS 2.)
- (3) Defendants State Farm Mutual Automobile Insurance Company, State Farm Fire and Casualty Company, and State Farm Life Insurance Company are all corporations formed under Illinois law with their principal place of business in Bloomington, Illinois. State Farm General Insurance Company is a California corporation with its principal place of business in California. (PTOS 3.)
- (4) State Farm provides various insurance and financial services products to the public. (PTOS 4.)

(5) State Farm's securities products, including mutual funds, are provided by State Farm VP Management Corp. ("A Program to Market Mutual Funds to All Customers," Tab 3, P. SFMNASFA 00001260, annexed to letter to Court from Paul S. Reichler, dated August 2, 2005).

(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. (PTOS 5.)

(7) State Farm provides insurance to the public principally through its network of approximately 16,000 independent contractor Agents located throughout the states and provinces in which it does business. (PTOS 6.)

(8) Although State Farm sells many lines of insurance and financial services products to the public, its core business is auto and fire (homeowner) insurance. Consequently, Agents' compensation is dominated by commissions on auto and fire insurance. (PTOS 7.)

(9) 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 one of three basic forms of the Agent's Agreement known as the "AA3," the "AA4," and the "AA97." (PTOS 8.)

(10) 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 1996. (PTOS 9.)

(11) As each new agreement went into effect, existing agents had the option to elect to become agents pursuant to the new agreement; new agents could sign up only on the new forms of agreement. These three agreements are substantially identical. (PTOS 10.)

(12) 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. (PTOS 11.)

(13) All Agents who have joined State Farm since 1997 operate under the AA97 Agreement. (PTOS 12.)

(14) At present, approximately 50 percent of all active Agents operate under the AA97 Agreement. (PTOS 13.)

(15) Under the AA3 Agreement and the AA4 Agreement, Agents receive a 10% commission on auto policy premiums paid to State Farm, and a 15% commission on fire policy premiums. (PTOS 14.)

(16) Under the AA97 Agreement, Agents receive an 8% commission on auto policy premiums paid to State Farm, and a 10% commission on fire policy premiums. (PTOS 15.)

(17) These commission rates apply to "personally produced" business; that is, to policies for which the Agent him or herself has solicited the initial application. (PTOS 16.)

(18) Agents sometimes also receive "assigned business;" that is, customers referred to the Agent by State Farm, consisting primarily of customers formerly assigned to another Agent who has retired or passed away. The commission rates applicable to assigned business vary by contract and by product type. (PTOS 17.)

II. PARTNER-AGENT PROGRAM

A. Findings of Fact

1. Contract Provisions

(19) All forms of the Agent Agreement contain this language in the preamble:

The Companies believe that agents operating as independent contractors are best able to provide the creative selling, professional counseling, and

prompt and skillful service essential to the creation and maintenance of successful multiple-line companies and agencies. (PX 1, 2, 3.)

- (20) All forms of the Agent Agreement contain the following language at Section I.A.:

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 the Companies, the agents and the policyholders. (PX 1,2,3.)

- (21) The AA 3 and AA4 Agent Agreements contain this language at Section I.H.:

We will leave in your account all automobile policies credited to your account so long as the policyholder resides within a 25 mile radius of your principal place of business and within a state in which you are duly licensed, except that we may, after prior written notice to you, transfer any automobile policy to the account of another State Farm agent when the policyholder makes a bona fide request in writing. 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. (PX 1, 2.)

- (22) The AA97 contract contains, at Section I.H., this language:

We will leave in your account all policies credited to your account so long as the policyholder resides within a 75 mile radius of your principal place of business and within a state in which you are duly licensed, except that we may, after prior written notice to you, transfer any policy to the account of another State Farm agent when the policyholder makes a bona fide request in writing. 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. (PX 3.)

- (23) Until the initiation of the Partner Agent Program (“PAP”), State Farm had a policy and practice of leaving all policyholders of a particular agent with that agent and not permitting raiding. (Knapp TR 7/26/05 pp. 95-96.)

(24) The agent's Agreement provides at section I. G:

The fulfillment of this Agreement will be your principal occupation, and you 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.

(25) There is no provision of any form of the Agent Agreement that requires agents to sell mutual funds or securities or to become licensed to do so. (PX 1-3; Wright TR 7/26/05 p. 197, 198.) Section I.A., which requires the agent to advance the interests of the Company, concerns only insurance. (PX 1-3; Wright TR 7/26/05 p. 199.)

2. Background

(26) Although State Farm has traditionally been an insurance company, during the 1990s, 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. (PTOS 18.)

(27) 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. (PTOS 19.) Among the new products State Farm decided to provide were mutual funds. (PTOS 20.)

(28) 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. (PTOS 21.)

(29) Registered representatives are required by federal securities laws to hold a "Series 6" license; state securities laws require the agents to hold "Series 63" licenses. Because State

Farm had not traditionally provided securities to the public, few Agents possessed the requisite licenses. (PTOS 22.)

(30) Having made the decision to enter the mutual fund business, State Farm encouraged all of its Agents to acquire Series 6 and 63 licenses. (PTOS 23.)

(31) 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. (PTOS 25.)

(32) The Company's answer was to initiate a "partnering" program (the "Partner Agent Program") whereby non-registered Agents could team with registered Agents to whom they could refer policyholders interested in mutual funds. (PTOS 26.)

3. "Grow or Go"

(33) In 2000, as it was preparing to sell mutual funds, State Farm held a convention in Dallas, Texas, at which it announced a program called "Grow or Go." The message the Company delivered at that convention was that if agents did not do certain new things that State Farm was asking them to do (*i.e.*, to "grow") that they would have to leave (*i.e.*, "go"). (Killingsworth TR 7/26/05 pp. 29-31.) A principal element of the "Grow or Go" program was the Partner Agent Program; agents had to sell or cooperate with the Company in the sale of mutual funds or they would have to leave. (Killingsworth TR 7/26/05 pp. 28-31.) Other elements of the Grow or Go program were the call response center, the Select Agent Program and mandatory meetings. (Killingsworth TR 7/26/05 p. 32.)

(34) Shortly after the 2000 Grow or Go Convention, Mike Dannewitz, a Vice President of Agency, instructed John Killingsworth, a State Farm AFE, to meet with agents 55 or older on

a monthly basis, discuss their retirement plans with them, and report back to the Company.
(Killingsworth TR 7/26/05 p. 34.)

(35) If agents over 55 retired, State Farm would enjoy an enormous windfall because retiring agents generally had the AA3 or AA4 contracts. The agents who would take over their books of business would be under the AA97, with commissions some 20 to 30 percent lower than the AA3 or AA4. State Farm also would be able to market securities products through these new agents. (Killingsworth TR 7/26/05 p. 35.)

(36) Mr. Killingsworth's testimony supports an inference, not refuted by State Farm, that it was using the Partner-Agent Program (and associated Select Agent Program) to push out older agents so that it could enjoy the windfall of converting to the AA97. This inference is supported by the fact that in connection with the Partner Agent Program, State Farm studied the correlation between agents' age and number of agents who were not registered to sell securities -- a study that revealed that most of the Unregistered Agents were age 55 or older (Court Exhibit 2, page SMF NASFA 00001339). The record, however, is devoid of any study correlating the number of Unregistered Agents with productivity, profitability, income-per-client household or policies-per-client household.¹

(37) An agent may choose not to become a registered agent because of the characteristics of his market or the relative profitability of mutual funds versus insurance.
(Knapp TR 7/26/05 p. 101 - 102.)

¹ Such a study might have revealed, for example, that Unregistered Agents were more successful at selling insurance than Registered Agents and therefore it would be in the Company's best interests to keep them busy selling insurance and not divert them to other products.

4. Introduction of the PAP to Agents

(38) State Farm introduced the Partner-Agent Program to the agents through meetings conducted by Agency Field Executives (AFEs) in approximately September, 2001. At these meetings the AFEs announced:

(a) The Company had gone into the business of selling mutual funds because the public, and customers, had demanded that the Company do so. (Knapp TR 7/26/05 p. 135.)

(b) Non-registered Agents were encouraged to select a registered Agent to whom they would refer customer inquiries about mutual funds. (PTOS 27.) This Partner Agent had to be a Select Agent. If an Unregistered Agent did not select a Partner Agent, the Company would select one for him. Registered Agents would be allowed to contact clients of Unregistered Agents and ask for their business. (Knapp TR 7/26/05 p. 135.)

(c) The Company was going to promote this program with a national advertising campaign that included television and direct mail. The Partner Agent would be provided with the identification of the Unregistered Agent's clients, and direct mail letters would be sent to those clients soliciting the purchase of mutual funds. (PX 8, Question 3; Knapp TR 7/26/05 p. 97, 133.) Partner Agents were to be allowed to contact policyholders of Unregistered Agents and ask for their business. (Knapp, TR 7/26/05, p. 135; see also PX 6, third bullet under "strategy;" PX 9, Questions 10, 15, 16.)

(d) State Farm was going to use electronic facsimiles of Unregistered Agents' photographs and signatures, without their permission, to send letters promoting the sale of mutual funds to their clients and give the information to the Partner Agent who would then send a follow-up letter. (Knapp TR 7/26/05 p. 99-101.) State Farm has previously used the Agents'

signatures and photographs for direct mail to policyholders without the Agent's permission (UT) (Knapp TR 7/26/05 p. 120.)

(39) Agents were also free to refuse to nominate partners. (PTOS 28.) As noted, in that event, State Farm would appoint one for them.

(40) Although to date, State Farm has not implemented the direct mail program, State Farm has never told the Agents that it was discontinuing the Partner Agent Program or not going forward with the direct mail program. (Knapp TR 7/26/05 pp. 108-109; Swift TR 7/26/05 p. 147, 149; Sikora TR 7/27/05 pp. 24-25, 27-28; Wright TR 7/26/05 p. 189.)

5. The Registered Representative Referral Database

(41) State Farm renamed the PAP as The Registered Representative Referral Database ("RRRD") in August 2003. (Sikora TR 7/26/05 p. 237; Wright TR 7/26/05 p. 187.)

(42) There is no substantive difference between the RRRD and the PAP. (Sikora TR 7/26/05 p. 244.) Under the PAP, if an Unregistered Agent did not appoint a registered "partner," the AFE appointed one for him. Under the RRRD, if an Unregistered Agent does not appoint a Partner, company policy calls for the Company to refer inquiries from that agent's customers to registered agents on a rotation basis. (Sikora TR 7/26/05 p. 244.) The agent to whom the client is assigned can market to that policyholder. (Sikora TR 7/27/05 p. 60.)

(43) On those occasions when the customer of an Unregistered 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. (PTOS 29.) In doing so, State Farm discloses the name, address and telephone number of the Unregistered Agent's client to the Partner Agent. (PX 72.)

(44) In fact, however, the evidence shows that AFEs can and do appoint Partner Agents for Unregistered Agents (PX 91) and that State Farm lets these appointments stand, without inquiry into whether they were voluntary appointments.

6. *Was the PAP Ever Changed or Discontinued?*

(45) State Farm has never told the Agents that the PAP is no longer in effect or has changed names or that the Company was not going to market to the clients of Unregistered Agents in connection with these programs. As far as the Agents know, the Partner Agent Program is in effect today and it is still a threat; State Farm can, at any time, begin marketing directly to their books of business. (Swift TR 7/26/05 pp. 150, 159-60; Wright TR 7/26/05 p. 218; Sikora TR 7/27/05 pp. 24-26, 27-28, 31, 52.)

7. *Characteristics of the Program*

(46) Because there was no evidence that the PAP has been changed or discontinued (except in name), it retains certain characteristics that it had at the outset, discussed below.

a. *Connection to the Select Agent Program*

(47) Unregistered Agents can appoint only Select Agents as Partner Agents; they may not appoint a registered agent who is not a Select Agent. If, under the RRRD, the Company appoints a registered agent on a "rotation basis," that agent must be a Select Agent. (Wright TR 7/26/05 p. 219; Sikora TR 7/27/05 p. 54.)

(48) By appointing a Partner Agent (or voluntarily participating in the RRRD), and agreeing to refer business to the Partner Agent, an Unregistered Agent satisfies the "product availability" criterion of the Select Agent program. (Wright TR 7/29/05 p. 576.)

b. *The Risk of Raiding*

(49) There is in fact a risk under the PAP or RRRD that Partner Agents will raid the books of business of Unregistered Agents, for several reasons. First, in order to sell a securities product to a client, an agent must engage in a more detailed and intimate relationship with the client than is required for the sale of insurance. For example, the agent must obtain a risk tolerance questionnaire from the client and make recommendations about suitability of mutual funds, based upon the client's financial condition, income, goals and tolerance for risk. (Killingsworth TR 7/26/05 p. 25.) This closer relationship presents a risk to Unregistered Agents that clients will see the Partner Agent as having a "higher and greater" relationship with them than with Unregistered Agents. (Killingsworth TR 7/26/05 p. 25.) Similarly, clients may gravitate toward Registered Agents who have sold them securities simply because those agents have made money for them, as opposed to Unregistered Agents, who have merely solicited premiums. (Nazziola TR 7/26/05 p. 164.)

(50) The risk of raiding is also evident in State Farm's practice of disregarding its own contract provisions and allowing transfers of business between agents without prior notice to the transferee agent or written instructions from the client. (Killingsworth TR 7/26/05 pp. 27-28; Knapp TR 7/26/05 p. 104-105, 107.)

(51) Internal State Farm flow charts for direct mail campaigns to clients of Unregistered Agents are almost devoid of references to the role of the Unregistered Agent, but contain many references indicating that the Partner Agent will get the Unregistered Agent's business, including "Future Mutual Funds marketing efforts to customer by Partner Agent," "Partner Agent Assigned," "Partner Introduces Self," and "Partner Agent Makes Sale." (Court Ex. 2, SMF NASFA 00001340-1343.)

(52) If the Unregistered Agent does not select a Partner Agent, and the mutual fund business is assigned on a rotation basis, the agent to whom the client is assigned is not asked to confirm that he will not raid. (Sikora TR 7/27/05 p. 61.)

c. *Risk of Other Products*

(53) Neither the PAP nor the RRRD is confined to mutual funds; it can be used for other products, including insurance products. (Knapp TR 7/26/05 p. 129; Swift TR 7/26/05 p. 146, 149; PX 91; PX 14 [Question 13]; Sikora TR 7/27/05 p. 33.)

d. *“Voluntary” Nature of the Program*

(54) A truly voluntary program pursuant to which Unregistered Agents referred business to Registered Agents would be just that: it would give Unregistered Agents the option to make referrals and perhaps provide information on how and to whom to make them, if desired. There would be no need for “partners;” for database referral systems; or for the Company to make assignments.

(55) Although State Farm contended that the PAP and RRRD were “voluntary,” they are not. Under both programs, the Agent must either select a partner or have one selected for him by the Company. (Sikora TR 7/27/05 p. 28; Swift TR 7/26/05 p. 144; Wright TR 7/26/05 pp. 183- 184.) If the agent selects a partner that State Farm does not approve of, it will appoint someone else without his permission. (Knapp TR 7/26/05 p. 133; Wright TR 7/26/05 pp. 207- 208.) Likewise, the presentation of the PAP to agents did not give them a “voluntary” choice as to whether the Company would be sending their clients promotional materials. (Knapp TR 7/26/05 p. 133.) The most recent communications from the Company directly to Unregistered Agents directs them to select partners, or the AFE will select one for them (PX 91). None of the information provided by State Farm to AFEs for them to pass on to agents discusses the program

in voluntary terms; indeed, the word "voluntary" is never used in any one of the primary documents given to AFEs -- the "Frequently Asked Questions" (PX 9, 14 and 71; Sikora TR 7/27/05 p. 31) or the "Procedures." (PX 8.) As previously noted, there are no documents given directly to agents nor testimony from any State Farm witness who directly spoke to agents.

e. *Public Demand*

(56) Contrary to what agents were told at the meetings introducing the PAP, there was no public or customer demand for mutual funds from State Farm. The only test, undertaken in 2003, showed no customers expressing interest. (PX 17.)

8. *The Current Status of the PAP and RRRD*

(57) On July 1, 2005, State Farm asked its AFEs to "update" the RRRD; the email sent to them said that the RRRD was "designed to . . . provide all customers' access to a local State Farm agent for all of their product needs." (DX 68; Fisher TR 7/27/05 p. 78.). It goes on to state that a list of agents who "currently do not have a partner registered agent" is attached to the email and charges the AFE to "update the list and email the updated list back. . . by July 15, 2005." Interestingly, only agents who did not have Partners were subject to this "update." Agents who had already selected Partners were not singled out -- or even give the chance to "update" by de-selecting their Partner or selecting another one. The clear intent and meaning of this email is to direct the AFE to have the Unregistered Agents select a "Partner" or, if they do not, to select a "Partner" for them. Indeed, Agency Vice President Greg Fisher understood the email to mean this. (DX 69 - 7/20/05 email from Judy Kelly on behalf of Greg Fisher to Brian Peacher.) Moreover, there would be no reason for selection of a "Partner" if the "Partner Agent Program" had ended. There would be no reason or purpose for such an "update" if selection of a Partner were "voluntary," or if the "actual practice" was, as Mr. Sikora contended, to refer

customers of Unregistered Agents to a Registered Agent only when an application for mutual funds was submitted by the client of the Unregistered Agent. Indeed, this email, sent only 25 days before the start of this trial, is totally consistent with the Partner Agent Program -- that a partner will be selected if the Unregistered Agent does not select one, and that the program is intended to market to more than mutual funds -- *i.e.*, to provide for "all [the customers'] product needs." It is totally inconsistent with the stated standards of the RRRD.

(58) In fact, in compliance with the July 1 email, AFEs did exactly what the Company directed: they told agents to pick a "Partner" or have one picked for them. Emails produced by Plaintiff, dated between July 1 and July 19, 2005, from AFEs to Unregistered Agents, demanded that the agents pick a "Registered Partner" or "Partner Agent," lest the AFE pick one for them by the July 15 deadline. (PX 91.) Neither the word nor the concept "voluntary" appears. State Farm claimed to have been unaware that these instructions had gone to the field until Plaintiff's counsel raised the issue in connection with this trial. (Fisher TR 7/27/05 p. 82.)

(59) State Farm contended that the emails that had been found by Plaintiff's counsel had been "in error" in requiring Agents to select a Partner or have one selected for them, or in referring to "Partners." (DX 70.)

(60) Although State Farm issued what it claimed at trial to be corrective emails to AFEs and to some of the agents who received the emails in PX 91, State Farm did not undertake to determine whether other agents had received misleading emails or made appointments of Partners pursuant to them. Indeed, Greg Fisher, who headed up the "corrective" effort, admitted that he did not know whether AFEs had received his instructions or had implemented them, nor did he do any follow up to ensure that they had implemented his instructions. (Fisher TR 7/27/05 p. 113.)

(61) More significantly, all of State Farm's "corrective" emails were dated after the July 15 deadline for agents to select a partner or have one selected for them. Although State Farm had the means to correct any misconceptions about the Partner Agent program or RRRD, (Fisher TR 7/27/05 p. 113), State Farm did nothing to undo -- or give agents the opportunity to undo -- selections that they may have made in the face of the involuntary ultimatum given to them: "Pick a Partner Agent or we'll pick one for you." Nor did it give agents the opportunity to undo selections made by AFEs or direct AFEs to undo them. In short, the only evidence of current "actual practice" produced at trial demonstrated that State Farm is today acting in accordance with the Partner Agent Program as originally conceived.

(62) At present, approximately 60% of State Farm Agents are licensed to solicit customers who may be interested in purchasing mutual funds from State Farm. (PTOS 24.)

B. Conclusions of Law

(63) The Partner Agent Program or RRRD violates the Agent Agreement in several respects.

(a) It violates section I.A. of the Agent Agreement because it requires the Agents to do something other than "solicit applications for insurance" and other insurance-related tasks, and conditions their ability to perform these duties fully upon their compliance with the PAP. Related to this provision is section I.G. which provides that the fulfillment of this Agreement will be the agent's principal occupation. A party to a contract may not interfere with the other party's ability to perform, *Levy & Hipple Motor Co. v. City Motor Cab Co.*, 174 Ill. App. 20 1912 WL 2716 (1912), and a principal has an obligation to refrain from interfering with an agent's work. Restatement (Second) Agency § 434 (1958)). By requiring Agents to either refer their clients to other Agents or have their clients referred to them and by requiring Agents to

open their books of business to other Agents, the PAP effectively interferes with their ability to perform their duties under the Agent Agreements. Mr. Killingsworth's unrefuted testimony that the PAP was intended to push out agents who did not sign up to sell mutual funds confirms both this intent and effect.

(b) The PAP violates section I.H.'s provision that State Farm would leave all policies in the Agent's account unless a policyholder made a bona fide written request to State Farm and the Agent was given prior notification. Two witnesses, Mr. Knapp and Mr. Killingsworth, testified that State Farm was already violating this provision by transferring policyholders from one agent to another without notice or a written request, and that the PAP encouraged this type of transfer. State Farm did not refute this testimony.

(c) Additionally, in conjunction with the Select Agent Program, PAP requires Agents to give up benefits that they would otherwise have under their contracts, by requiring them to do things that the Agent Agreement does not require. A party to a contract may not condition its performance upon a condition that is not part of the contract. There is nothing in the Agent Agreement that requires Agents to either sell mutual funds or refer customers who are interested in mutual funds to other agents. Yet, if an agent refuses to either appoint a Partner Agent or become a registered agent, he becomes ineligible to participate in the Select Agent Program, which, as discussed elsewhere, is the only way in which the agent can enjoy certain benefits from performing his contract in selling insurance. In short, an agent who is a Select Agent enjoys certain benefits (in addition to prizes and awards) that a non-select agent does not enjoy. The price of becoming a Select Agent is to do something that is not at all called for by the Agent Agreement—to sell existing clients mutual funds or send them to someone else for that purpose.

(d) Finally, the requirement that a unregistered agent refer business to a registered agent is an unwarranted interference with the agent's independence and status as an independent contractor. A natural consequence of the long-standing agent's status as an independent contractor is that the agent had complete control over his book of business. The PAP and RRRD throw open that book of business to other agents, without the consent of the unregistered agent. This violates the "sacred" practice at State Farm of respecting agents' independence and the primacy of his book of business.

(64) State Farm also violated the implied covenant of good faith and fair dealing in several respects.

(65) One branch of the implied covenant of good faith and fair dealing holds that a party to a contract may not exercise contractual discretion or rights that it has under a contract in bad faith; what this means is that the party may not have a purpose or motive that is inconsistent with the parties' bargain and their reasonable expectations. *Dayan v. McDonald's Corp.*, 466 N.E.2d 958, 972 (Ill. App. Ct. 1984).

(66) In this case, there was uncontroverted testimony by Mr. Killingsworth, substantiated in part by State Farm's own documents, that one of the purposes of the PAP (as well as the Select Agent Program, see below) was to eliminate agents who were older and, who by reason of being older, more likely to have the AA3 or AA4 contracts, which had much higher commissions than the AA97. One party's termination of a contract or relationship in order to deny the other party the anticipated benefits of that contract is a classic example of bad faith. *Dayan* at 972 (termination of employee is bad faith). Using the twin prongs of announcing that the Company would be sending direct mail to customers of these agents (and using the photographs and signatures of the unregistered agents without their express permission) and then

visiting with agents over 55 on a monthly basis to obtain information about their retirement plans—evidences that State Farm was using the PAP program, at least in part, to dislodge these older agents and obtain a windfall in savings on commissions. While this evidence of motive, unrebutted by any witness from State Farm, is alone enough to demonstrate a breach of the implied covenant of good faith and fair dealing, the manner in which State Farm handled information given to, and more significantly, not given to the agents—and indeed, the manner in which it handled information in this trial—not only reinforces State Farm’s lack of good faith but provides a separate basis for such a finding.

(67) The implied covenant of good faith and fair dealing also requires that a party act in good faith in the manner in which it performs its contractual obligations. *Mid-west Energy Consultants, Inc. v. Covenant Home, Inc.*, 815 N.E.2d 911, 916 (Ill. App. Ct. 2004). In this case, the record is rife with examples of how State Farm did not act in good faith in dealing with agents in connection with the PAP:

(a) First, in its initial announcement of the program, State Farm told agents that if they did not become registered agents, it was going to have someone else market directly to their clients, using their names, photographs and signatures, like a puppeteer, to direct the agent’s clients to a “partner” who would either be selected by the agent or selected by State Farm. State Farm was thus jettisoning years of custom and practice, during which the Agent’s right to his or her book of business was “sacred.” State Farm’s internal documentation of this process, leading inevitably in almost every case to the Partner Agent closing the sale, meeting the client or marketing to the unregistered agents’ clients, was outlined in internal flow charts with exquisite intricacy.

(b) At trial, State Farm's upper level executives told a story that the Partner Agent Program had been discontinued; that it had been replaced by the RRRD; that the programs were voluntary; that the direct mail program had never been implemented; and that most agents were either registered or had selected partners.

(c) There was, however, an alarming lack of proof that this information had in fact been communicated to the Agents. State Farm's witnesses had no direct contact with agents and virtually no documents actually given or shown to agents were produced at trial.

(d) Indeed, State Farm's witnesses contradicted themselves; Mr. Sikora's testimony contradicted the terms of the documents that State Farm has published on the program; and there was absolutely no evidence that any of the ameliorative, such as the RRRD, steps had been communicated to the Agents.

(e) The most blatant example of State Farm's lack of good faith—indeed its bad faith—were the emails that its AFEs sent to the field, pursuant to Mr. Fisher's direction, immediately before trial, directing unregistered agents to pick agents or have partner agents picked for them. State Farm's "corrective" efforts were not even lukewarm: Neither the agents nor the AFEs were told the program was "voluntary" as has been trumpeted by State Farm in its trial testimony; and, more importantly, State Farm's corrective efforts were undertaken after the horse had left the barn—*i.e.*, after the agents had either selected partners or partner has been selected for them. None of the "corrective" documentation gave these agents the opportunity to undo the selection that they had made.

(f) At trial, State Farm introduced no evidence that it had attempted to discover, on a nationwide basis, whether other agents had been "erroneously" led to the select partner agents or to demonstrate that the incidents of emails actually found by plaintiffs' counsel was the universe

of errors. State Farm's failure in this regard warrants inferences that in fact the error took place on a nationwide basis; that the "update" of the database—pursuant to which AFEs erroneously called for unregistered agents to appoint Partner Agents or have them appointed—took place ubiquitously; and that State Farm, in an equally universal and callous disregard of its own stated policies, let those involuntary appointments stand in order to further its bad faith motive of dislodging older agents with the AA97 contract. *See United States v. Young*, 463 F.2d 934, 939 (D.C. Cir. 1972) (“[I]f a party has it peculiarly with his power to produce witnesses whose testimony would elucidate the transaction, the fact that he does not do it permits an inference that the testimony, if produced, would be unfavorable”).

(68) State Farm's conduct can only be explained by the “Grow or Go” goal, and its pursuit of a motive to eliminate as many older or AA97 agents as it could, a motive never disclosed to the agents. Instead, it hid its motive and objectives, instead creating the illusion that customers were demanding mutual funds when they were not, and creating an elaborate scheme to threaten and intimidate Agents into leaving.

(69) State Farm's conduct in this regard constitutes extreme bad faith.

(70) For all of the foregoing reasons, this Court declares that State Farm has violated the Agent Agreement and implied covenant of good faith and fair dealing. Henceforth, State Farm may not enforce or implement either the Partner Agent Program or the RRRD; it may not market mutual funds in any way, directly or indirectly, to clients of unregistered agents; and it is directed, within 30 days of the date of this Order, to inform all agents, in writing, of the terms of this decision, with a copy attached, and that the Partner Agent Program and RRRD no longer exist, and that if agents wish to make referrals of customers to other agents, they may do so in their sole discretion as independent contractors.

III. SELECT AGENT PROGRAM

A. Findings of Fact

1. Contract Provisions

(71) All forms of the Agent's Agreement provide at Section I. F:

We will advertise, provide promotional materials, and participate in the cost of your advertising, in accordance with policies determined from time to time to us. You will not use any advertisements referring to us or identifying us in any way without our prior approval.

(72) All forms of the Agent's Agreement provide at Section II.A:

Each Company will make payments to the Agent as set forth in the applicable Schedule of Payments.

(73) All forms of the Agent's Agreement provide at Section II.C:

Each Company reserves the right to fix and determine the amount, extent, and conditions of any bonuses, awards, prizes and allowances.

(74) The Agent Agreements do not contain any provisions requiring Agents to sell mutual funds or to appoint someone to sell mutual funds.

(75) For many years, State Farm had always encouraged its agents to sell as much insurance as they could, and State Farm made available as much fire or life insurance, as agents could sell. (Swift TR 7/28/05 p. 264.)

(76) The provision of the contract that asks the agent to advance the interest of the company (I.A.) only concerns insurance. (Wright TR 7/26/05 p. 199.)

2. Background

(77) The AA97 Agent Agreement, introduced in approximately 1996, reduced auto commissions by 20 percent and fire commissions by about a third from the prior AA3 and AA4 contracts. (Knapp TR 7/29/05 p. 490.) Under the prior AA3 or AA4 forms of agreement, agents who sold prescribed levels of insurance over short periods of time, such as 30 to 90 days,

received bonuses or awards, including trips and cash awards. (Knapp TR 7/29/05 p. 492, 502.) Agents were not required to convert from the AA3 or AA4 to the AA97. Only new agents were required to sign the AA97.

(78) When State Farm introduced the AA97 Agreement with its reduced commissions, it told agents that they would have an opportunity to make up the reduced income through increased opportunities for bonuses (Knapp TR 7/29/05 pp. 492-493.) Agents, such as Steve Knapp, who had the AA4, signed up on the AA97 in the belief that its "bonuses and awards" provision, which is identical to the provision in the AA 4, would, in practice, mean the same thing -- that Agents would qualify for such bonuses or awards solely through sales of insurance over short periods of time (Knapp TR 7/29/05 pp. 492 - 93, 508-509), but that they would have increased opportunities to win such awards.

(79) Starting in approximately 1998, State Farm instituted a new program known as the "Select Agent" Program. (PTOS 31.) It was not implemented until 2000. (Wright TR 7/29/05 p. 547.) 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 certain benefits from the Company. (PTOS 32.)

(80) When the Select Agent program was introduced, the awards and bonuses previously available to all agents became available only to Select Agents; in contrast to past practice (and the past meaning of the "bonuses and awards" provision of the contract), agents could no longer win awards or bonuses without qualifying as Select Agents. (Knapp TR 7/29/05 p. 494.)

(81) Knapp, for example, is not eligible to win the same awards or prizes that he did in the past because he is not a Select Agent. (Knapp TR 7/29/05 p. 502.)

(82) Former AFE John Killingsworth identified the Select Agent Program as part of the "Grow or Go" campaign that State Farm had implemented in 2000. (Killingsworth TR 7/26/05 p. 34.)

3. Summary of Criteria and Benefits

(83) The current criteria to become a Select Agent are:

- a. participation in the Customer Response Center;
- b. have at least one LSA-4 or LSA-5 licensed staff member;
- c. (i) solicit 40 net paid life insurance policies OR create 25 new life households; (ii) \$8,500 in life premium credits; and (iii) 80% or better 2nd year life persistency; (SJPS A.1.)
- d. licensed or certified in all products and services OR agree to refer clients to another licensed or certified State Farm Agent;
- e. create and implement a business plan.

(SJPS A.1.)

(84) The current benefits and rewards of Select Agent Program include:

- a. eligibility to receive coop advertising monies;
- b. eligibility to receive block assignments and internet leads concerning new customers;
- c. free designation in Yellow Pages block advertisements as a "Select Agent;"
- d. eligibility to participate in additional bonus programs;
- e. registered Select Agents are eligible to receive mutual fund referrals.

(SJPS A.2.)

(85) Select agents are also eligible to broker policies for Phoenix Life and AON Insurance. (Knapp TR 7/29/05 p. 503.)

(86) Currently, 76% of Agents nationwide are Select Agents. (PTOS 33.)

4. Connection between Select Agent and Partner Agent Programs

(87) Prior to the Partner Agent Program, there was a requirement that agents be willing to refer business to other agents. (Wright TR 7/29/05 p. 566.) Under the Partner Agent Program, however, an Unregistered Agent must designate a Partner Agent who is a Select Agent or have a Select Agent designated for him. If an agent selected a partner who was not a Select Agent, then the AFE would select someone else. (Wright TR 7/26/05 pp. 207-208, 219; Sikora TR 7/27/05 p. 54.)

(88) The current requirement for being a Select Agent (as noted above) is that the agent be willing to make referrals to other agents of products that that agent does not handle. Using the Partner Agent requirement to meet the product availability category for Select Agent is the connection between the two programs. (Wright TR 7/29/05 p. 574.). This connection is illustrated in the email of Lori Welty in PX 91 (Wright TR 7/29/05 pp. 574-575.)

(89) The two programs work in tandem: A Select Agent must make referrals if he cannot handle the products (*e.g.*, an Unregistered Select Agent must agree to make referrals), *and* must designate a Partner Agent who is a Select Agent.

5. Achievability of Criteria

(90) There was considerable testimony and evidence that not all of the Select Agent criteria could be equally achieved by all agents. Although State Farm witnesses responded to this testimony, they did not demonstrate personal knowledge of the application of the requirements, and their testimony was vague and conclusory.

(a) *The Quality Standard*

(91) Prior to the requirement for sales of life insurance, the Select Agent Program required agents to meet a "quality" or profitability standard known as QRP. (Wright TR 7/29/05

p. 568.) Agents who were very good agents were sometimes precluded from becoming Select Agents because of this criterion. (Killingsworth TR 7/26/05 pp. 37-39.) The QRP requirement was not realistic or reasonable for many agents in inner city or urban areas because car thefts or arson fires would make it difficult for the agent to achieve a consistent profit. (Knapp TR 7/29/05 p. 500.) Indeed, when the quality requirement was changed from QRP to a life insurance sales requirement, there were 106 agents who gained Select Agent certification by making this change. (Wright TR 7/29/05 p. 570.)

(92) State Farm's exhibit purporting to show that agents of various geographic and ethnic backgrounds had achieved Select Agent status on a par with others (DX 78) is of little probative value; the exhibit speaks to the diversity of agents, not to the diversity of their policyholders, which would be the source of difficulties for their attaining the profitability of life insurance "quality" objectives, and, in any event, there was no State Farm witness who could interpret or read the document in a way so as to make it meaningful. (Fisher TR 7/29/05 pp. 607-610.)

(93) The Company dropped the QRP requirement so that 100 agents not otherwise eligible would be able to become Select Agents. (Wright TR 7/29/05 pp. 570-571; DX 38.)

(94) Nonetheless, the requirement that the agent sell a certain number of life insurance policies with 80 percent persistency, which requires that the customer pay premiums on that policy for a full two years, is not realistic for all agents. (Knapp TR 7/29/05 pp. 498-499.) Steve Knapp, who serves a lower income area and knows policyholders there, testified that agents in such areas would find it difficult to get customers to keep up the payments for that period of time. (Knapp TR 7/29/05 p. 499.)

(b) *The Business Plan*

(95) The Select Agent Program's requirement of a business plan is not applied evenhandedly or fairly. The requirement has deteriorated to where it is very undefined. Good agents already had plans and were frustrated with having to do a plan in the company format and to provide the level of information that they felt put them at risk. Other agents had a very hard time reaching the requirements of a plan. (Killingsworth TR 7/26/05 p. 37.) In other cases, agents such as Mr. Knapp do not submit a business plan because he believes it to be intrusive on his own trade secrets as to how he conducts his business. (Knapp TR 7/26/05 p. 137.)

(96) Additionally, the requirement for a business plan is not uniform because each individual zone is permitted to have its own requirements. (Knapp TR 7/29/05 pp. 500-501.) There are no objectives or standards for a business plan, and the agency field executive is not required to forward plans to any other company official. (Knapp TR 7/29/05 p. 501; Fisher TR 7/29/05 p. 611.)

(c) *Licensed Staff Requirement*

(97) The requirement that agents have at least one Licensed Staff Associate (LSA) at the LSA 4 or 5 level is not fair or achievable to all agents. (Killingsworth TR 7/26/05 p. 39.) LSAs are employees of agents who are licensed to sell insurance. (Killingsworth TR 7/26/05 p. 40; Knapp TR 7/29/05 p. 496.)

(98) In order to obtain an LSA license in most states, it is necessary to first obtain a license through the state, and then State Farm provides a rigorous curriculum that the staff person must pass in order to get the designation. (Knapp TR 7/29/05 p. 498.)

(99) Not every agent can achieve the requirement of an LSA 4 or 5. Some smaller agencies would have difficulty doing this. In many instances, an agent does all the binding

himself and simply has a staff person to answer the phone, take claims and accept payments, which does not require licensing. (Knapp TR 7/29/05 p. 498.) Similarly, an agent who had no employees could not fulfill the requirement to have a licensed staff member. (Killingsworth TR 7/26/05 p. 41.)

6. *The Call Response Center ("CRC")*

(100) In approximately 1997, State Farm initiated an after-hours call service for Agents and policyholders known as the Customer Response Center ("CRC"). (PTOS 34.)

(101) The CRC takes calls from policyholders when Agents' offices are closed in the evening and during weekends. (PTOS 35.)

(102) 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. (PTOS 36.)

(103) AA3 and AA4 Agents are, however, given the option of participating in the service if they so choose. (PTOS 37.)

(104) For those who do, the cost of participation is \$1.75 per household per year. For those who choose not to participate, there is no cost. (PTOS 38.)

(105) All AA97 Agents receive the CRC free of charge. This is one of the benefits those Agents receive in return for their acceptance of lower commission rates than AA3 and AA4 Agents. (PTOS 39.)

7. *Benefits of Select Agent Status are Not Available to Other Agents*

(106) State Farm has historically had a variety of award programs to reward Agents for meeting objectives the Company deemed important. Examples of other bonus or reward

programs include the Inner Circle, Chairman's Circle, Legion of Honor, the Millionaire Club, and the Extended Millionaire Club. (PTOS 30.)

(107) Now, only Select Agents are eligible for prizes and awards. Only Select Agents may broker certain products such as the Phoenix life products and the AON commercial professional liability products. Only Select Agents can receive Internet referrals or new sales or receive state-to-state transfers or block assignments. (Knapp TR 7/29/05 p. 503.)

(108) Before the Select Agent Program, co-op advertising was administered by the zones; agents who were not profitable, for example, might not be eligible for co-op advertising. There were other zones that would allow an agent to use that which was not used by another agent. Today, only Select Agents get the benefit of the company's portion of co-op advertising. (Wright TR 7/26/05 pp. 220-221; Knapp TR 7/29/05 p. 503.)

(109) Only a select agent is entitled to have the services of what is called a life specialist. That is a person supplied by the company that comes to the agent's office to help the agent with the sale of life insurance. (Knapp TR 7/29/05 p. 503.)

8. Yellow Pages Advertising

(110) Under the Select Agent Program, Select Agents are identified as such to the public, and distinguished from other agents in prominent yellow pages advertising. (Killingsworth TR 7/26/05 p. 35; Knapp TR 7/29/05 p. 504; PX 19) Select Agents appear in these ads without cost. A non-select agent must pay at least \$500 if he wishes to appear in the display ad, but he will not have the legend "Select Agent" next to his picture (Knapp TR 7/29/05 p. 505.)

(111) State Farm has concluded that the designation of "Select Agent" may confuse the public; that the public has difficulty comprehending the value of some of the criteria, such as a business plan; and that it creates different classes of agents. (PX 74).

(112) Former AFE Killingsworth observed that the Select Agent Program divided the ranks. Many very good agents were unable to be Select Agents, and were placed in a second class position. (Killingsworth TR 7/26/05 p. 38).

9. *Nature of the Benefits of the Select Agent Program*

(113) The ability to broker the products of other companies, to receive block assignments, to receive internet referrals or mutual fund referrals is not a prize, bonus or award; it is a benefit. (Wright TR 7/29/05 p. 567 - 568.)

(114) Although Mr. Wright characterized portions of the Select Agent Program as a prize or award (Wright TR 7/29/05 p. 546), no State Farm document describes it as a bonus or award program. (*See, e.g.*, PX 73-84.)

(115) Because agents under the AA3 and AA4 contracts have to pay for the CRC, it is not a bonus program. (Knapp TR 7/29/05 p. 529.) Although all AA97 Agents currently receive the CRC free of charge, (PT 0539), there is no contractual guarantee that it will remain free in the future. (PX 3.)

(116) State Farm never admonished, threatened or sanctioned any agent who chose not to participate in the program, who refused to refer prospective mutual funds purchasers to other agents, or who refuse to designate a partner agent (JPSD.7, as modified by the Court's Pretrial Order of July 12, 2005.)

B. Conclusions of Law

(117) The Select Agent Program violates a number of provisions of the Agent Agreement.

(118) The Agent Agreements require the Agents to sell insurance as a full-time occupation. Additionally, the Company has historically provided to the agents as much

insurance as they could sell. State Farm has an implicit, if not explicit duty, to make insurance available to them for this purpose. *Speakman v. Allmerica Financial Life Insurance & Annuity Co.*, 367 F. Supp.2d 122 (D. Mass. 2005). The Agent Agreements are uniform as to form—all agents do business under the same agreements. These agreements will be construed against the drafter, State Farm. *Brian Props, Inc. v. Burley*, 662 N.E.2d 522, 524 (Ill. Ct. App. 1996); *Bishop v. Lakeland Animal Hosp., P.C.*, 644 N.E.2d 33 (Ill. Ct. App. 1994). Additionally, such a form agreement means the same thing in all circumstances; it cannot mean one thing for purposes of one agent and another thing for a different agent. Restatement (second) of Contracts § 211 (1981). State Farm, under the SAP, makes entire lines of insurance and sources of business available to one class of agent—Select Agents—but not to others. This includes the brokering privileges for AON and Phoenix products; referrals of Internet sales and block assignments. Select Agents also get benefits such as co-operative advertising, that non-select agents do not. The Agent Agreements contain no provision permitting State Farm to create classes of agents, to treat one class of agent differently from another. State Farm is in breach of the Agreement.

(119) The Select Agent Program specifically violates Section II.A. which states that Agents will be compensated according to a schedule that is attached to the Agreement. The provision does not contemplate different categories of agents selling different categories of insurance for different compensation. State Farm introduced no schedule showing that one class of agent is entitled to compensation that another class is not. This compensation obviously flows from the commissions generated from Internet sales, mutual fund sales, block assignments and other business that Select Agents obtain and for which non-Select Agents are ineligible.

(120) State Farm’s position, articulated by Messers Wright and Fisher, that it may grant benefits to agents because those benefits are not covered by the contract, is sophistry. Most of the “benefits”—block assignments, insurance referred or sold over the Internet, brokering of Phoenix or AON products, co-op advertising—are the bread and butter of the Agent Agreement—that is, insurance policies. The Company is denying a substantial portion of its agents—roughly a quarter—categories of policies, categories of referrals, advertising benefits and even mutual fund referrals—when those agents have fully performed the contract.

(121) To contend, as State Farm does, that these are “incentive” programs is unsupported by the facts or the contractual language. Indeed, the fact that 76 percent of the agents are currently Select Agents completely undercuts the notion that the Select Agent Program is an incentive program.

(122) The Company has also violated Section II.C., the “prizes and awards” provision. This provision, which is identical to the same provision in the AA3 and AA4 contract, historically has been construed by the Company as meaning that prizes and awards are available to all agents for performance over a short period of time as a reward for productivity or profitability in a particular line of insurance. There is no record that the Company has at any time created an across-the-board category, premised upon requirements outside of the contract, to deny prizes and awards. State Farm is in breach.

(123) The Company has also violated Section I.F., concerning advertising. That provision states that State Farm will participate with Agents in the cost of advertising in accordance with “policies.” The SAP was never described as a “policy” in either writing or in testimony. Moreover, if the “policy” is to deny advertising because agents do not contract with

another company or agree to refer their customers to another agent, then the “policy” is a breach of the contract.

(124) Specifically, wholly apart from the respects in which it breaches the Agent Agreement, the SAP was shown to be unavailable to entire categories of agents on bases not related to their performance or abilities. The Agents signed their agreements with no knowledge or notice of the SAP. They had expectations that the benefits they had enjoyed for years, and that had been set forth in their agreements, would be continued on the same basis. There is absolutely nothing in the Agent Agreement that gives State Farm the right to deny benefits to a class of agent because that agent, for example, chooses to have a smaller office and not to have an LSA or because that agent serves a lower-income clientele for whom life insurance is an unaffordable luxury. State Farm's distinctions under the SAP are therefore arbitrary and capricious, inconsistent with the Agents' reasonable expectations, and in violation of the implied covenant of good faith.

(125) Additionally, State Farm has violated the implied covenant of good faith and fair dealing in that the SAP, like the PAP, was motivated by an unlawful motive to oust older agents.

(126) Accordingly, the Court declares that the Select Agent Program is a breach of the Agent Agreement and of the implied covenant of good faith and fair dealing, and that henceforth, State Farm may not continue with the program and must offer the benefits of the program to all agents on a fair and reasonable basis.

IV. RESTRICTIONS ON THE SUBMISSION OF NEW BUSINESS

A. Findings of Fact

1. Contract Provisions

(127) The AA3 and AA4 Agent Agreements provide at Section I. L.:

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

Historically, State Farm used this provision with respect to individual policies, such as setting premiums or rates. It never referred to this provision in imposing limitations on sales as a result of natural disasters. (Swift TR 7/28/05 pp. 266-267.)

(128) The AA97 Agent Agreement provides at Section I. L.:

“We retain the right to prescribe all policy forms and provisions; premiums, fees, and charges for insurance and services; and 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 and, by line of coverage, by policy type, by Company, or by other means.”

2. General

(129) For many years, State Farm had always encouraged its agents to sell as much insurance as they could, and State Farm made available as much fire or life insurance, as agents could sell. (Swift TR 7/28/05 p. 264.)

(130) Like any insurance company, State Farm must manage the risks that it is willing to assume by establishing underwriting criteria. (PTOS 40.)

(131) Unlike many other enterprises, volume and profitability are sometimes at odds with each other in the insurance industry. (PTOS 41.)

(132) 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. (PTOS 42.)

(133) Historically, these previous limitations were occasioned by unforeseen or unforeseeable events like natural catastrophes or economic downturns. (PTOS 43.)

(134) 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. By itself, Hurricane Andrew caused policyholder losses of approximately \$3.7 billion, more than the entire surplus of the Fire Company at the time. (PTOS 44.)

(135) 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. The programs involved quantitative limits on new risks the Company was willing to insure in certain areas, including Texas, Florida and Louisiana. (PTOS 45.)

(136) 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. (PTOS 46.)

(137) Even as the limitations on new business production were being announced, the Northridge Earthquake occurred in southern California in January 1994. The earthquake itself cost over \$3 billion in policyholder losses. (PTOS 47.)

3. Restrictions after 2000

(138) Beginning in 2002, State Farm imposed restrictions on the sale of home or auto insurance in 43 states, primarily home and fire insurance. (TR 7/28/05 p. 269.) More specifically, the company had some restrictions in effect for some period of time in the following years as follows:

<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
43 states	25 states	8 states	8 states

(DX 45.)

(139) State Farm imposed these restrictions because it lost money. (Swift TR 7/28/05 p. 270.) It lost \$5 billion dollars in 2001 and \$2.5 billion dollars in 2002. (Wright TR 7/28/05 p. 295.)

(140) The principal causes of these losses were unprecedented claims severity, rising costs, rapid growth and rate inadequacy. (Wright TR 7/28/05 p. 295.) During this time, State Farm did not lose more money in underwriting that it had in previous years. (Swift TR 7/28/05 p. 270.) Thus, it can be inferred that the increase in losses was attributable to the other causes. Several of these causes were foreseeable and within State Farm's control—particularly losses from aggressive growth and new ventures. In particular, State Farm had initiated a campaign in 1998 called "The Big Dog Off The Porch," which was a very aggressive effort to increase sales of auto insurance; that campaign continued into the early 2000s. (Wright TR 7/28/05 pp. 312-313.)

(141) It is well known in the insurance industry that new business is more risky and less profitable than old business, (Wright TR 7/28/05 pp. 297-298, 312) and the aggressive growth of sales of new auto policies would predictably lead to losses. In fact, in announcing the restrictions, Ed Rust, Jr., State Farm's Chairman, stated that the aggressive growth of "The Big Dog Off The Porch" campaign had led to the losses that caused the company to restrict sales. (Wright TR 7/28/05 p. 314.)

(142) Similarly, when the company decided in the late 1990s or early 2000 to go into the mutual fund and banking businesses, it knew that these ventures would lose money for several years. (Wright TR 7/28/05 pp. 315, 316.)

(143) In 2003, State Farm had a pretax operating profit of \$3.1 billion dollars and in 2004 of \$5.5 billion. (PX 41.) Nonetheless, restrictions in many states persisted during this period.

4. Effects on Agents

(144) Restrictions on the sale of new products have negative effects upon agents. In general, agents typically lose 12 to 15 percent of their policyholders each year. (PX 43.) Over three years an agent would lose 36 percent at a 12 percent attrition rate if he or she could not replace those policies. (Swift TR 7/28/05 p. 272.) A policyholder who leaves an agent will almost never come back. (Swift TR 7/28/05 p. 272.) Hence, it is necessary for an agent to replace these lost policyholders with new business in order to maintain a consistent policy count from year to year.

(145) When State Farm restricts agents' ability to sell, agents suffer a number of losses: (1) loss of new sales of insurance; (2) loss of existing policyholders who cannot be replaced; (3) loss of business from centers of influence that have been developed as referral sources, because the agent cannot sell new business (Swift TR 7/28/05 p. 271); (4) loss of allied business. That is, if an agent cannot write fire business; it is likely to adversely affect his ability to write auto business, or vice versa, because customers want to buy both in a package. (Swift TR 7/28/05 p. 270.)

(146) Restrictions on sales also push agents to retire. Retirement compensation to State Farm agents is based on the agent's last year's income, and if restrictions are in place, and they force income down, then the retirement compensation will go down. Thus, faced with restrictions on sales, many agents retire early in order to avoid a reduction in retirement income. (Swift TR 7/28/05 p. 276.)

(147) Agents' incomes increased throughout the period the limitations on new business were widely in place. Nationally, average compensation was up 13.3%, from \$272,788 in 2001 to \$309,158 in 2002. In 2003, they were up another 10.1%, to \$340,483. (PTOS 54.) In Texas, average agent compensation was up 15.7% in 2002 over 2001. In California, commissions per agent were up 19% in 2002 over 2001. In Florida, commissions per agent were up 8.5% in 2002 over 2001. (PTOS 55.)

(148) Although agents' incomes went up during the period restrictions were in effect, this was because of premium increases. (Swift TR 7/28/05 p. 306.) If the restrictions had not been in effect, their incomes would have been higher. (Swift TR 7/28/05 p. 293.)

(149) State Farm can cut losses in a number of ways other than curtailing sales of new policies that have less of an adverse effect upon agents, including raising rates, increasing deductibles or imposing exclusions on coverage. (Swift TR 7/28/05 p. 275.)

5. Decision-Making

(150) A number of State Farm witnesses testified about how the decisions to impose restrictions on sales had been made. Charles Wright testified at trial; Mary Bitzer, a Zone Manager, was State Farm's designated deposition witness with knowledge on the subject of restrictions, and while she testified at deposition, and was included on defendant's list of trial witnesses, she was not called as a witness at trial. Likewise, Vincent Trosino, State Farm's Chief Operating Officer, testified at deposition but not at trial. Barry Thomas, testified both at trial and by deposition.

(151) The testimony of the State Farm witnesses with respect to how the decisions had been made to restrict sales after 2000 was inconsistent and contradictory. For example, both Trosino and Wright testified that the decision was made by both the zone and headquarters

(Trosino, PDD 41, 42; Wright, TR 7/28/05 p. 302). Barry Thomas testified in deposition that the decision was made primarily by the zone, with headquarters only "consulting" in certain "situations" (Thomas, PDD 43).

(152) Wright testified at trial that there was a procedure pursuant to which the zones made written recommendations on proposed restrictions of business to headquarters, in accordance with specific targets or criteria issued by headquarters; for example, a zone might be required to provide a plan that targeted at least a break even result and up to a three percent operating profit. (Wright TR 7/28/05 pp. 302, 311, 312) Mary Bitzer, however, testified that there was no standard or criterion that State Farm followed in making the decision to restrict sales (PDD 48), no regular compilation of reports (PDD 45) and no procedure (PDD 46). She called it a "process," but "not an exact process" (PDD 46) that involved looking at "a number of reports" and "having conversations" and "looking at the business and regulatory environment." She did not know whether there were any written recommendations (PDD 46). There was no collection of documents or records created in connection with the decisions to restrict the sale of new products that would allow her to retrace her steps concerning a decision to restrict sales. She was unable to recall any "conversation" in which the interests of agents were discussed, did not look at any documents concerning agents, and did not consider the effect of restrictions on agent compensation. (PDD 49-50, 51; PDD 48). Wright, however, testified that there certainly was a criterion, and that if anyone said there was not, that it would not be true (Wright TR 7/28/05 p. 311). He confirmed that there was a procedure under which the zone made written recommendations to headquarters. (Wright TR 7/28/05 pp. 311-12).

(153) None of State Farm's witnesses testified that there was any consideration given to the terms of the agent agreement in determining restrictions.

(154) State Farm failed to produce a single document explaining how it decided to restrict sales, demonstrating a connection between its “losses” and the restrictions or showing what impact, if any, these restrictions have had.

B. Conclusions of Law

(155) Because the two forms of contract are different, two sets of conclusions are set forth here.

(156) State Farm had an obligation, rooted in the Agent’s Agreement but confirmed by its custom and practice, to furnish agents with as much insurance as they could sell. *Gray v. Mundelein College*, 695 N.E.2d 1379, 1386 (Ill. App. Ct. 1998).

(157) Additionally, where an insurer enters into a line of business, it is obligated to remain in that business so that agents will not be deprived of the benefits of their contracts. *Speakman v. Allmerica Financial Life Ins. and Annuity Co.*, 367 F. Supp.2d 122 (D. Mass. 2005).

(158) With respect to the AA3 and AA4 contracts, there is no specific provision pursuant to which State Farm can limit applications for insurance by lines or types of policies, or other categories. The provisions of Section I.L. that relate to State Farm’s power to govern the acceptance or rejection of risks concern individual policies, and not categories of policies. Section I.L. does, however, grant State Farm the power to prescribe policy forms and provisions, a power that includes the ability to create exclusions, raise deductibles or raise rates.

(159) While a seller or provider of goods and services may be excused from performance by impossibility or commercial impracticability, this excuse applies only when the procuring cause is not occasioned as a result of foreseeable and avoidable events or the seller’s own acts. *Greenlee Foundries, Inc. v. Kussel*, 301 N.E.2d 106, 109 (Ill. 1973); *Northern Illinois Gas Co. v.*

Energy Cooperative, Inc., 461 N.E.2d 1049, 1059 (Ill. 1984). A party seeking to excuse performance through impracticability must show that reasonable efforts were made to surmount obstacles. *Bartlett Commons Shopping Center v. Schultz Sav-O-Stores, Inc.*, 1992 WL 345052 (N.D. Ill. 1992).

(160) State Farm's witnesses testimony about the restrictions on sales in 2002 and thereafter referred only to "losses." There was no testimony that the losses were unforeseeable or could not have been managed in other ways. Indeed, to the contrary, State Farm witnesses admitted that one of the principal causes of the losses incurred in the early 2000s was State Farm's own decision to aggressively pursue new automobile business through "The Big Dog Off The Porch" campaign and the foreseeable losses that that campaign generated.

(161) Similarly, State Farm's venture into mutual funds and banking in the late 1990s were anticipated to lose money. State Farm had made substantial profits in the stock market in the late 1990s, but there was no explanation as to why it could not have hedged against these foreseeable losses through reserves from the profits that it had made.

(162) The absence of any documentation on the restrictions on sales warrants an inference that those documents would demonstrate that it was not necessary to restrict sales in order to manage its losses. *Interstate Circuit v. U.S.*, 306 U.S. 208, 225-26 (1939).

(163) Accordingly, State Farm's restrictions of sales of new products are not warranted by the contract or by circumstances and were a breach of its agreement with the agents under the AA3 and AA4 contracts.

(164) The Court concludes, therefore, that under the AA3 and AA4 contracts, State Farm is obligated to continue to offer or continue offering the lines of insurance that it has historically offered and cannot withdraw them except and unless they demonstrate compelling circumstances

of impossibility or commercial impracticability. State Farm is directed to offer all of the same lines that were offered before 2000 in any areas in which it is not offering them today with respect to agents with AA3 and AA4 contracts.

(165) The AA97 contract, however, contains provisions that grant State Farm discretion not to offer lines of insurance by area, class of customer, or otherwise.

(166) While this express provision allows State Farm to withdraw from the offering or sale of insurance, it is subject to the implied covenant of good faith and fair dealing, and can therefore only be exercised reasonably. *Interim Health Care of Northern Illinois v. Interim Health Care, Inc.*, 225 F.3d 876, 884 (7th Cir. 2000).

(167) The implied covenant of good faith and fair dealing applies to both the exercise of discretion itself, and the manner in which it is exercised.

(168) In this case, there was no testimony that demonstrated that State Farm exercised its power to withdraw from sales of certain lines in any reasonable way. The fact that State Farm, in depositions, designated Mary Bitzer as a witness with knowledge of restrictions; that it listed her on the witness list; and then without explanation did not call her and instead substituted Mr. Wright to testify on this subject creates an inference that Ms. Bitzer's testimony, rather than Mr. Wright's (which was contradictory) should be believed. State Farm's shuffle of these witnesses is strongly suggestive of an effort by State Farm to whitewash Bitzer's deposition testimony with the tidy testimony of Mr. Wright.

(169) Ms. Bitzer's testimony demonstrates that the decision-making process for withdrawing lines from sale was undirected, without standards, and apparently arbitrary.

(170) It is also telling that State Farm produced no records to show how its decision-making process worked, what the criteria were, that any sort of uniformity prevailed or that

fairness was any kind of a standard. Rather, knowing that agents would be negatively affected in their policy counts by limitations on sales, the company went forward, apparently with each zone acting independently, without any guidance or a criterion from headquarters except for unspecified “conversations.”

(171) The court concludes that State Farm has breached the implied covenant of good faith and fair dealing under the AA97 by imposing restrictions on sales in an unreasonable and arbitrary manner.

(172) The court declares that under the AA97 contract, State Farm may not impose restrictions on sales without doing so in a reasonable manner that is uniform, fair and that takes account of the interest of agents.

V. STATE FARM’S DENIAL OF AGENTS’ REQUESTS TO BROKER INSURANCE FOR OTHER COMPANIES

A. Findings of Fact

1. Contract Provisions

(173) All forms of the Agent Agreement provide at Section I.G. as follows:

The fulfillment of this Agreement will be your principal occupation, and you 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.

2. Background

(174) For at least half a century, State Farm Agents have been exclusive agents who, except in rare circumstances, solicit business only for State Farm. There are no insurance agents other than State Farm exclusive Agents who solicit business for and receive commissions from the Company. (PTOS 48.)

3. Existing Brokerage Arrangements

(175) The Company invests resources nurturing its brand identity through Agents, including State Farm's frequent national television advertisements highlighting the qualities of its "good neighbor" Agents. The exclusive relationship between State Farm and its Agents benefits the Agents as well as State Farm. (PTOS 49.)

(176) State Farm has 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 thru IPSI. (PTOS 50.) The IPSI Agreement was not produced at trial.

(177) 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. (PTOS 51.)

(178) Pursuant to Section 1(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. (JPSG (25) as modified by Court's Pretrial Order 7/12/05.)

(179) In addition, in very rare circumstances, such as where no State Fair plan or industry association plan is available, the Company has allowed agents to write business for other private insurance companies (JPSG (26) as modified by Court's Pretrial Order of 7/12/05.)

(180) 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. (JPSG (27) as modified by Court's Pretrial Order of 7/12/05.)

4. Agent Requests to Broker

(181) Beginning in 2002, State Farm imposed restrictions on agents' sale of certain new policies in 43 states. In some states these restrictions continued for more than a year. Agent policy counts were reduced as a result. Agents were not able to serve existing customers, and were unable to replace the loss of policyholders that occurs as a matter of ordinary attrition, which can easily run 10 to 15 percent per year. (Swift TR 7/27/05 p. 128.) Similarly, for example, if the Company has restricted the sale of home insurance, the agent risks the loss of auto insurance because policyholders want to purchase all insurance as a package. (Swift TR 7/27/05 p. 129).

(182) During periods when State Farm is not offering a line of insurance in a particular jurisdiction, State Farm Agents want to be able to broker those products from insurance companies that are not full line competitors of State Farm. (Swift TR 7/27/05 p. 128.). If Agents were able to offer these lines of insurance, they would have an incentive to move the policyholders back to State Farm when and if State Farm offered the line again, since Agents' retirement compensation is based on their State Farm income. (Swift TR 7/27/05 p. 130).

(183) 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. (DX 79; PTOS 52.)

(184) 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. (DX 79; PTOS 53.)

(185) Ron Dodd, Mr. Swift's Agency Vice President, called Mr. Swift in response to this letter and said that Mr. Swift would not be permitted to broker insurance. (Swift TR 7/27/05 p. 131.)

(186) Clifford Mueller, who has been a State Farm agent for 30 years in Amosville, Virginia, asked State Farm for permission to broker fire insurance in October, 2002 because State Farm had stopped writing it (PX 92; Mueller TR 7/27/05 p. 151-152.) Mueller was concerned because his centers of influence, which he had worked to develop for over 25 years, were asking for fire insurance and it was embarrassing for him to not be able to take care of their needs. (Mueller TR 7/27/05 p. 156.)

(187) According to Mueller, in a discussion with State Farm's Bill Whitney, he asked if he could broker fire insurance from Loudon County Mutual or Northern Neck Insurance Co., two small Virginia insurers. Mr. Whitney responded to this request and told him that he would never be permitted to broker with any other company (Mueller TR 7/27/05 pp. 154, 182.)

(188) Mr. Whitney testified that in his discussion with Mr. Mueller, neither Loudon County nor Northern Neck was mentioned (Whitney TR 7/27/05 p. 192), but that it would not have mattered. In his view, the Company did not permit brokering of the products of any company that is in any kind of competition with State Farm. (Whitney TR 7/27/05 p. 198.) Any company offering fire insurance at the time was in competition with State Farm. (Whitney TR 7/27/05 p. 204.)

(189) Although State Farm resumed writing fire policies in Virginia in December, 2002, it did not know in October, 2002 that it would be resuming such sales in two months. (Whitney TR 7/27/05 p. 204.)

(190) The following State Farm Agents submitted written requests to State Farm for permission to write business for other insurers: Terry McManus (April 9, 2003), Jim Moore (April 10, 2003), Alan Schultz (June 14, 2003), Patricia Adkins (April 9, 2003), Frank Dutto (April 25, 2003). (SJPS A.9.)

(191) State Farm sent letters to each of these Agents denying their requests. (SJPS A.10; PX 45).

(192) In its responses to these agents' requests, State Farm stated that it considered a number of factors in making its decision. The letter from Michael J. Hargis to Terry L. McManus of May 19, 2003 is typical:

In deciding whether to grant its consent, State Farm considers the following factors: (1) the general market situation, (2) the potential for conflicts of interest, (3) the possibility of customer confusion, (4) the potential for claim handling complications, (5) the potential liability to State Farm in the even that he other insurer fails to perform to the client's satisfaction; (6) the difficulty in protecting trade secrets, (7) the protection of the State Farm brand, (8) the value of the training and support provided to the Agent and staff, (9) the long term potential to market the line of business through State Farm or a partnered company. (PX 45.)

(193) Other multi-line companies such as Allstate and Nationwide allow their agents to represent other insurers. Mueller's sons are independent agents and represent several different companies without conflicts or problems. (Mueller TR 7/27/05 pp. 156-157; Swift TR 7/27/05 p. 141.)

5. *The Application of the Factors*

(194) State Farm's witnesses contradicted each other with respect to how and where the decision to allow brokering was made. James Casino testified that the decision was made at the zone level (Casino, PDD 30); Mary Bitzer, Zone Manager, testified it was made at headquarters, and that no one in the Zone had authority (Bitzer, PDD 31), although she did not know who at headquarters had the authority.

(195) Greg Fisher, State Farm's designated witness with knowledge of brokering, testified about the factors in the letters State Farm had sent to the agents denying their requests to broker. He was unaware of any instances of confusion by policyholders as to who insured them (Fisher, PDD 29); he knew of no instances of problems with trade secrets in connection with brokering (Fisher, PDD 37); he knew of no instances of confusion by policyholders as to who was servicing them (Fisher, PDD 36); he testified that he was unaware of any study the Company had done that showed that brokering would have an adverse effect on the Company (Fisher, PDD 39); there was no study or review of difficulties with claim handling (Fisher, PDD 39); the Company's determination that brokering would create problems with claims handling was not based on any study; rather, it was based on "conversations" and "common sense." (Fisher, PDD 39-40).

(196) In fact, these factors are not taken into account because State Farm does not permit brokering. (Fisher TR 7/27/05 pp. 206-207.) The only exception is when (a) the company is not in a market; (b) it has no plans to enter or reenter the market; and (c) it does not feel that the other company is competing with State Farm. (Fisher TR 7/27/05 pp. 218; 228-229.)

(197) In the letters responding to agents' requests to broker (PX 45), these three factors are not listed. (Fisher TR 7/27/05 p. 229.)

B. Conclusions of Law

(198) The Agent Agreement contemplates that State Farm will permit agents to broker business in certain circumstances. The language of the Agreement does not, by its terms, give State Farm sole or exclusive discretion to determine whether to permit agents to broker; accordingly, State Farm can only exercise its discretion in a reasonable manner. *Interim Health Care, Inc.*, 225 F.3d at 884.

(199) The record demonstrates that in response to Agents' request to broker in the past, State Farm has been less than candid. On the one hand, Mr. Fisher testified that only three factors govern the decision whether to allow brokering—whether State Farm was in the market, whether it intended to go into the market, and whether it felt it was in competition with the other company. Instead of telling agents these factors in a forthright manner or, as Mr. Fisher testified, that its actual policy was not to permit brokering, State Farm generated elaborate responses that would lead the agents to believe that it had subjected their requests to laborious consideration and application of seven to nine different factors. In truth, however, if Mr. Fisher is to be believed, this was not the case at all. State Farm simply didn't permit brokering. Furthermore, Mr. Fisher admitted in his deposition that there was no basis for the factors that State Farm cited in its letters denying brokering.

(200) State Farm's duplicitous and callous attitude towards agents' brokerage requests was also mirrored in Mr. Whitney's response to Mr. Mueller's request. While Whitney denied that Mueller had requested to broker the products of two small companies—Louden County Mutual and Northern Neck—Mr. Whitney admitted that it did not matter what company Mr. Mueller asked about—the answer would be no.

(201) More fundamentally, State Farm's decisions to refuse brokering to agents failed to reflect any reasonable consideration of those requests. To claim, as State Farm's witnesses did at trial, that allowing brokering of a line of insurance by a small company would be handing over its customers to a "competitor" is both illogical and unsupported by the evidence. If State Farm is not offering a line, then it has *ipso facto* ceded the field to all its competitors; allowing its agents to broker such a line, at the least, keeps the agents, and State Farm, in the competitive arena.

(202) State Farm unquestionably has the right, in setting the terms of its contracts, to take the position that brokering is not allowed. Here, however, the bargain that was struck with the Agents was that brokering was indeed allowed, and State Farm furthered this belief by enumerating many factors it considered to be relevant. The fact that the factors that are enumerated are not the controlling factors, and that State Farm never articulated the controlling factors to the agents demonstrates that State Farm breached the agent agreements in refusing to consider Agent requests to broker and then denying those requests.

(203) Accordingly, the Court declares that under the forms of Agent Agreement, State Farm must consider each request to broker reasonably and in light of the Agent's interests and that in responding to any Agents' request to broker it must provide the actual, candid reasons for its decision.

VI. MANDATORY MEETINGS

A. Findings of Fact

1. Contract Provisions

(204) The Preamble of the Agent Agreement states:

We do not seek, and will not assert, control of your daily activities, but expect you to exercise your own judgment as to the time, place, and manner of soliciting insurance, servicing policyholders, and otherwise carrying out the provisions of this Agreement.

(205) The Preamble also states:

State Farm makes available to all agents the experience and technical knowledge required and developed over the years with respect to selling, underwriting, and servicing insurance. We will provide you, through our personnel, with information and guidance as to the operation of your agency; and from time to time we will designate specific employees to advise you regarding your activities. In turn, we will invite you to attend such meetings as may be called by the Companies for the purpose of introduction new products, ideas, services and procedures, promoting sales, and furnishing you with assistance, guidance, and consultation to better enable you to achieve.

(206) Section I.B. of the Agent Agreement states:

You are an independent contractor for all purposes. As such you have full control of 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.

(207) The Agent Agreement nowhere states that Agents have to go to meetings.

(208) Mr. Wright admitted that State Farm does not “exercise control over [agents’] activities in a fashion that would require them to attend any meeting.” (PDD 66.) Mr. Fisher testified that “there are independent contractor agents. We don’t order our independent contractor agents to do things.” (Fisher TR 7/27/05 p. 99.)

(209) During the 1990s, the insurance industry endured a considerable amount of adverse publicity. (PTOS 56.)

(210) In response to these developments, a number of insurers came together and formed “IMSA,” the Insurance Marketing Standards Association. (PTOS 57.)

(211) As part of its mission, IMSA offers certification that member insurers are “compliant” organizations if they can demonstrate their commitment to ethical business practices. (PTOS 58.)

(212) In approximately 1998, State Farm sought IMSA certification for the first time. (PTOS 59.)

(213) 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. (PTOS 60.)

(214) IMSA Certification was not dependent on having agents actually attend the meetings. (Wright PDD 64.)

(215) The first such program was conducted in 1998; it has been held every year since. The topics covered vary from year-to-year. (PTOS 61.) Some had an emphasis on ethics, others had less emphasis on ethics and more emphasis on business practices in general. (Knapp TR 7/29/05 p. 616.)

(216) The program lasts for half a day, typically the morning hours. (PTOS 62.)

(217) Personal attendance by all Agents is required. Agents who do not attend risk having State Farm terminate their contracts. (PTOS 63.)

(218) According to Chuck Wright, 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. (PTOS 64.)

(219) Other methods can be used to provide information to agents including a monthly magazine and newspaper, email and websites. (Knapp TR 7/29/05 p. 617.)

(220) State Farm in fact teaches information security over the Internet. (Knapp TR 7/29/05 p. 617.)

(221) The study materials given to agents for the mandatory ethics meeting in fact states that they are for self-study as opposed to classroom use. (PX 47; Knapp TR 7/29/05 pp. 617-618.)

(222) Knapp's field office schedules only one meeting a year. If he cannot attend that meeting, then there might be no other classes. If he is late, he cannot sign up. (Knapp TR 7/29/05 p. 619.)

(223) If the agent is ill, there is no alternative. He has to attend the meeting. (Knapp TR 7/29/05 p. 620.)

B. Conclusions of Law

(224) State Farm's requirement of a mandatory meeting breaches its agreement with the agents. The provision that specifically says that the agent has "full control" of his daily activities prevails over the much broader provision that State Farm relies on calling for the agent to cooperate with State Farm.

(225) The Court declares that State Farm may not require the Agents to attend meetings.

RESPECTFULLY SUBMITTED,

DATED: September 5, 2005

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CERTIFICATE OF SERVICE

I hereby certify that on this 1st day of September, 2005 a true and correct copy of “PLAINTIFF’S PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW and POST TRIAL MEMORANDUM OF NATIONAL ASSOCIATION OF STATE FARM AGENTS was served upon the following attorneys of record for Defendants herein, by Federal Express:

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