

**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.)	

**POST TRIAL MEMORANDUM OF
NATIONAL ASSOCIATION OF STATE FARM AGENTS**

The National Association of State Farm Agents (“NASFA”) submits this post trial memorandum in accordance with the Court’s instructions of August 1, 2005. This memorandum will approach the trial on a topical basis, in the order suggested by the Court.

We believe that, for the most part, the accompanying Findings of Facts and Conclusions of Law are self-evident. We will, therefore, focus this memorandum on points that we suspect may not be self-evident or that may require elaboration.

I. THE PARTNER AGENT PROGRAM

A. *Findings of Fact*

Several aspects of the evidence adduced at trial merit discussion because they support the factual findings: The knowledge of State Farm’s witnesses; the witnesses that State Farm did not call; the nature of the documentary evidence; the testimony by NASFA’s witnesses that State Farm let stand unrebutted; and the conflicting nature of State Farm’s evidence.

State Farm’s witnesses, Messrs. Wright, Fisher and Sikora, were employees of its home office in the executive suite. None of them testified that his regular duties involved communicating or dealing directly with Agents on a day-to-day basis. Indeed, these witnesses’

contact with State Farm Agents occurred through a very attenuated chain of delegation, exemplified by Mr. Fisher's attempts to communicate with Agents in July 2005 (DX 61, 62, 63): Mr. Fisher's secretary prepared an email for him that was transmitted to an intermediary in Dallas, who then transmitted it to AFEs; who then were charged with delivering the message to the Agents. Other examples include three types of "Frequently Asked Questions" that were not made directly available to the questioners—the Agents: (PX 9, 14, 71.) Similarly, Mr. Wright testified that when State Farm wished to inform the agents that it was not going to pursue direct mail promotions of mutual funds, he could not point to any direct communication, but instead contended that "word got out" to the Agents. (Wright TR 7/26/05 p. 189.) This lack of knowledge of the witnesses State Farm called is paralleled by its failure to call anyone with actual knowledge of communications with agents—one of its 500 AFEs, for example. State Farm's documentary evidence likewise fell short of anything actually shown or given to the Agents.

In short, State Farm failed to produce any witness with personal or direct knowledge of any direct communications with Agents about the Partner Agent program—its initial announcement, the change to the RRRD, the "voluntary" nature of the program or the decision not to pursue direct mail. The evidence State Farm produced—amounting to a conclusory contention that the PAP no longer exists—is of little, if any, probative weight.

State Farm similarly failed to rebut the testimony of John Killingsworth that State Farm had adopted a "Grow or Go" program that included the PAP and SAP, and that was part of an effort to drive out agents who were under the AA3 or AA4, so as to reap a windfall by transferring their businesses to the far more lucrative (for State Farm) AA97.

Likewise, it is disturbing that State Farm witnesses testified to documentary materials created by State Farm that were never produced or produced only after trial. These include a videotape presentation of the Partner Agent Program, a document entitled “A Second Look” and an introductory package of materials referred to in Court Exhibit 2. State Farm did not offer any explanation as to why it had not produced these documents at trial.

A final aspect of State Farm’s evidence is the wildly contradictory evidence as to exactly what State Farm did when an unregistered agent’s customer inquired about mutual funds:

- Three documents state that in response to inquiries about mutual funds from a customer of an Unregistered Agent, the Company will refer the customer to a Registered Agent (PX 14, question 3; PX 71, question 3; PX 72, p. 5426); one of the documents says a packet of materials is sent out and two of them do not.
- Mr. Sikora testified that while these exhibits reflected the “current state” of the program, the statement in them that the Company would make referrals was not correct or consistent with the actual practice of the company (Sikora TR 7/27/05, pp. 22-33, 47-48). There was no documentation of what the “actual practice” was.
- Mr. Fisher repeated this “incorrect information” about referrals being made to Registered Agents when he sought to “correct” the emails sent to agents in July 2005. (Fisher TR 7/27/05 pp. 87-89.)
- In the field, however, AFEs actually directed Agents to appoint Partner Agents or told them that if they did not, the AFEs would appoint partners for them. (PX 91.)

The plain inference to be drawn from this contradictory welter of information—and lack of any State Farm evidence or of what was actually told to the Agents—is that currently, the program works as it was initially designed: Agents may appoint Partner Agents, and if they do not, one will be appointed for them; business of Unregistered Agents is sent to Registered Agents; and the motive to drive out agents and replace agents on the AA3 or 4 with agents on the AA97 is intact.

This conclusion is reinforced by the evidence of what actually happens in the field—the July 2005 emails directing agents to pick Partner Agents or have them picked for them. More significant is State Farm’s failure to investigate whether this “error” was repeated on a nationwide basis, or to give agents an opportunity to undo the appointments they had made pursuant to a coercive, “incorrect” set of directions. The Court can infer both that (a) the problem was nationwide and (b) State Farm intended to force agents to pick Partner Agents, consistent with the initial, announced intent of the program. *Comm. Hospitals of Central Cal. V. NLRB*, 335 F.3d 1079, 1086 (D.C. App. 2003) (absence of evidence in record concerning a party’s decision warranted inference that if produced, evidence would have been unfavorable to that party).

B. *Conclusions of Law*

One party to a contract cannot interfere with the other party's performance of the contract *Levy & Hipple Motor Co. v. City Motor Cab Co.*, 174 Ill. App. 20, 1912 WL 2716 (1912); nor may a principal interfere with an agent's work on the principal's behalf. Restatement (Second) Agency § 434 (1958). Likewise, a party to a contract may not impose upon another party conditions for performance of the agreement that were not agreed to or are not part of the contract.

The sale of mutual funds is not required by the Agent's Agreement. Indeed, the mutual funds are sold through a separate company, State Farm VP Management Corp. (*see* Document SFM NASFA 00001260 at Tab 3 of documents accompanying Mr. Reichler’s letter to the Court of August 2, 2005). Thus, the Partner Agent Program requires an Agent to either do business with a person not party to the Agent Agreement or refer business to such a party. None of this is required by the Agent Agreement.

Accordingly, the Partner Agent Program violates Section I.A. of the Agent Agreement, which requires the agents to "solicit application for insurance" and perform other tasks related to the sale and servicing of insurance policies, as well as section I.G., which states that fulfillment of the Agent's Agreement will be the Agent's full-time occupation. The PAP requires agents to support the sale of mutual funds being offered through a stranger to the Agent Agreement -- something they did not agree to do when they made the agreement, and for which State Farm pays no consideration. Moreover, they risk losing clients to the Partner Agents, an interference with their performance of their duties. Accordingly, the PAP is a breach of these provisions.

In connection with the Select Agent Program, the PAP requires Agents to give up benefits to which they are entitled under their Agent Agreements upon the condition that they do things -- support the sale of mutual funds -- that they are not required to do under the Agent Agreement. As noted below, only Select Agents may discharge their *insurance related* duties with respect to certain *insurance products* such as policies received through block assignments or internet referrals; or sales of Phoenix Mutual or AON policies. State Farm's requirement that Agents comply with these non-contractual conditions, and its deprivation of insurance-related products and services to them if they do not comply, are breaches of the Agreement.

Finally, these requirements interfere with the Agents' independence, as set forth in the Findings and Conclusions.

The PAP violates the implied covenant of good faith, because of both the unlawful motive it furthered and the manner in which State Farm executed it. In *Dayan v. McDonald's Corp.*, 466 N.E.2d 958, 972 (Ill. App. Ct. 1984), the Court observed:

Where a party acts with improper motive, be it a desire to extricate himself from a contractual obligation by refusing to bring about a condition precedent or a desire to deprive an employee of reasonably anticipated benefits through termination, that party is exercising contractual discretion in a manner

inconsistent with the reasonable expectations of the parties and therefore is acting in bad faith.

Thus, for example, where a party imposed unreasonable, non-contractual requirements on another's exercise of a right to expand, a violation of good faith was found. *Keener v. Sizzler Family Steak Houses*, 424 F. Supp. 482 (N.D. Tex. 1977), aff'd in part, remanded in part, 597 F.2d 453 (5th Cir. 1979); *see also Stetzer v. Dunkin' Donuts*, 87 F. Supp. 2d 104 (D. Conn. 2000).

State Farm's manner of handling of the PAP is also evidence of its bad faith. The implied covenant requires that a party act reasonably in the performance of its duties. Here, State Farm had an intent to drive out agents under the AA3 or AA4, but instead of informing them of that intent, it used the PAP and SAP to marginalize them; confronted with Agent objections to the PAP, State Farm purported to change it to the RRRD; but in fact, that change was cosmetic only. Immediately prior to trial, State Farm was sending out emails directing Unregistered Agents to pick partners or have them picked for them.

A party may not "encourage the other party to expand or incur additional expenses where, unlike the other party, the terminating party knows information that leads it to believe actual termination is likely." *Morris Silverman Management Corp. v. Western Union Financial Services, Inc.*, 284 F. Supp.2d 964, 973 (N.D. Ill. 2003); *Sons of Thunder, Inc. v. Borden, Inc.*, 148 N.J. 396, 690 A.2d 575 (N.J. 1997). State Farm's conduct was in extreme bad faith, and the remedy provided is warranted.

II. SELECT AGENT PROGRAM

A. Findings of Fact

The evidence with respect to the Select Agent Program was considerably less complex than for the Partner Agent Program. What stands out is that:

- State Farm admitted that at least some of the aspects of the program were not “prizes and awards” but were “benefits” including Internet referrals, block assignments, and the ability to broker lines of insurance such as AON or Phoenix Mutual.
- A second aspect that stands out in sharp relief is that the benefits offered to Select Agents are central to the business of an insurance agent. Block assignments are assignments of insurance policies; lines such as AON or Phoenix Mutual are insurance products.
- An area where there was some, but not great dispute, had to do with the ability of all agents to achieve Select Agent status. The testimony of the NASFA Agents and Mr. Killingsworth was specific as to the ability of Agents to achieve the quality criterion—whether it was the earlier QRP criterion or the later life insurance criterion; or the licensed staff requirements; or the business plan requirement.
- State Farm witnesses testified that these objectives were achievable by all agents in only vague and conclusory terms; since these witnesses did not deal with agents on a day-to-day basis, there was no foundation for them to know whether Agents could achieve these objectives or not.

B. *Conclusions of Law*

The aspects of the Select Program that invoke legal principles are fairly straightforward. First, benefits under the program are central to the sale of insurance and are encompassed within the subject matter of the contracts.

The Agent Agreements require agents to sell insurance as a full time occupation; historically, State Farm has made as much insurance available to agents as they could sell, this custom and practice illuminates the contract’s requirements that the agents sell insurance full time: That is, State Farm had an implied obligation to furnish insurance to them to sell. *Technology Solutions v. Northop Grumman Corp.*, 826 N.E.2d 1220, 1225 (Ill. App. Ct. 2005) (custom and practice is binding on parties). Additionally, State Farm had an express duty to make insurance available to agents. *Speakman v. Allmerica Financial Life Insurance & Annuity Co.*, 367 F. Supp.2d 122 (D. Mass. 2005). A number of principles flow from these premises.

The Agent Agreements are form contracts. A necessary incident for form contracts is that they be interpreted in a uniform and consistent way.

The Restatement (Second) of Contracts, § 211, states:

1) Except as stated in Subsection (3), where a party to an agreement signs or otherwise manifests assent to a writing and has reason to believe that like writings are regularly used to embody terms of agreements of the same type, he adopts the writing as an integrated agreement with respect to the terms included in the writing.

(2) Such a writing is interpreted wherever reasonable as treating alike all those similarly situated, without regard to their knowledge or understanding of the standard terms of the writing.

(3) Where the other party has reason to believe that the party manifesting such assent would not do so if he knew that the writing contained a particular term, the term is not part of the agreement.

Restatement [Second] Contracts § 211 (1981) (emphasis added).

The comment provides:

Equality of treatment. One who assents to standard contract terms normally assumes that others are doing likewise and that all who do so are on an equal footing. In the case of a public utility, that assumption is fortified by statutory and common law limitations on discrimination among customers; a term prescribed by statute or regulation in the case of an insurance policy also carries an assurance of equal treatment. Apart from government regulation, courts in construing and applying a standardized contract seek to effectuate the reasonable expectations of the average member of the public who accepts it. The result may be to give the advantage of a restrictive reading to some sophisticated customers who contracted with knowledge of an ambiguity or dispute.

Restatement [Second] Contracts § 211, cmt. e (1981).

Hence, the Agent Agreement cannot mean one thing for one class of agent and another things for other agents. If the Company treats “insurance” as meaning Phoenix Mutual policies for one class of Agents but not for another under the same form of contract, then there is a breach, and that is the case here.

While this is true in general, it is particularly true with respect to individual sections of the Agent Agreement. Thus, Section II.A. states Agents will be compensated according to a schedule. The Agreement does not provide for one schedule for one class of agent and another schedule for others. The same is true for Section II.C., the "prizes and awards" provision. In this regard, State Farm's longstanding custom and practice of making prizes and awards available to all agents, and its historical usage is illuminating. Indeed, the construction that parties have put on a contract is strong evidence of the intent of the parties. *Bertlee Co. v. Illinois Pub. & Printing Co.*, 52 N.E.2d 47 (Ill Ct. App. 1943); *Orlando Orange Groves Co. v. Hale*, 61 So. 284 295 (Fla. 1935). The Select Agent Program turns this custom and practice, as well as the contract language on its head; prizes and awards are available only to Select Agents. This is a breach of the agreement.

Apart from these breaches, State Farm had an obligation to administer the Select Agent Program in a reasonable way, consistent with the parties' reasonable expectations. *Interim Health Care of Northern Illinois, Inc. v. Interim Health Care, Inc.*, 225 F.3d 876, 884-85 (7th Cir. 2000). Here, the evidence demonstrated that agents had a reasonable expectation that they would be provided with all types of insurance that the Company offered; and that they would be accorded benefits, advertising and prizes and awards on an even-handed basis consistent with past practices. But the Select Agent program did not do that. State Farm failed to show any rational relationship between the "benefits" of the Select Agent Program and the criteria for achieving it, or that the denial of benefits was consistent with the parties' expectations. For example, an agent who chose to have a small office, without an LSA, might perform very well, but would not achieve "Select Agent" status because of his or her choice to have a small staff or no staff. Likewise, an agent who excelled at serving the needs of lower-income clients might not

achieve the "Quality" criterion. The criteria for Select Agent status, therefore, even if warranted by the contract (which they are not) are arbitrary and inconsistent with the parties' expectations.

The *Interim Health Care* case is instructive. In that case, a franchise agreement provided that the franchisor would "furnish national account leads" to the franchisee. The franchisor ceased providing any leads to the franchisee, and the franchisee claimed a breach of the implied covenant of good faith. The franchisor claimed it had stopped sending leads because the franchisee performed poorly. The Court disagreed:

But the franchise agreement does not condition the furnishing of account leads on performance. And there is no evidence that [the Franchisor] advised [the franchisee] that it would withhold leads if her performance waivered. . . . In the present case, the franchise agreement specifically states that [the franchisor] will furnish franchisees with materials to help them abide by [its] standards and use [its] procedures. These provisions establish a reasonable expectation by both parties that the franchisor would make remedial efforts with struggling franchisees. . . . In light of the contract's implicit assurances of franchisee assistance, and its silence as to the link between performance and account leads, the failure to advise Williams that she was jeopardizing her access to national account leads by poor performance weights against a finding that [the franchisor] exercised its discretion in accord with the reasonable expectations of the parties.
Id.

Here, when the parties entered into their agreements, there was no Select Agent Program; State Farm did not reserve to itself (as it could have) any right to create a second class of agent. To the contrary, agents signed agreements upon the contractual representation, bolstered by years of custom and practice, that they would be provided with prizes and awards, benefits, advertising and other consideration on the same basis as in the past and as shown in the agreement. State Farm's creation of a second, superior class of Agent -- the Select Agent -- is therefore inconsistent with the implied covenant of good faith and fair dealing and a breach of the contract.

As was the case earlier, the Company's implementation of the Select Agent Program is indicative of a motive to oust certain Agents while retaining others. As noted with respect to the

Partner Agent Program, this motive is well supported by the evidence and applies equally to the Select Agent Program.

III. RESTRICTIONS ON THE SUBMISSION OF NEW BUSINESS

A. *Findings of Fact*

The facts here are self-evident, and only a few points need to be emphasized. First, the restrictions that State Farm imposed after 2000 were foreseeable; they arose as a result of the Company's own aggressive sales of auto insurance under the "Big Dog Off The Porch" campaign, the sales of mutual funds, and the launch of the banking business. Evidence was introduced, and not contradicted, that underwriting losses after 2000 did not exceed levels that they had in prior years.

The Company's evidence of the reasons for ceasing the sale of new insurance products was, at best, impressionistic. No one from the underwriting department was called as a witness; there was no correlation between the level of losses and the need to restrict business; there was no demonstration of a systematic, consistent approach to the imposition of restrictions; nor was there any evidence that State Farm conferred with agents or took their interests into account in any systematic or planned way.

In contrast, the evidence did show that the effects on agents of these restrictions were severe. Since agents typically lose 12 to 15 percent of their policyholders each year, the loss of new business caused severe injury. Indeed, it is fair to infer from the evidence that these restrictions were consistent with State Farm's "grow or go" campaign.

One of the more striking aspects of the testimony is the contrast between the testimony of Mary Bitzer, who was State Farm's designated witness with knowledge of restrictions, and who was not called as a witness at trial, and Mr. Wright, who was called as such a witness. The

contrast between these two witnesses, which is detailed in the Findings of Fact, could hardly be more stark: Wright presented the picture of decision-making at headquarters in which the Company set standards or guidelines that would presumably move the Company back towards profitability, while Bitzer described a haphazard process without standards, guidelines or direction.

Extremely notable for its absence is the lack of any documentation showing the factors that State Farm considered, how the decision making process was carried out, how it was monitored, how agent concerns were taken into account and how restrictions were lifted. One would expect that where the very lifeblood of the Company is concerned—the sale of insurance—that a decision to stop offering that product to the public in 43 states would merit at least a few sheets of paper. Not one was produced to show the decision making process. The Court would be warranted in drawing a negative inference with respect to what the documents would show—that there was no rational decision making process, consistent with the testimony of Ms. Bitzer. *Interstate Circuit v. U.S.*, 306 U.S. 208, 225-26 (1939).

B. *Conclusions of Law*

State Farm has historically made insurance available to agents and, in the absence of natural disasters, made as much available to them as they could sell. This testimony of custom and practice gives meaning to the provisions of the contract that state the Agent will make the sale of insurance his full time occupation and that he will solicit insurance. *Gray v. Mundelein College*, 695 N.E.2d 1379, 1386 (Ill. App. Ct. 1998).

In *Speakman v. Allmerica Financial Life Insurance & Annuity Co.*, 367 F. Supp.2d 122 (D. Mass. 2005), insurance agents agreed to repay to the company certain past commissions in exchange for a promised stream of higher "trail" commissions in the future. The Agents

borrowed from the Company in order to repay these commissions, and the loans were to be repaid from the proceeds of the "trail" commissions and the agents were to keep the difference. Less than two years after entering into this agreement, the insurer stopped offering new annuity business and severely cut back on servicing its existing business. Like State Farm here, the insurer claimed that this cut-back was required because of "declining income and increased expenses." The "trail" commissions plummeted, and the agents sued, claiming a violation of the implied covenant of good faith. The court upheld their complaint:

Here, AFLIAC took unilateral, voluntary action that advanced its own self-interest and prevented or hindered plaintiffs from reaping substantial benefits of the contract. The agents could not earn sufficient commissions to offset their loan obligations, much less earn higher amounts, if AFLIAC discontinued competitive services to Eligible Annuity Contracts and disavowed generally its commitment to the annuity business. [Footnote omitted] The predictable effect of those actions was to trigger large-scale surrenders of annuities, which reduced the gross amount of annuities subject to trail commissions and correspondingly reduced those commissions.

The contract therefore necessarily contemplated performance duties on the part of AFLIAC to remain in the annuity business and to service existing customers during the pendency of the Trail Program. 367 F. Supp.2d at 134.

The same principle applies here with even greater force, where there is a contractual duty to continue to supply insurance.

Under the AA3 and AA4 contracts, there is no provision that permits State Farm to stop offering a line of insurance or lines of insurance by geographic territory, type, or category. While a party may be excused from performance by commercial impracticability, *Barlett Commons Shopping Center v. Schultz Sav-O-Stores, Inc.*, 1992 WL 345052 (N.D. Ill. 1992) (citing *Greenlee Foundaries Inc. v. Kussel*, 301 N.E.2d 106, 109 (Ill. 1973)) there was no evidence introduced that would support application of this doctrine. Moreover, the doctrine

relies upon the existence of an unforeseeable event, and there was nothing to show that anything was unforeseeable here.

While the AA97 contract contains provisions that give State Farm some discretion not to offer lines of insurance by area, class of customer, or otherwise, its discretion must be exercised reasonably. The testimony of Mr. Bitzer, which should be believed as opposed to Mr. Wright, supports the view that the decision making process for withdrawing lines of insurance was undirected, without standards and apparently arbitrary. The absence of records further supports an inference that State Farm did not exercise its discretion reasonably.

IV. STATE FARM'S DENIAL OF AGENTS' REQUESTS TO BROKER INSURANCE FOR OTHER COMPANIES

A. *Findings of Fact*

The facts adduced to trial show that State Farm indeed permits brokering; that it apparently does so pursuant to agreements, not introduced in evidence, with other insurance companies; that it has denied agent requests upon the pretext that it has considered many different factors, but in fact, those factors are not controlling. The only factors that control State Farm's decision is whether State Farm is not in a market, has no plans to enter or reenter the market and does not feel the other company is competing with it. State Farm has never disclosed these three factors to agents who requested permission to broker.

B. *Conclusions of Law*

State Farm's refusals to permit agents to broker is in violation of the implied covenant of good faith and fair dealing. Its refusals were not in accord with its stated reasons; State Farm failed to show that it gave any reasonable consideration to the Agent's requests; and State Farm's reasoning—that allowing agents to broker would amount to turning its clients over to competitors is illogical and unsupported. State Farm's refusal to broker is in violation of the

implied covenant of good faith, and the Agents are entitled to a declaration that State Farm must consider each request reasonably and in light of Agents' interests.

V. MANDATORY MEETINGS

A. *Findings of Fact*

The evidence regarding mandatory meetings is very straightforward. Mr. Wright and Mr. Fisher both admitted that the Company does not "require them to attend any meeting" or "order our independent contractor agents to do things." The Agent Agreement does not require agents to go to meetings, and affirmatively states that State Farm will not interfere with the Agents' daily activities.

B. *Conclusions of Law*

For these reasons, requiring agents to attend a mandatory meeting is a breach of the contract.

CONCLUSION

For all of the foregoing reasons, the Court should find in favor of the Agents.

RESPECTFULLY SUBMITTED,

DATED: September 5, 2005

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