

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

SUPERIOR COURT OF THE DISTRICT OF COLUMBIA

CIVIL DIVISION

- - - - - x

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

Plaintiff, :

vs. No. CA 4089-02

STATE FARM MUTUAL AUTOMOBILE, :  
INSURANCE COMPANY, et al, :

Defendants. :

- - - - - x

Washington, D.C.  
Thursday, July 28, 2005

The trial in the above-entitled matter was resumed before the HONORABLE LEONARD BRAMAN, Senior Judge, in Courtroom No. 318, commencing at approximately 9:00 a.m., pursuant to continuance on Wednesday, July 27, 2005.

THIS TRANSCRIPT REPRESENTS THE PRODUCT OF AN OFFICIAL REPORTER, ENGAGED BY THE COURT, WHO HAS PERSONALLY CERTIFIED THAT IT REPRESENTS THE TESTIMONY AND PROCEEDINGS OF THE CASE AS RECORDED.

MARIA M. ALLISON, RPR  
Official Court Reporter Telephone (202) 879-1050

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

APPEARANCES:

On behalf of the Plaintiff:

MICHAEL GARNER, ESQ.  
ALLAN P. HILLMAN, ESQ.  
ROBERT O'CONNOR, ESQ.  
Attorneys at Law

On behalf of the Defendants:

PAUL REICHLER, ESQ.  
LAWRENCE MARTIN, ESQ.  
SARAH ALTSCHULLER, ESQ.  
JAMES WRIGHT, ESQ.  
Attorneys at Law

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

TABLE OF CONTENTS

WITNESSES

Direct Cross Redirect Recross

For the Plaintiff:

DAVID SWIFT

(By Mr. Garner) ..... 262

(By Mr. Reichler) ..... 278

(By Mr. Garner) ..... 292

STEVEN KNAPP

(By Mr. Garner) ..... 327

(By Mr. Reichler) ..... 334

CLIFF MUELLER

(By Mr. Garner) ..... 358

For the Defendants:

CHARLES WRIGHT

(By Mr. Reichler) ..... 294

(By Mr. Garner) ..... 308

BARRY L. THOMAS

(By Mr. Martin) ..... 318

(By Mr. Hillman) ..... 322

EXHIBITS

For the Defendants:

			Marked	Admitted
23	No. 84	Internet Site - Knapp	..... 350	
	No. 85	Internet Sites	..... 353	

MISCELLANY

Certificate of Court Reporter..... 362

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

P R O C E E D I N G S

THE DEPUTY CLERK: Your Honor, resuming the trial of National Association of State Farm Agents, Incorporated vs. State Farm Mutual Auto Insurance Company, et al., Civil Action 4089-02. Counsel, would you please reidentify yourselves for the record?

MR. GARNER: W. Michael Garner, Dady & Garner, Minneapolis, for the plaintiff.

MR. HILLMAN: Allan Hillman, Neuberger, Quinn, Baltimore, Maryland, for the plaintiff.

MR. O'CONNOR: Robert O'Connor, Omaha, Nebraska, for the plaintiff.

MR. WRIGHT: James Wright, Bloomington, Illinois, for defendants.

MR. REICHLER: Paul Reichler, Foley, Hoag, Washington, D. C., for the defendants.

MR. MARTIN: Lawrence Martin, Foley, Hoag, Washington, D. C. for the defendant State Farm.

MS. ALTSCHULLER: Sarah Altschuller, Foley, Hoag, Washington, D. C., for the defendants.

THE COURT: Thank you. Be seated, please.

Before we begin our next topic, which will be restriction on sales. Mr. Reichler, on yesterday the Court requested the defendant to produce all records and documents

1 relating to directions given to the AFEs on what the  
2 agencies -- the agents were instructed or to be instructed  
3 regarding the triple RD program. Would you please report on  
4 the status of that?

5           MR. REICHLER: Your Honor, I'm pleased to report  
6 that after diligent search late into the morning hours, we  
7 were able to find those documents and we are prepared to  
8 proffer them to the Court, and the Court will see that they  
9 have date stamp numbers on them indicating that they had  
10 been produced in timely discovery to the plaintiffs.

11           In addition, if the Court pleases, we were also  
12 able to locate similar instructions that were given to the  
13 AFEs by Mr. Sikora in September 2001, which he testified to  
14 with respect to communicating the details of the partner  
15 agent program to the agents at that time. So we have both  
16 his instructions to the AFEs as to what to say to the  
17 agents, what information to provide to the agents about the  
18 RRRD and also his instructions to the AFEs as to what to  
19 tell the agents about the details of the partner agent  
20 program, and we'd be happy to offer those up to the Court at  
21 this time.

22           THE COURT: Very well. I will receive them.

23           MR. REICHLER: While Mr. Martin is handing them to  
24 your clerk, Your Honor, just as a way of precaution, we have  
25 also asked Mr. Sikora, who is otherwise done testifying, to

1 remain in Washington overnight, just in case Your Honor has  
2 any additional questions about these documents after  
3 receiving them. So, he will remain here. He is still being  
4 treated as a witness subject to being called, so he is not  
5 remaining in the courtroom, but if Your Honor has any  
6 questions about these documents, either now or tomorrow, we  
7 will keep Mr. Sikora here as long as Your Honor would like,  
8 in case Your Honor would like to question him further.

9           THE COURT: Thank you, Mr. Reichler. Let's have  
10 the documents relating to the partner agent program, year  
11 2001, marked Court Exhibit No. 2, and the documents which  
12 were separately stated as presented to me, dated in the year  
13 2003, apparently relating to the triple RD program, marked  
14 Court Exhibit 3.

15           MR. REICHLER: Your Honor, if I may just make a  
16 comment on that Court Exhibit 3? You will notice, in  
17 reviewing Court Exhibit 3 on the first and second page, the  
18 word "redacted" at the top of that, and I just wanted to  
19 explain that, in case a question arises in the Court's mind  
20 as you review this.

21           THE COURT: It does arise in my mind.

22           MR. REICHLER: It doesn't?

23           THE COURT: Yes, it does.

24           MR. REICHLER: It does, and I'll be happy to  
25 explain. These are the documents as produced to the

1 plaintiff in the course of discovery. There were comments  
2 by counsel at the top of each of these pages. They don't  
3 affect the body of Mr. -- they were not part of the body of  
4 Mr. Sikora's e-mail instructions to the AFOs, but when this  
5 document was produced by State Farm to counsel, in response  
6 to their discovery request, this particular one had a  
7 notation on here by State Farm's internal counsel to us. It  
8 was not -- again, it was not part of Mr. Sikora's  
9 documents, so that's what's been redacted for obvious  
10 privilege reasons.

11 THE COURT: Very well.

12 MR. REICHLER: It doesn't affect Mr. Sikora's  
13 document. (Pause.)

14 Your Honor also asked us to -- If I may proceed,  
15 Your Honor?

16 THE COURT: Yes. I asked you for a specimen of  
17 the printout --

18 MR. REICHLER: Yes. And we have that as well,  
19 Your Honor.

20 THE COURT: -- from the 3 RD database.

21 MR. REICHLER: Yes, Your Honor. We have specimen  
22 from the printout. If Your Honor feels more pages are  
23 required, we are happy to produce them. We can have them  
24 FAX'd to us during the course of the day. But what we were  
25 able to do is provide one page which shows --

1 THE COURT: Let me have it, sir, please.

2 MR. REICHLER: Oh, I'm sorry.

3 (Document passed to the Court.)

4 THE COURT: I have several pages stapled. So

5 there are two stapled documents that have been presented to

6 me.

7 MR. REICHLER: They are two printed-out pages that

8 have been stapled as one document, so there should be one

9 document which has two pages stapled together.

10 THE COURT: Front and back?

11 MR. REICHLER: No, Your Honor. What I'm holding

12 is just a two-page -- two pages stapled together.

13 THE COURT: Yes. Do they represent what would be

14 one page coming off the computer?

15 MR. REICHLER: They represent separate pages

16 coming off, Your Honor.

17 THE COURT: Oh. So you've given me two printout

18 pages?

19 MR. REICHLER: That's correct, Your Honor. And if

20 I may explain?

21 THE COURT: So that I have two pages?

22 MR. REICHLER: That's correct. Two pages -- it's

23 not one page, but we have stapled them together just for

24 convenience. But, obviously, the staple can come out.

25 THE COURT: Yes.

1           MR. REICHLER:  What we have produced -- and I  
2 repeat if the Court wants more, we are happy to provide it  
3 -- is a sample of what the page looks like when the  
4 non-registered agent has voluntarily selected a referral  
5 agent, and that, if the Court is looking at the same page I  
6 am, should be the top page.  It's --

7           THE COURT:  I don't know which is your top.

8           MR. REICHLER:  Okay.  The top one that I have has  
9 names filled in under non-registered agent and under  
10 registered partner.

11          THE COURT:  Wait a moment, please.  In each, the  
12 non-registered agent is Patricia Abernathy; is that correct?

13          MR. REICHLER:  No.  Your Honor must have a  
14 document that has two copies of the same page, then, because  
15 -- I apologize, Your Honor.  We'll make sure that you have  
16 the right document.  Maybe we didn't -- We have a collating  
17 error in my office, and I apologize if that's the case.  
18 We'll hand up the right document in a moment.  I'm holding  
19 it in my hand.  In fact, may I --

20          You can give the Court mine.

21          THE COURT:  Do you have the other page?

22          MR. MARTIN:  Your Honor, I believe the other page  
23 is stapled to that front one.

24          THE COURT:  I see.  So what you have presented to  
25 me is one document consisting of two pages that are stapled

1 together?

2 MR. REICHLER: That is correct.

3 THE COURT: Is that correct?

4 MR. REICHLER: That is correct, Your Honor.

5 THE COURT: All right. Now, will you proceed to  
6 explain?

7 MR. REICHLER: Yes, sir. In the stapled copies  
8 that we produced, the first page, the non-registered agent  
9 in question is a lady by the name of Patricia Abernathy  
10 listed under the heading "unregistered agent," and this is  
11 presented to the Court as a sample of what the RRRD looks  
12 like with respect to a non-registered agent who has  
13 voluntarily chosen a referral agent, and in this case it  
14 shows that the referral agent whom she has chosen is Thomas  
15 Lunsford. You see that under the heading "registered  
16 partner."

17 THE COURT: It is.

18 MR. REICHLER: The second page, Your Honor, is a  
19 -- it's a sample. There are many examples of both of these  
20 -- is a page, and the agent, the non-registered agent is a  
21 lady by the name of Aileen Baldwin. Aileen Baldwin chose  
22 not to select a registered referral agent, and as a result  
23 what appears in the database next to her, under "registered  
24 partner" is completely blank, and we represent to the Court  
25 that this is what the RRRD looks like, that where the

1 non-registered agent has chosen not to select a registered  
2 representative as a referral agent, the name of the  
3 non-registered agent appears and the portion of the page  
4 that relates to registered partner is left completely blank.  
5 This is an indication that no selection was made and,  
6 obviously, nobody was appointed by the company to be a  
7 registered partner.

8           THE COURT: Your title ST Agent Code, what does  
9 that represent?

10           MR. REICHLER: May I ask my client?

11           THE COURT: Yes. And the agency field office  
12 code. It's under the address of -- on the page, both the  
13 non-registered agent and the registered partner.

14           (Pause.)

15           MR. REICHLER: Pardon me. Thank you, Your Honor.  
16 I have obtained the answer to this. For purposes of  
17 computerization and databases, every State Farm agent is  
18 assigned a number. The first digits in the number, in this  
19 case 06, represents the state. They are identified, first  
20 place, by state.

21           THE COURT: Wait a moment.

22           MR. REICHLER: I'm sorry.

23           THE COURT: Oh, you are looking at Baldwin?

24           MR. REICHLER: That's right. I could look at  
25 either page.

1 THE COURT: That's all right.

2 MR. REICHLER: Okay.

3 THE COURT: 06 is the state?

4 MR. REICHLER: 06 is the state because, as you  
5 know, insurance agents have to be licensed by the state.

6 THE COURT: Yes.

7 MR. REICHLER: Even if they are selling  
8 securities, as agents they have to be licensed by the state.  
9 And then this is the -- the rest, 1778, is the  
10 identification number. Moving down below, under "agency  
11 field office," again for purposes of computerization, every  
12 agency field office is assigned a number. So, this would  
13 indicate the agent, the AFO, agency field office, where  
14 Aileen Baldwin liaises.

15 (Court reporter interrupts.)

16 Aileen Baldwin liaises. That is, she comes under  
17 the jurisdiction of Agency Field Office F624. And just one  
18 other entry, Your Honor. Next to that, just to the right of  
19 that, agency field office code, it says "regional office"  
20 and here, although there is a typographical error and  
21 misspelling, it's listed Mountain States, and that's the  
22 name of the zone. As Your Honor will recall, State Farm  
23 divided --

24 THE COURT: Yes.

25 MR. REICHLER: -- is divided into --

1 THE COURT: I understand.

2 MR. REICHLER: So this is the Mountain State zone.  
3 Ms. Baldwin is under the jurisdiction of Agency Field Office  
4 F624. Her agent code is there, and we can see the state is  
5 in fact Colorado, which would match with the Mountain State  
6 zone.

7 Again, Your Honor, entirely for the Court's  
8 convenience, if Your Honor would like to question Mr. Sikora  
9 about this, he's here. It's entirely up to the Court.

10 THE COURT: Let the computer specimen be marked  
11 Court Exhibit 4.

12 THE DEPUTY CLERK: Yes, Your Honor.

13 THE COURT: May I have duplicates, for my own  
14 purposes, of 2, 3 and 4?

15 MR. REICHLER: Yes.

16 MR. MARTIN: Yes, Your Honor.

17 MR. REICHLER: Happy to hand them up. Our  
18 versions, of course, are not marked, but the clerk can mark,  
19 I think, the exhibit now.

20 THE COURT: Well, I'll do the marking.

21 MR. REICHLER: That's fine.

22 (Documents passed to the Court.)

23 THE COURT: Finally, Mr. Reichler, were you able  
24 to connect the website printouts regarding Loudon County  
25 Mutual and Northern Neck to the year 2002?



1 satisfied on fire for either one of them.

2 THE COURT: Fire?

3 MR. GARNER: Fire for either one of them, for  
4 Loudon County and Northern Neck.

5 THE COURT: The documents that were used yesterday  
6 were used for the purpose of showing that with regard to  
7 Loudon County, it was selling automobile as well as fire;  
8 and Northern Neck, the personal umbrella insurance --

9 MR. GARNER: That's correct, Your Honor.

10 THE COURT: -- in addition to fire.

11 MR. GARNER: Yes.

12 THE COURT: Now, are you satisfied with that?

13 MR. GARNER: All I see on Northern Neck was fire.  
14 So, I will let Mr. Reichler proceed.

15 MR. REICHLER: Your Honor, --

16 THE COURT: We're back where we started from,  
17 Mr. Reichler.

18 MR. REICHLER: That's right. I still have the  
19 documents --

20 THE COURT: All right.

21 MR. REICHLER: Your Honor, what we were attempting  
22 to accomplish with the other documents was to show not only  
23 auto but that they were offering other lines of insurance  
24 that competed with State Farm apart from just fire  
25 insurance. And auto was one example, that's true, but we

1 also mentioned homeowners and personal umbrella coverage, et  
2 cetera. What we were able to find overnight, Your Honor,  
3 was this. Of course, if Your Honor wants -- What we were  
4 able to find is this. I will describe it in a second, but  
5 obviously we are prepared to send somebody down to Richmond  
6 to the Insurance Commissioner's office and pull out further  
7 public information today. We'll have somebody back before  
8 the end of the day if Your Honor desires, but what I am able  
9 to produce this morning are printouts from A. M. Best, which  
10 is like Standard and Poor's. It's a company that analyzes  
11 -- financial analyst specializing in insurance companies.

12 THE COURT: Yes.

13 MR. REICHLER: And we have their report. It's  
14 called the Best's rating, and we have their report for  
15 Loudon Mutual Insurance Company and Northern Neck Insurance  
16 Company covering their activities in the year 2002. It  
17 indicates not only what they were selling but how much they  
18 sold, and it contains a lot of other financial information.

19 THE COURT: All right. Well, point me to the  
20 referable material; that is, the relevant material. I have  
21 before me -- Let's start with Loudon Mutual.

22 MR. REICHLER: Yes, sir. In Loudon Mutual, if you  
23 turn to the third page, it says, under the heading "business  
24 review," --

25 THE COURT: Yes.

1           MR. REICHLER: It says, "The company provides  
2 homeowners, farm owners, fire and allied lines and personal  
3 umbrella insurance coverages in the state of Virginia," and  
4 then it goes on. And then it says, under "2002 business  
5 production and profitability," you see exactly how much they  
6 sold of these lines in the year 2002. So, it shows what  
7 they were selling. Not only what they were selling, what  
8 they in fact sold in 2002.

9           THE COURT: Apparently they weren't selling auto.

10          MR. REICHLER: It is not indicated that they were,  
11 but it says in the second sentence, under "business review,"  
12 it says, "The company has developed a personal automobile  
13 policy and is waiting to deploy it when they determine it is  
14 strategically in their best interest." That's what it says  
15 with respect to auto. So they were planning to compete with  
16 State Farm for the auto business -- State Farm and others  
17 for the auto business as of that --

18          THE COURT: Well, that's precisely why Mr. Garner  
19 objected yesterday.

20          MR. REICHLER: Well, --

21          THE COURT: They weren't in 2002.

22          MR. REICHLER: It appears -- That's right, Your  
23 Honor, it appears that they were not selling auto in 2002.

24          THE COURT: But they were selling personal  
25 umbrella.

1           MR. REICHLER: They were selling personal  
2 umbrellas, they were selling homeowners insurance and they  
3 were selling farm owners insurance in addition to fire  
4 insurance. So they were a multi-line company, but they were  
5 not precisely in 2002 selling homeowners insurance -- I'm  
6 sorry -- auto insurance, but they had specific plans to get  
7 into that business, which we believe is also a relevant  
8 consideration. But we can certainly stipulate that in 2002,  
9 they apparently were not -- in 2002, they didn't sell any  
10 automobile insurance company.

11           MR. GARNER: Your Honor, may I be heard?

12           THE COURT: Wait a moment, sir.

13                                 (Brief pause.)

14           We have already ascertained that this document  
15 refers to 2002. I see a publication date of July 2003.

16           MR. REICHLER: Yes, Your Honor, because it says  
17 2002 business production and profitability. So, it is --  
18 After the conclusion of the year 2002, this is a review of  
19 what the company did in 2002 and the various lines of  
20 insurance that they were selling -- that they sold are  
21 listed here and described.

22           THE COURT: Doesn't have anything for personal  
23 umbrella.

24           MR. REICHLER: Well, it says under "business  
25 review" that the company provides personal umbrella

1 insurance coverage.

2 THE COURT: Yes. Theoretically, it's possible  
3 that they were doing it in 2003 but not in 2002.

4 MR. REICHLER: Well, theoretically, I would agree  
5 with Your Honor theoretically it's possible, but this is --

6 THE COURT: We know that they were selling farm  
7 owners, homeowners and fire.

8 MR. REICHLER: Yes, Your Honor, and whatever  
9 "allied lines" means. It may be included under "allied  
10 lines," it may be included under "all other." Now, I will  
11 agree with Your Honor that this is not absolutely conclusive  
12 proof that they were selling -- undebatable proof that they  
13 were selling personal umbrella insurance coverage in 2002,  
14 but it is, I submit, admissible evidence from which a  
15 reasonable person could draw an inference that they were  
16 doing it, given the way this report is written and given the  
17 fact that there are categories, such as all other, where  
18 they sold directly. Well, where they sold \$58,000 worth of  
19 premiums directly, \$68,000 under the heading "net."

20 THE COURT: Have we finished with Loudon Mutual?

21 MR. REICHLER: If Your Honor has, I --

22 THE COURT: All right, let's move to Northern  
23 Neck.

24 MR. REICHLER: Yes. Might I make one other  
25 comment about Loudon very quickly?

1 THE COURT: Yes.

2 MR. REICHLER: There is another significance to  
3 this document as well, Your Honor, I would submit while we  
4 are on it, and I'll do this very briefly. You can see that  
5 Loudon Mutual on the first page received a Best's rating of  
6 A-, which is excellent, and under the rating rationale -- I  
7 won't take the time to read it to the Court now -- it  
8 obviously makes it clear that this is a company of  
9 significant financial strength to be a serious competitor in  
10 the insurance business.

11 THE COURT: All right, let's turn to Northern  
12 Neck.

13 MR. REICHLER: Under Northern Neck, again this  
14 publication date of the Best report was July 22, 2003. And  
15 again, the reason we selected the reports that were  
16 published in 2003 is because they show exactly what the  
17 company did in 2002, and we have the same indication under  
18 the heading "business review" on the third page, Your Honor,  
19 where it says Northern Neck writes personal lines coverages,  
20 primarily homeowners, mobile homeowners, dwelling, fire and  
21 farm owners. Then it lists 2002 business production and  
22 profitability, homeowners, fire, farm owners, and then all  
23 other, which are not described. The document --

24 THE COURT: Wait a moment, please.

25 MR. REICHLER: Sorry.

1 (Brief pause.)

2 THE COURT: Yes.

3 MR. REICHLER: The document does not state that in  
4 2002 they were selling automobile insurance, but it does  
5 state that they were selling lines in addition to fire  
6 insurance. And I would also state, consistent with  
7 Mr. Fisher's testimony yesterday, companies do grow and  
8 change and expand and compete along more and more lines.  
9 And so as you look at the rating rationale again on the  
10 first page for Northern Neck, they too received the Best  
11 rating of A-, which is considered excellent and just reading  
12 the first two lines under rating rationale again on the  
13 first page, "The rating reflects the company's excellent  
14 capitalization and management's local market knowledge.  
15 These positive rating factors are derived from the company's  
16 long-standing local market presence and solid business  
17 persistency." So, even though some of us might never have  
18 heard of Northern Neck or Loudon Mutual as insurance  
19 companies, they are serious competitors in the Virginia  
20 market.

21 THE COURT: Mr. Garner, can we stipulate that  
22 State Farm writes farm owners insurance?

23 MR. GARNER: My client tells me that's part of  
24 fire.

25 THE COURT: And what of mobile homeowners?

1 MR. GARNER: It's also part of fire.

2 MR. REICHLER: Your Honor, that may be the  
3 testimony.

4 THE COURT: Wait a moment.

5 MR. REICHLER: I'm sorry.

6 (Brief pause.)

7 THE COURT: And homeowners, Mr. Garner?

8 MR. GARNER: Homeowners is also fire.

9 THE COURT: Now, unless you have Mr. Fisher or  
10 somebody testify that they are distinct, insofar as State  
11 Farm is concerned, then I don't think that this would be  
12 probative.

13 MR. REICHLER: May I consult with my client?

14 THE COURT: Pardon.

15 MR. REICHLER: May I consult with my client?

16 THE COURT: Yes.

17 (Pause)

18 MR. REICHLER: Your Honor, we need to consult with  
19 one of our other State Farm witnesses who is here to be  
20 sure. I think we may be able to resolve this by  
21 stipulation, but I do need to consult with another  
22 gentleman, who is here. Can we --

23 THE COURT: Yes. In other words, if while -- if  
24 the withdrawal by State Farm from writing fire policies also  
25 constituted a withdrawal from the writing of farm owners and

1 mobile homeowners and homeowners, then it seems to me that  
2 the documents prove nothing.

3 MR. REICHLER: If that is the case -- you're  
4 right, Your Honor, that is the -- Let me take that back. I  
5 don't want to agree so quickly. They certainly would not  
6 prove -- if that were the case, and that's precisely the  
7 question we want to ask our expert from underwriter who --

8 THE COURT: Yes. You don't have all your eggs in  
9 that basket, so to speak.

10 MR. REICHLER: Exactly.

11 THE COURT: You've got multiple proffered  
12 justifications.

13 MR. REICHLER: Yes.

14 THE COURT: The question is whether this is  
15 allowed to stand --

16 MR. REICHLER: Yes, Your Honor.

17 THE COURT: -- as evidence.

18 MR. REICHLER: Yes, Your Honor.

19 THE COURT: And you may consult, but I suggest  
20 that you do that during the recess.

21 MR. REICHLER: Oh, yes, Your Honor.

22 THE COURT: And let's move on.

23 MR. REICHLER: That's exactly what I was going to  
24 propose as well. We are happy to do that, Your Honor.

25 Thank you.

1 THE COURT: And we'll leave this in abeyance.

2 MR. REICHLER: Thank you, Your Honor.

3 THE COURT: And in the meantime, I leave it to you  
4 whether you want the Best documents marked for  
5 identification as a defense --

6 MR. REICHLER: I think that is a good idea.

7 THE COURT: Pardon.

8 MR. REICHLER: I think that would be a good idea,  
9 Your Honor, so that we can refer to them by number.

10 THE COURT: All right. Then would you pass to the  
11 Court the court copies for my own use? What would the  
12 numbers be, Mr. Anderson?

13 THE DEPUTY CLERK: Your Honor, Defendant's 82 and  
14 83.

15 THE COURT: Which is 82?

16 THE DEPUTY CLERK: Your Honor, 82 is Northern  
17 Neck.

18 THE COURT: 82 is Northern Neck?

19 THE DEPUTY CLERK: Yes, sir.

20 THE COURT: And 83 is Loudon?

21 THE DEPUTY CLERK: Yes, Your Honor.

22 THE COURT: We're ready to commence hearing  
23 testimony on the topic of restrictions on sales.

24 MR. GARNER: Thank you, Your Honor. I have one  
25 brief housekeeping matter. Yesterday, pursuant to Your

1 Honor's request, we attempted to file the deposition of  
2 Mr. Wright with the clerk's office, but we were told that  
3 they don't file discovery. We understand, though, that  
4 defendants were able to --

5 THE COURT: This isn't discovery.

6 MR. GARNER: Well, --

7 THE COURT: The rules say that you can also file  
8 with the Court. So, you may file with the Court now.

9 MR. GARNER: Very well. We have a compendium of  
10 all of the depositions of the defendants' trial witnesses  
11 here. I have a copy that can be filed with the Court, and  
12 if the Court so wishes, we have a courtesy copy.

13 THE COURT: Yes. In other words, the separate  
14 depositions that were supplied to me, I no longer have to  
15 reference?

16 MR. GARNER: If they --

17 THE COURT: This will dispense those?

18 MR. GARNER: Any of the defendants' trial  
19 witnesses, although our excerpts are separate compendium  
20 that I think are useful.

21 THE COURT: I understand.

22 MR. GARNER: But any separate deposition of  
23 defendants' trial witnesses would no longer be necessary.

24 THE COURT: This is not, I don't believe, a  
25 substitute for the necessity to file depositions that you

1 use in cross-examination?

2 MR. GARNER: Would you want -- I might use those  
3 depositions in cross-examination. Would you want those  
4 depositions filed separately?

5 THE COURT: Yes. This has to do with depositions  
6 of defendants' witnesses. If you are on cross-examination  
7 of a witness, presumably that's not your witness.

8 MR. GARNER: Yes.

9 THE COURT: But if you use the deposition, it must  
10 be filed.

11 MR. GARNER: And it would be defendants' witnesses  
12 that we would be cross-examining, and therefore it would be  
13 those witnesses.

14 THE COURT: Oh, this is just the defendants'  
15 witnesses?

16 MR. GARNER: Just defendants' witnesses.

17 THE COURT: I see. Okay.

18 MR. GARNER: Plaintiff calls David Swift.

19 THE DEPUTY CLERK: Raise your hand, sir.

20 Thereupon,

21 DAVID SWIFT,

22 having been called as a witness for and on behalf of the  
23 Plaintiff, and having been first duly sworn by the Deputy  
24 Clerk, was examined and testified, as follows:

25 DIRECT EXAMINATION

1 BY MR. GARNER:

2 Q. Mr. Swift, I believe you testified earlier that  
3 you have the AA34, A4 contracts?

4 A. Yes, sir.

5 Q. And that's Exhibit 2 -- Plaintiff's Exhibit 2.  
6 Would you turn to Plaintiff's Exhibit No. 2, please?

7 A. Can I get my glasses? Can somebody get my glasses  
8 in the other room? I left them back there. I can't read  
9 without them. Sorry. My arms aren't long enough.

10 (Pause.)

11 Thank you sir. Okay.

12 Q. Do you have Plaintiff's Exhibit 2 there?

13 A. Yes.

14 Q. Let me direct you to the preamble, first  
15 paragraph, second sentence. Do you see where it says it is  
16 to our mutual interest to satisfactorily serve the insuring  
17 public, to comply with all applicable laws, to increase  
18 business commensurate with available potential and to  
19 maintain the company's operations on a profitable basis, in  
20 order to assure the necessary financial strength to protect  
21 the policyholders interest?

22 A. Yes, I do.

23 Q. And in the 35 years that you were an agent, did  
24 you have -- did you make a note -- did you make an  
25 observation as to what this meant in practice in your

1 relations with State Farm?

2       A.     Well, when I was hired by State Farm, they told me  
3 that what we would do is we would be able to write as much  
4 business as we wanted to write, and I think that's what that  
5 says, that we can write as much business as we possibly can.

6       Q.     Let me direct you to Section 1A, where it says the  
7 agent will solicit applications for insurance, collect  
8 premiums, fees and charges, countersign and deliver  
9 policies. It goes on and says assist policyholders and  
10 cooperate with adjusters and advance the interest of the  
11 company, the agents and the policyholders. And did you have  
12 an understanding of what that meant?

13      A.     It appears to me that that's what -- My  
14 understanding would be how we really run our office, what we  
15 do and how we collect the premiums and issue policies or  
16 countersign policies, send policies out and sell the  
17 business, sell as much business as we can.

18      Q.     Okay. Now, you say that you understood that to  
19 mean that you could sell as much business as you could.  
20 Prior to 2000, were there any circumstances under which you  
21 couldn't sell as much insurance as you wanted to?

22      A.     Well, there were some times when we had some  
23 natural disasters, like hurricanes or earthquakes, things  
24 like that.

25      Q.     Would you look at Section 1L of the agreement?

1           MR. REICHLER: Excuse me, Your Honor. Just want  
2 to pose an objection here. This issue of the circumstances  
3 in which State Farm has imposed limitations on the writing  
4 of new business is fully covered in a stipulation to the  
5 Court, and the witness is testifying inconsistently with  
6 what has been stipulated to.

7           THE COURT: I don't know that it's fully covered.  
8 I know that it is covered, and if there is any portion of  
9 the testimony that is covered by the stipulation, I'll hear  
10 your objection.

11          MR. REICHLER: Thank you, Your Honor. Well, the  
12 witness --

13          THE COURT: I didn't know that it purported to  
14 cover comprehensively the entire subject.

15          MR. REICHLER: Well, --

16          THE COURT: Is that what you are telling me?

17          MR. REICHLER: I'm just finding the -- I will  
18 find it quickly, Your Honor.

19          Your Honor, these are -- I can read two of the  
20 stipulations.

21          THE COURT: But the question is whether it's being  
22 covered by the pending question.

23          MR. REICHLER: My objection, Your Honor, was that  
24 the witness has offered testimony that contradicts -- that  
25 the witness -- My objection is that the witness has offered

1 testimony that contradicts the joint pretrial stipulations.

2 THE COURT: What portion is it?

3 MR. REICHLER: These are -- the relevant  
4 stipulations, Your Honor, are at numbers 42 and 43, and  
5 particularly 43.

6 THE COURT: Wait a moment. What page is that?

7 MR. GARNER: 29, Your Honor.

8 THE COURT: 42 and 43?

9 MR. REICHLER: 42 and 43 and 45, Your Honor.

10 THE COURT: Let's have a fresh question,  
11 Mr. Garner.

12 MR. REICHLER: Thank you, Your Honor.

13 BY MR. GARNER:

14 Q. I was going to ask the witness to look at Section  
15 1L of the agreement.

16 A. Okay.

17 Q. And can you read that into the record, sir?

18 A. "We retain the right to prescribe all policy forms  
19 and provisions, premiums, fees and charges for insurance and  
20 the rules governing the binding, acceptance, renewal,  
21 objection or cancellation of risk and adjustment of the  
22 payment of losses."

23 Q. Now, in your 35 years as an agent, did State Farm  
24 ever use this provision or refer to this provision?

25 A. I think they would use it in their daily use of

1 policies. They described the policies, they set the forms  
2 and the premiums, the rights. They do that for every  
3 insurance individual policy.

4 Q. Now, from time to time in the past, when State  
5 Farm curtailed sales as a result of natural disasters, do  
6 you recall the company ever referring to this provision as a  
7 reason for that?

8 A. No, sir, not this provision for that.

9 Q. What did the company say when it curtailed sales?

10 A. It would only say that we lost money or we had a  
11 problem, and that's the reason why they were curtailing the  
12 sales.

13 Q. Now, before 2000, did State Farm ever impose  
14 restrictions on sales of insurance when it was not in  
15 connection with a natural disaster?

16 MR. REICHLER: Objection, Your Honor. That is  
17 covered by the stipulation, 43. Particularly, that State  
18 Farm has imposed the limitations --

19 THE COURT: Well, the question had to do with  
20 whether there were limitations that were not occasioned  
21 because of natural disasters or economic turn-downs.

22 MR. REICHLER: I don't think the question -- If  
23 that were the question, I would not object, Your Honor, but  
24 I thought Mr. Garner excluded the words "or economic  
25 turn-downs" from his question.

1           MR. GARNER: No. I simply said did they ever  
2 impose limitations on sales when it was not in connection  
3 with natural disasters before the year 2000.

4           THE COURT: Well then, the stipulation does say  
5 with economic turn-downs there were restrictions.

6           MR. GARNER: And my question goes to the -- Let  
7 me rephrase it.

8           Your Honor, I'd like the question to stand because  
9 we've got two things here - economic turn-downs and natural  
10 disasters, and I think we need to find out how frequently  
11 any restrictions that Mr. Swift is aware of were  
12 attributable to either cause.

13          THE COURT: I'll permit the question.

14          MR. GARNER: And the question is: Before 2000,  
15 did State Farm ever impose limitations on sales of insurance  
16 when it was not in connection with natural disasters?

17          MR. REICHLER: Objection, Your Honor. That is the  
18 same original question where my objection was sustained. It  
19 is stipulated by Mr. Garner, by his client that they did  
20 impose restrictions.

21          THE COURT: Yes. But apparently he wants to get  
22 into numerosity, and I'm going to permit that on a limited  
23 basis. The objection is overruled.

24          MR. GARNER: Can you answer the question?

25          A. Yes, they did impose limitations in some smaller

1 and limited areas. They did impose limitations, yes.

2 Q. Now, after 2000, did State Farm impose  
3 restrictions on sales in circumstances where it did not  
4 involve natural disasters?

5 A. I'm sorry. Would you do it again? I didn't hear  
6 you.

7 Q. After 2000, did it impose restrictions on sales in  
8 circumstances that did not involve natural disasters?

9 A. Yes, it did.

10 Q. And what did it do?

11 A. Well, it stopped writing in 43 states.

12 Q. And what types of insurance did it stop selling?

13 A. Homes and fire insurance mainly.

14 Q. Now, did it stop selling home and fire in Texas?

15 A. Yes, it did.

16 Q. And how much of your income does that represent?

17 MR. REICHLER: I have an objection here, Your  
18 Honor, because the State Farm company that does business in  
19 Texas is not a party to this lawsuit.

20 THE COURT: Again, I don't have any evidence of  
21 that. You are giving me testimony that the insurance is  
22 written by a company that is not a defendant. That's not  
23 before me in the form of testimony. So, the objection is  
24 overruled.

25 MR. REICHLER: Thank you, Your Honor.

1 BY MR. GARNER:

2 Q. How much of your income does that represent?

3 A. About 40 to 45 percent of my income is based on  
4 fire insurance, but that's not all. When we can't write  
5 fire insurance, it also affects our auto coverage, so we  
6 can't write auto, and people won't take their auto with you  
7 if they can't take their fire with you. So, that does work  
8 into a problem when we don't have that, and --

9 Q. Did State Farm, when it imposed these restrictions  
10 in 43 states, did it say why they were imposing the  
11 restrictions?

12 A. Said they lost money.

13 Q. Do you know whether they were losing money?

14 A. I know they lost a great many -- billions of  
15 dollars in the stock market in investments that year.

16 Q. Okay. Do you know whether they lost money in  
17 underwriting?

18 A. Yes, I'm sure they lost money in underwriting, but  
19 no more than they had in previous years when they hadn't put  
20 restrictions in.

21 Q. How long did the restrictions imposed in 2000  
22 continue in effect?

23 A. Well, today they are still in effect in Louisiana.  
24 And home insurance, I can't write it; and in Texas we have  
25 limits to what we can do in Texas. I am limited to write 62

1 homeowners policies a year is what I'm allowed to write.  
2 They don't write any home insurance on the coast and they  
3 don't allow us -- They allow us to write one fire policy and  
4 rental dwelling policy in Texas.

5 (Court reporter interrupts.)

6 I'm sorry, a rental dwelling policy in Texas. So  
7 if someone comes to me with four or five policies, rental  
8 houses they want me to insure, I can only insure one of them  
9 because that's all State Farm will let me do.

10 Q. And what is the effect of these restrictions on  
11 you as an agent?

12 A. As an agent? Well, it did several things. One of  
13 them, it killed my centers of influence because over my 35  
14 years period of time, I had worked on developing centers of  
15 influence who would send me business, refer business to me  
16 -- the realtors, the mortgage companies, whatever friends  
17 would send business to me, but over that period of time when  
18 we couldn't write business, they started sending that  
19 business elsewhere. So, I lost those centers of influence.

20 Q. Were you able to sell apartment insurance?

21 A. No, sir. What happened to me on apartment  
22 insurance is they stopped writing commercial insurance for  
23 apartments back in '95, and what it did to me was my income  
24 in '95 was \$385,000, and today my policy count went from  
25 1657 fire policies down to 1106 fire policies. I lost 550

1 fire policies, and that's a third of my fire policy  
2 production that I lost, and my income went than from 385 to  
3 268, and now it's higher because of rate increases.

4 Q. In the ordinary course, do you have attrition of  
5 policies?

6 A. Yes. The normal rate of attrition is about  
7 anywhere from 12 to 15 percent a year, which means that you  
8 would lose -- over a three-year period of time, you could  
9 lose 36 percent if it was 12 percent attrition rate.

10 Q. And as an agent for 35 years, have you observed  
11 how frequently a policyholder will come back to you once  
12 they have left?

13 A. Almost never.

14 Q. Do you still have any restrictions in Texas?

15 A. Yes, I do.

16 Q. Now, I believe you testified earlier that you had  
17 been the president of NASFA. Is that correct?

18 A. That's correct.

19 Q. And when were you president?

20 A. Let's see. 2002 through 2004.

21 Q. And during that period of time, were restrictions  
22 in effect in various states?

23 A. Yes, they were.

24 Q. And as part of your duties as president of NASFA,  
25 did you communicate with agents with respect to

1 restrictions?

2 A. Yes, I did.

3 MR. REICHLER: Objection, Your Honor. This is  
4 calling for hearsay.

5 THE COURT: Well, he hasn't asked any question yet  
6 that involves hearsay.

7 MR. REICHLER: He asked him about his  
8 communications with other agents.

9 THE COURT: Yes. He said he had communications.  
10 That's not hearsay.

11 MR. REICHLER: That's correct. I jumped the gun,  
12 Your Honor. I apologize.

13 BY MR. GARNER:

14 Q. And was it part of your regular duties to  
15 communicate with these agents about restrictions?

16 A. Yes. It was to answer their questions, their  
17 problems.

18 Q. And was it part of your duties to hear their  
19 problems?

20 A. Yes.

21 Q. And generally speaking, what did you hear from the  
22 agents in your capacity as president of NASFA and in the  
23 regular course of your business as president of NASFA?

24 MR. REICHLER: Objection, Your Honor. That does  
25 call for hearsay.

1 THE COURT: I never heard of an oral business  
2 records exception. I've heard of a business record  
3 exception, which contemplates that it's in writing.

4 MR. GARNER: Uh-huh. Mr. --

5 THE COURT: You have asked him whether he had  
6 conversations.

7 MR. GARNER: Okay.

8 THE COURT: And the objection will be sustained.

9 MR. GARNER: I'll try to cure that.

10 Did you receive any written communications from  
11 agents during the time you were president?

12 A. Yes.

13 Q. With respect to restrictions?

14 A. Yes.

15 Q. And were those written communications that you  
16 received in the regular course of your business?

17 A. Yes.

18 Q. And what did the agents tell you about  
19 restrictions?

20 MR. REICHLER: Objection, Your Honor. This is  
21 not --

22 THE COURT: Objection sustained. If you've got  
23 the records, produce them.

24 MR. GARNER: Okay.

25 THE COURT: The exception is for the admissibility

1 of records that otherwise would be hearsay.

2 BY MR. GARNER:

3 Q. Now, you mentioned before that State Farm had  
4 experienced these losses after 2000. Are there ways that  
5 you are aware of, other than the withdrawal from the market,  
6 that State Farm can cut its losses?

7 A. Well, yes, they can do that by -- What they did  
8 is, they raised their rates. That's one way they can do it  
9 - reduce their losses by raising rates. They also increased  
10 the deductibles, to make larger deductibles, so that if you  
11 had a claim, that the policyholder was -- don't have to pay  
12 more of the claim. So that helped reduce losses.

13 Q. Do you have to obtain the state's permission in  
14 Texas to raise rates?

15 A. No, sir. We have what's called a band and rates  
16 system, and as long as you charge what's inside that band,  
17 you don't have to ask the state for permission to raise the  
18 rates.

19 Q. Are there other means of limiting losses by an  
20 insurance company?

21 A. Well, there is -- I mean you can exclude things.  
22 Like we had a mould problem in Texas, and the company --

23 (Court reporter interrupts.)

24 Mould -- M-O-L-D, I'm sorry -- Mould claims in  
25 Texas, and the company excluded mould and water damage

1 coverage from the policies. And along our Gulf Coast, the  
2 homeowners policies that were written a long time ago that  
3 are on the coast now, the company has excluded the wind and  
4 hail and we have to write that through the Texas wind storm  
5 pool. It's a separate deal. And they have, of course,  
6 excluded flood. So, that basically covers the hurricanes  
7 down there on the coast. They have excluded that. But I  
8 don't know why they won't write -- homeowners still down  
9 there they only cover them for fire and theft and liability,  
10 but they still won't write it, though. They have excluded  
11 those coverages.

12 Q. Do these restrictions have any effect on agents  
13 generally?

14 A. Well, yes. If you are an AA34 contract agent,  
15 then what happens is your retirement is based on your last  
16 year's income, and if the restrictions are in place and it  
17 forces your income to go down, then what will happen is your  
18 retirement is going to go down too. So I know a lot of  
19 agents that gave up their agencies because of that. Because  
20 of the restrictions, they were afraid they were going to  
21 lose more money, so they --

22 MR. REICHLER: Objection, Your Honor. This is  
23 hearsay. It's what other agents told him, exactly the kind  
24 of --

25 THE COURT: Well, he may know. I don't know

1 whether he knows for a fact that an agent gave up the  
2 business.

3 MR. REICHLER: If he would -- if he knows because  
4 another agent said this to him.

5 THE COURT: If you know, sir.

6 THE WITNESS: Yes, sir, I do know.

7 THE COURT: The objection is overruled. Let's  
8 proceed, Mr. Garner.

9 MR. REICHLER: May I be heard briefly?

10 THE COURT: No, sir. I've heard you.

11 BY MR. GARNER:

12 Q. Mr. Swift, you've testified to the various effects  
13 of these restrictions on agents. Is that something that you  
14 have observed personally?

15 A. Yes, I have.

16 Q. And that's in more areas than Texas; is that  
17 right?

18 A. That's correct.

19 Q. And, now, many of these restrictions have ceased  
20 to be in effect today; is that right?

21 A. Right.

22 Q. And so why is it still an issue to NASFA?

23 A. Well, if it's still in the contract that they can  
24 establish restrictions at any time they want to, then it  
25 really does limit what an agent can do and really concerns

1 the agents that they call these limitations and you could be  
2 out of business. That's why the brokering issue was such an  
3 important thing to tie with the restrictions because without  
4 that, if they restrict us, we are in trouble.

5 MR. GARNER: Nothing further.

6 THE COURT: Mr. Reichler.

7 MR. REICHLER: Thank you, Your Honor.

8 May I just consult with Ms. Altschuller for 30  
9 seconds?

10 THE COURT: Yes.

11 (Brief pause.)

12

13 CROSS-EXAMINATION

14 BY MR. REICHLER:

15 Q. Mr. Swift, you remember when at your deposition I  
16 asked you about other agents whom you alleged had been  
17 adversely affected or forced out of business as a result of  
18 the restrictions?

19 A. Yes.

20 Q. And do you remember that in every case when I  
21 asked you how you knew about this, you told me that it was  
22 because the particular agent told you this? Don't you  
23 remember that?

24 A. Yes.

25 MR. REICHLER: Your Honor, I would beg the Court

1 to reconsider my objection to the testimony that was  
2 offered, now that the witness has indicated that it is based  
3 on hearsay.

4           THE COURT: This is a nonjury trial, Mr. Reichler.  
5 I'll recognize that this is hearsay. I'll allow the  
6 testimony to stand.

7           MR. REICHLER: Thank you, Your Honor.

8           In 2001, 2002, State Farm suffered losses of  
9 approximately eight billion dollars; isn't that true?

10          A.     That's correct.

11          Q.     And part of the eight billion dollar loss was  
12 attributable to reduced investment income because of the  
13 decline of the stock market; correct?

14          A.     That's correct.

15          Q.     Part of it was due to rising costs and the fact  
16 that rates didn't rise fast enough to keep pace with the  
17 rising costs that State Farm incurred; correct?

18          A.     That's correct.

19          Q.     And part of it was due to the rapid growth in new  
20 policies generated in the late 1990s, which produced  
21 substantial increases in expenses, claims and risk exposure;  
22 correct?

23          A.     I don't know that.

24          Q.     You don't know?

25          A.     No, I don't know that.

1 Q. In 2001, State Farm paid out \$1.25 claims for  
2 every one dollar that it brought in, didn't it?

3 A. I don't know.

4 Q. When insurance companies like State Farm are  
5 losing money, one of the remedial measures that they employ  
6 is to limit the number of new insurance policies they sell,  
7 at least until they are able to raise rates or cut expenses  
8 so that they can operate profitably again; isn't that true?

9 A. Could be.

10 Q. Sometimes the insurance company puts limits on the  
11 number of new policies it will sell, or sometimes it stops  
12 selling a certain kind of insurance altogether, or it stops  
13 selling in a particular geographic area; correct?

14 A. That's correct. I think I stated that earlier.

15 Q. In the 1990s when you were a State Farm agent, you  
16 sold commercial insurance covering apartment buildings?

17 A. That's correct.

18 Q. And after a while, the company determined -- this  
19 is in the mid 1990s; is that correct?

20 A. That's right.

21 Q. The company determined it couldn't sell this kind  
22 of insurance profitably, so it eventually got out of the  
23 market?

24 A. That's correct, and wouldn't let us write it with  
25 anybody else.

1 Q. And really, there wasn't anything you could do  
2 about it because it's up to the company whether to sell a  
3 particular kind of insurance, how much of it to sell, what  
4 rates, consistent of course with the legal and regulatory  
5 requirements; correct?

6 A. That's right. That's exactly what they can get  
7 out of it, do what they want to.

8 Q. Whenever State Farm sells a new policy, there is  
9 income but there's also expenses and risks associated with  
10 selling that new policy; correct?

11 A. Yes.

12 Q. And with every sale of a policy, the company may  
13 increase its expenses and its exposure to loss; correct?

14 A. Could be, yes.

15 Q. Not every policy sold is profitable?

16 A. Not every one, no.

17 Q. So it's not always in State Farm's interest or any  
18 insurance company's business to write as much business as  
19 possible; correct?

20 A. That I don't know.

21 Q. And the contract you signed gives State Farm the  
22 final decision whether to write the new business or not?

23 A. Yes.

24 Q. Now, in 2001, 2002, because of the extreme  
25 financial condition in which the company found itself, it

1 decided to limit its sales of auto and fire insurance in  
2 most states; correct?

3 A. That's correct.

4 Q. And that was to avoid losing even more money;  
5 correct?

6 A. I don't know that that was what it was for, but  
7 they limited the sales; that's correct.

8 Q. But they said it was in order to avoid losing more  
9 money; correct?

10 A. That's what they said. That's correct.

11 THE COURT: We'll overlook that that's hearsay  
12 also, Mr. --

13 BY MR. REICHLER:

14 Q. The precise limitations varied from state to state  
15 and within states, depending on the company's assessment of  
16 each geographic market and in particular how much new  
17 business it could afford to take on at existing --

18 (Court reporter interrupts.)

19 The precise limitations established by State Farm  
20 varied from state to state and within states; correct?

21 A. That is correct.

22 Q. And it depended on the company's assessment of  
23 each particular geographic market and how much business the  
24 company felt it could afford to take on at existing rates;  
25 correct?

1 A. That's correct.

2 Q. And that meant in some markets, it could not  
3 afford to take on any new business at all; correct?

4 A. Yes.

5 Q. But at the same time as it was imposing these  
6 temporary limitations on new business, the company was  
7 working to achieve rate adequacy in all markets; correct?

8 A. I don't know that. I think they were trying to  
9 raise the rates.

10 Q. And what they were trying to do is to increase the  
11 rates, as needed, to cover expenses, claims and risks, so  
12 that they could return to profitable operations and resume  
13 selling more insurance; correct?

14 A. Yes, I hope so.

15 Q. And as it turned out, when the company did achieve  
16 rate adequacy in most markets, it removed the limitations on  
17 the selling of new fire and auto policies; correct?

18 A. No, sir, there are still limitations on states  
19 right now currently.

20 Q. Yes. In three states; correct?

21 A. Well, I don't know. I know in New Orleans -- I  
22 mean Louisiana, California can only write when they lose  
23 one, and Texas we still have restrictions also.

24 Q. But in most of the 40 states, the limitations were  
25 eliminated; right?

1 A. I don't know, no. I don't know that.

2 Q. You don't know one way or the other; is that  
3 correct?

4 A. No, that's correct.

5 Q. Mr. Swift, I'd like you to take a look at Exhibit  
6 D-46 which is Defendants' 46. I believe it's in the white  
7 three-ring binder. Do you have that before you?

8 A. Yes, uh-huh.

9 Q. Oh, may I wait while the plaintiff's counsel finds  
10 it, Your Honor?

11 THE COURT: Yes.

12 MR. HILLMAN: If it please the Court, I lent  
13 defense counsel our defendant's exhibit book, and now we  
14 have to get another one.

15 (Brief pause.)

16 MR. GARNER: Okay.

17 MR. HILLMAN: Sorry for the delay, Your Honor.

18 BY MR. REICHLER:

19 Q. Mr. Swift, I'd like to -- You testified about the  
20 impact of the restrictions on your business?

21 A. That's correct.

22 Q. Recent restrictions. I'd like you to take a look  
23 at Exhibit D-46, and let me refer you to a particular page.  
24 Counting separately each side of the page, it's the 16th  
25 page.

1 THE COURT: Are you saying 16 separate pages?

2 MR. REICHLER: No. It's of the -- No, 16  
3 counting each side of the page as separately. So it would  
4 be, I believe, around the eighth leaf. Have you found it?

5 A. Yes, I have.

6 Q. Mr. Swift, do you know what this document is, this  
7 page is?

8 A. The one that has my income on it or the one that  
9 has just my history on it?

10 Q. Well, it says earnings history summary,  
11 confidential, David M. Swift?

12 A. Right. That's correct.

13 Q. Is this an accurate reflection of your income  
14 earned as a State Farm agent?

15 A. It appears to be.

16 Q. So that when the restrictions -- your income  
17 actually increased from the year 2000 to just before the  
18 restrictions went into effect from approximately \$277,000 in  
19 the year 2000, and in 2001 you earned more; is that correct?

20 A. Yes.

21 Q. And then in 2002, you earned even more than you  
22 did in 2001?

23 A. That's correct.

24 Q. So your income did, in fact, go up during the  
25 period of these restrictions on writing new business --

1       A.     Yes, because the rate increases went up perhaps 45  
2 percent.  So that would have a tendency to raise my income  
3 by that much.  I lost policies, policy count, yes.

4       Q.     But I believe your answer is yes, your income did  
5 go up during the period the restrictions were in effect?

6       A.     Well, --

7            THE COURT:  He needed to explain his answer, sir.

8       A.     My income is down this year.  I am down \$7,000  
9 because rates are going down and my policy count is down.  
10 So I am down \$7,000 so far this year; and if it keeps up,  
11 I'll be down \$14,000.

12       Q.     Do you have any documents to prove that?

13       A.     Yes, I do.

14       Q.     Do you have them with you?

15       A.     Yes, I do.  Want to see them?

16       Q.     Not while we're on.  I don't want to take up the  
17 Court's time.  Maybe during a recess you can show me.  But  
18 this document is correct that your income did go up during  
19 the period 2000 to 2001, 2001 to 2002, and then it went up  
20 again from 2002 to 2003; correct?

21       A.     That's correct.  Because of rate increases, that's  
22 correct.

23       Q.     Now, can you please turn to the very first page of  
24 Exhibit -- Defendant's 46?

25            THE COURT:  First page?

1 MR. REICHLER: Yes, the first page of Exhibit  
2 D-46.

3 A. Yes.

4 Q. Are you aware what this exhibit is?

5 A. It appears to be the -- says five-year history of  
6 average earnings.

7 Q. And this is for all independent contractor agents  
8 of State Farm; correct?

9 MR. GARNER: Your Honor, I'm going to object to  
10 having the witness testify about a State Farm document that  
11 he didn't generate and that he's apparently not familiar  
12 with. It's in evidence.

13 THE COURT: Well, it's not in evidence yet.

14 MR. REICHLER: It is in evidence.

15 THE COURT: It is in evidence?

16 MR. REICHLER: Yes.

17 THE COURT: Then if it is in evidence, let me hear  
18 what the question is going to be, Mr. Garner, and --

19 MR. GARNER: Very well.

20 THE COURT: -- you may object to a particular  
21 question.

22 MR. GARNER: Thank you.

23 BY MR. REICHLER:

24 Q. Do you have any reason to doubt that agents  
25 average earnings, the average earnings of State Farm agents,

1 all State Farm agents increased from 1998 to 1999, again  
2 from 1999 to 2000, again from 2000 to 2001, again from 2001  
3 to 2002 and again from 2002 to 2003?

4 A. No, I don't.

5 Q. And just one more, and I'll ask you the same  
6 question and then we'll finish with this. Can you take a  
7 look at the second page? I'm sorry, the fourth page of this  
8 exhibit. And the fourth page of the exhibit, do you have  
9 any reason to believe that the information set forth here  
10 showing the average earnings of State Farm agents in Texas  
11 went down from 1998 to 1999 before the restrictions were in  
12 place?

13 THE COURT: Pardon me.

14 MR. REICHLER: Went down from 1998 to 1999. Went  
15 up from 1999 to 2000 slightly, and then during the period of  
16 the restrictions went up from 2000 to 2001 and then went up  
17 again from 2001 to 2002. Do you have any reason to doubt  
18 that data?

19 A. No. It looked like the fire insurance commissions  
20 went way up. That's when the premiums were increased.

21 Q. And your commissions that you earn are based on a  
22 percentage of the premiums; correct?

23 A. That's correct.

24 Q. So, all other things being equal, if State Farm  
25 raises the premiums, that will raise your commission income;

1 correct?

2 A. That's correct, unless we lose policies. Then we  
3 are in trouble.

4 Q. Now, your retirement income that you've talked  
5 about, --

6 A. Right.

7 Q. -- that's based on your last year's annual income;  
8 correct?

9 A. That's correct.

10 Q. So it's not based on the number of policies you  
11 have, it's based on your income?

12 A. That's correct.

13 Q. So, if you were to lose policies heading toward  
14 your last year, but if your income were to go up so that  
15 your policy count were lower but your income were higher in  
16 last year prior to retirement, your retirement would be  
17 higher, not lower?

18 A. Well obviously, but if the rates go down, then  
19 just the reverse would be true.

20 Q. Now, really the last question. Mr. Garner had you  
21 read from the preamble to your AA 4 agreement?

22 A. Do you know what exhibit that was?

23 Q. It's Exhibit - Plaintiff's 2.

24 A. Okay.

25 Q. Really, from the same preamble that Mr. Garner had

1 you read, would you read -- follow along in the first  
2 paragraph, where it says it is to our mutual interest to  
3 satisfactorily serve the insuring public, to comply with all  
4 applicable laws, to increase business commensurate with the  
5 available potential and to maintain the company's operations  
6 on a profitable basis, in order to assure the necessary  
7 financial strength to protect the policyholders interest.

8 Do you see that language?

9 A. I see that.

10 Q. So you agree that one of the objectives of this  
11 contract, your contract, is to maintain the company's  
12 operations on a profitable basis; correct?

13 A. Sure. I was a silver scroll agent with ten years  
14 profitability. For ten years in a row, I made profits, so  
15 yes, I am aware of profitability.

16 Q. Yes. I appreciate that, and I congratulate you on  
17 your achievement and wish you continued success, but the  
18 profitability that is talked about in the preamble is the  
19 company's profitable?

20 A. Well, that's exactly what the silver scroll is.  
21 If you understand that, that's me making a profit for the  
22 company; not my profit, making profit for State Farm.

23 Q. I'm a little confused. Would you agree with me  
24 that one of the objectives of the contract you signed is to  
25 maintain the company's operations on a profitable basis?

1 A. That's what I tried to say. Okay? The silver  
2 scroll agent means I have made the company profits for 10  
3 years in a row. I understand that.

4 Q. Okay. And also, one of the objectives of the  
5 contract that you signed and you understand to be one of the  
6 objectives is to assure that the company remains  
7 sufficiently strong financially to protect the policyholders  
8 interests?

9 A. Absolutely.

10 Q. The entity of State Farm that actually imposed the  
11 limitations on writing of the fire insurance business in  
12 state of Texas where you operate is State Farm Lloyd's,  
13 isn't it?

14 A. That's correct.

15 THE COURT: State Farm what?

16 MR. REICHLER: State Farm Lloyd's, L-L-O-Y-D-'S.

17 A. Yes.

18 Q. So the limitations that you have been complaining  
19 about that are still in effect prevents you from writing the  
20 policies -- I think you mentioned rental apartments or --

21 A. Rentals, apartments, houses and et cetera.

22 Q. All of that insurance is actually provided by  
23 State Farm Lloyd's in Texas?

24 A. In Texas, yes.

25 Q. And so that's the -- all of those limitations or

1 restrictions on writing that kind of business were imposed  
2 by State Farm Lloyd's; correct?

3 A. Probably by State Farm or State Farm Lloyd's, but  
4 it was imposed on the agents up in Texas, yes.

5 Q. By State Farm Lloyd's. Yes?

6 A. It was writing State Farm Lloyd's business, but I  
7 think they were imposed by the company. The memos came from  
8 the company, not from State Farm Texas Lloyd's.

9 Q. And you are aware, are you not, that State Farm  
10 Lloyd's is not a party to this lawsuit? Correct?

11 A. No, I'm not.

12 Q. You don't know whether they are or not?

13 A. No, I don't know.

14 MR. REICHLER: Okay. Thank you. No further  
15 questions.

16

17 REDIRECT EXAMINATION

18 BY MR. GARNER:

19 Q. Mr. Swift, Mr. Reichler showed you a chart that  
20 showed your income for a number of years. Did that chart  
21 bring it up from 2002 up to 2005?

22 A. No, it did not.

23 Q. And how has your income changed, if at all, from  
24 2002 to 2005?

25 A. It's up from 2002 to 2005. It's just down this

1 year by some \$7,000.

2 Q. Yes. And since 2000 has your policy count gone up  
3 or down?

4 A. No, it's gone down.

5 Q. And if your policy count had not gone down and  
6 everything else had remained -- it remained or changed the  
7 way it did, what would have happened to your income?

8 A. It would have been up dramatically.

9 MR. GARNER: Nothing further.

10 THE COURT: If there is nothing further, the  
11 witness will be excused.

12 MR. REICHLER: Thank you, Your Honor.

13 THE COURT: All right, we'll take the mid-morning  
14 recess and resume in 15 minutes; that is, quarter to 11:00.

15 (Court recess. 10:30 a.m.)

16 (Proceedings resumed. 10:45 a.m.)

17 THE COURT: Mr. Garner, do you have any further  
18 witnesses?

19 MR. GARNER: No further witnesses, Your Honor.

20 THE COURT: Mr. Reichler.

21 MR. REICHLER: Thank you, Your Honor. We would  
22 like to call to return to the stand Mr. Charles, Chuck,  
23 Wright.

24 THE DEPUTY CLERK: Sir, you've already been sworn.  
25 Please be seated. You remain under oath.

1           Thereupon,

2                           CHARLES WRIGHT,

3 having been called as a witness for and on behalf of the  
4 Defendants, and having been previously sworn, was examined  
5 and testified, as follows:

6

7                           DIRECT EXAMINATION

8           BY MR. REICHLER:

9       Q.     Good morning, Mr. Wright.

10      A.     Good morning.

11      Q.     Mr. Wright, when you were chief agency officer of  
12 State Farm prior to your retirement, did you serve on the  
13 Chairman's Council?

14      A.     Yes, I did.

15      Q.     Who else sits on the Chairman's Council?

16      A.     The Chairman's Council was comprised of the chief  
17 financial officer, the chief agency officer, the chief  
18 executive of the organization, the chief operating officer,  
19 chief legal counsel, the chief administrative officer, the  
20 heads of the various business units -- like the head of the  
21 life company, the head of the fire company, and so on -- and  
22 several other senior vice presidents.

23           MR. REICHLER: I notice, Your Honor, that the  
24 witness is sitting back in the chair. Is he close enough to  
25 the microphone?

1 THE COURT: Yes. Yes, he is.

2 MR. REICHLER: Okay. Then remain in place. I  
3 don't mean to disturb you, Mr. Wright.

4 And what did the Chairman's Council do?

5 A. Well, first I should say it is not a governing  
6 body, it was designed for the CEO to get feedback, it was  
7 designed for communication. There were opportunities for  
8 various members to vent major activities and plans for the  
9 organization, and the group spent a lot of time looking at  
10 profit and loss and production.

11 Q. Do you know what the financial condition of State  
12 Farm was in 2001, 2002?

13 A. Yes, I do. The surplus of the overall  
14 organization remained adequate at that period of time, but  
15 it was declining. We lost five billion dollars -- over five  
16 billion dollars in 2001, and two and a half billion dollars  
17 in 2002, and we were in a trend that could definitely not  
18 continue for the financial health of the organization.

19 Q. What were the causes of those losses?

20 A. Well, there were a number of causes. The  
21 principal ones were unprecedented claim severity, rising  
22 costs. We had rapid growth, we had an investment area that  
23 was achieving lower rates than it had previously, and rate  
24 inadequacy.

25 Q. Let me just see if I can ask you to explain those

1 a bit one at a time. What do you mean when you say  
2 increased claim severity?

3 A. Claim severity is a measure of the average cost  
4 per claim, and our claim severity, our average cost per  
5 claim was going right through the roof at that period of  
6 time.

7 Q. Do you have any numerical measurements, any  
8 specific numbers that you can tell us about?

9 A. Not with me at this point in time, at least in  
10 terms of claim severity, but it was going -- it was  
11 unprecedented.

12 Q. Why did claim severity increase in that fashion,  
13 if you know?

14 A. Well, claim severity was going up because of  
15 rising repair costs and medical costs, doctor costs  
16 associated with injuries that were going up rapidly, and of  
17 course increased litigation was a part of that too.

18 Q. When you say rising repair costs, repair of what?

19 A. Repair of autos. Cars that were being built were  
20 being built in a more sophisticated manner that made them  
21 more difficult to repair. They were more susceptible to  
22 damage because of the materials that were being used in  
23 them.

24 Q. What do you mean when you use the term "rate  
25 inadequacy," and how did that concept apply to State Farm at

1 the time?

2 A. Well, very simply, rates are inadequate when the  
3 amount of money that's being taken in is not adequate to  
4 meet the expenses and claim costs that are also a part of  
5 that policy.

6 Q. Was that happening at State Farm?

7 A. Very definitely. We found ourselves rate  
8 inadequate in most jurisdictions because of these conditions  
9 that were going on.

10 Q. What caused the reduced investment income?

11 A. That was really a function of the marketplace.  
12 Everyone recalls that the stock market was in a definite  
13 down turn at that point in time, and at the same point  
14 rates, interest rates, were going to historical lows, and  
15 that of course affected the bond market and which were our  
16 major investors.

17 Q. You mentioned rapid growth as a factor in all of  
18 this?

19 A. Yes, rapid growth was a factor. When you are  
20 growing rapidly, when you are taking on a lot of new  
21 business, there are costs associated with absorbing that  
22 business, underwriting and other expenses. Furthermore,  
23 there is inevitably some slippage of the quality of business  
24 that's coming on board when you are taking on that volume of  
25 business. And finally, for reasons that no one has ever

1 quite been able to understand, a block of new business tends  
2 to be less profitable than an existing or seasoned block of  
3 business. And that's not just for State Farm, that's for  
4 all companies.

5 Q. Why couldn't you just raise the rates all around  
6 to take care of this?

7 A. Well, that would have been nice, but in most  
8 jurisdictions in which we operate, we must seek prior  
9 approval of rates, and then there are also some  
10 jurisdictions in which there is a particular situation that  
11 rates alone are not going to correct, such as was the case  
12 in Texas, where in a very short period of time we paid out  
13 over a billion dollars in mould claims.

14 THE COURT: In mould?

15 THE WITNESS: Mould claims. Do you want any  
16 amplification of that, Your Honor?

17 THE COURT: Yes.

18 THE WITNESS: In Texas, the insurance form on the  
19 homeowners policy had been approved by, and in fact was used  
20 by all companies. It was a statewide form that had been  
21 promulgated by the insurance department, and everybody  
22 thought that mould was not covered, and there was a court  
23 case in Texas involving an ensured -- Farmers Insurance  
24 Group, and all of a sudden mould became part of the policy,  
25 and about 18 months later a billion dollars of claims for

1 State Farm later, and we found ourselves with a significant  
2 problem. And my point simply was that with rates, we  
3 couldn't have possibly raised rates enough in that brief  
4 period of time to take care of that problem.

5 Q. What steps did the company take to -- in response  
6 to these losses that you described?

7 A. Well, we did a number of things, and we did them  
8 very diligently, we did them as quickly as we could. We  
9 attacked expenses on every front. We also became very  
10 aggressive at taking rates wherever we possibly could. We  
11 also did a lot of reinspection of business. We had been  
12 doing some previously, but we stepped up our reinspection  
13 efforts because there are times that you find on-board  
14 business that no longer meets the standards that you set for  
15 them coming on board - people who have had numerous  
16 accidents or people whose driving record has deteriorated,  
17 things of that sort. And finally, we placed limitations on  
18 the new business that was coming in.

19 Q. On what basis did the company place limits on the  
20 new business that was coming in?

21 A. Well, based on our contractual right to do so.

22 Q. And without going into detail, are you able to  
23 identify the place in the contract where that is  
24 established?

25 A. Yes. I believe you find that in Section 1L in the

1 agreement, the agents agreement.

2 Q. Is the insurance business like other businesses,  
3 where the more you sell, the better off you are?

4 A. I wish it were, but it's not. Unfortunately, when  
5 the cash register rings for us, we simply know that we've  
6 taken on an obligation and we have an amount of money to  
7 handle that, but we don't know until the end of the policy  
8 term, the end of the six months or the end of the year  
9 whether or not the business that we've taken on board and  
10 the money we've taken for that is going to be sufficient to  
11 handle the claims and the expenses. That's not like any  
12 other business, where typically you sell something and you  
13 know you've made money that day.

14 Q. Why did the company limit agents production of new  
15 policies in 2002?

16 A. Well, as I said earlier, there were a combination  
17 of things that we did to attack this large problem, and we  
18 felt that taking on a more limited amount of new business  
19 was absolutely necessary. For one thing, we were getting  
20 signs and signals from the rating companies, in terms of a  
21 down grade, and in the case of one rating company and a  
22 warning from another about the adequacy of our finances.  
23 And that's a state of affairs you don't want to have as an  
24 insurance company, and we felt that we had to limit our  
25 growth during that period of time until our financial health

1 was once again secure enough to take on new business in the  
2 volume that we had been in 2000 and 2001.

3 Q. What do you mean by rating? Is it rating company?

4 A. Rating agencies. Best's rating agency, Standard  
5 and Poor's are among the rating agencies that give you a  
6 financial rating, and these ratings are very important  
7 because the insurance departments and the lenders look at  
8 them in terms of policies coming to them. For example,  
9 there are certain companies that wouldn't be able to have  
10 their policy used by a mortgage company in the case of  
11 homeowners insurance because their ratings aren't solid  
12 enough for the lender to accept them.

13 Q. Can you be a little bit more specific about how  
14 the ratings at State Farm resulted?

15 A. Well, in the case of State Farm Mutual, we  
16 retained the highest possible rating but with a negative  
17 outlook instead of a positive outlook, and in the case of  
18 State Farm Fire and Casualty, one of the rating agencies  
19 actually downgraded us at one point.

20 Q. Were the limitations on new business at State Farm  
21 set? Were they uniformed across the country?

22 A. No, they were not. Each state is different. Our  
23 rates are set by state and by territory within states, and  
24 there were different points of rate adequacy in these  
25 different state. Our losses were different in different

1 states and rating territories, and so we targeted our  
2 actions toward those territories within each state.

3 Q. Who decided what the specific limitations would be  
4 in each state or market area?

5 A. Well, it was really a collaborative effort between  
6 the zone management led by each of the zone vice presidents,  
7 his or her team of people, and then also the team in  
8 corporate comprised of actuary, general underwriting  
9 department and members of the Chairman's Council.

10 Q. And how did they decide what specific limitations  
11 to set?

12 A. Well, there were very specific targets based on  
13 the historical lost trend and the state and the territory,  
14 based on our rating adequacy, and we gave each one of the  
15 zones a target in auto insurance that gave them some  
16 flexibility. They were required to come up with a plan that  
17 targeted at least a zero or break-even point in auto  
18 insurance and up to three percent operating profit. In fire  
19 insurance, the targets ranged from just under five percent  
20 in 2001 to eight percent in 2004.

21 Q. And how do those -- how did the limitations  
22 relate to those targets?

23 MR. GARNER: Your Honor, I'm going to object.  
24 There's really no foundation for this witness' knowledge of  
25 the decision-making process.

1 MR. REICHLER: I'll ask him the question.

2 MR. GARNER: There's other testimony, and it's  
3 been --

4 THE COURT: He said he was on the Chairman's  
5 Council, and he said the Chairman's Council was in on the  
6 decisions --

7 MR. GARNER: Very well, Your Honor. I'll withdraw  
8 the objection.

9 THE COURT: -- with respect to the rates and  
10 restrictions.

11 MR. GARNER: I'll withdraw the objection.

12 BY MR. REICHLER:

13 Q. I think my question was what relationship, if any,  
14 was there between those profitability targets that you  
15 mentioned and the specific limitations on writing new  
16 business.

17 A. Well, they were very specific because as the plans  
18 came in from each zone, and particularly in 2001, where we  
19 were in the midst of this loss cycle, heavily into this loss  
20 cycle, some of the zones were so rate inadequate that they  
21 were having trouble coming up with a plan that would show a  
22 profit, and in those instances we went back to the zones and  
23 said you're going to have to find a way, whether it's  
24 cutting expenses, whether it's doing more re-underwriting or  
25 you may have to cut back even further on new production.

1 Q. And was there a process by which these decisions  
2 were made about the establishment of the limitations?

3 A. Yes. The process that I just described - a  
4 collaborative process where all of these factors were  
5 reviewed and then finally approved by the Chairman's  
6 Council.

7 Q. At the time the limitations were put in place, how  
8 long did you expect to keep them?

9 A. Well, we were anxious to restore the financial  
10 health of the organization and to get ourselves back to  
11 being rate adequate in all of these areas. So, we only  
12 intended to use them until that point. Frankly, as we got  
13 into this thing heavily in 2001, we expected that it would  
14 probably be five or six years, perhaps longer in some  
15 jurisdictions, before that would happen. Fortunately,  
16 because of the strong cooperation of everybody and the  
17 partnership that was a part of this with operations and  
18 agency people, we were able to turn this loss cycle around  
19 much quicker.

20 Q. What do you mean by partnership?

21 A. Well, by partnership I'm talking about the  
22 historical way in which we view our agents and our  
23 operations people as a team of people working not at cross  
24 purposes but working together toward the same end for the  
25 benefit of the organization and the policyholders.

1 Q. In establishing the limitations, did you take  
2 account of the interest of the agents?

3 A. Yes. We were very concerned about our agents. We  
4 were concerned principally about two things -- about their  
5 incomes. We were also concerned about the considerable  
6 amount of time that they would be spending talking with  
7 customers and explaining double digit rate increases,  
8 sometimes both in auto insurance and fire insurance as well  
9 in a jurisdiction, and of course we were soliciting their  
10 help and their support in the re-underwriting activity that  
11 we would be engaged in and their understanding of the  
12 limitations on production.

13 Q. What happened to agents incomes during the period  
14 that limitations were in effect?

15 A. Well, they actually went up during that period of  
16 time.

17 Q. Can you turn to Exhibit - Defendant's 74, please?

18 A. I guess I have to go over here.

19 Q. It's in --

20 A. Yes, I have it here.

21 Q. What does Defendant's Exhibit 74 show, Mr. Wright?

22 A. Well, first off, I always like to point out that  
23 when you are looking at an agent's income, you are looking  
24 at a gross income figure because independent contractor  
25 agents do have expenses. So, that's a gross income figure

1 there, but the chart --

2 Q. Excuse me. When you say gross income, do you mean  
3 the income that they receive from State Farm?

4 A. The income that they receive from State Farm is an  
5 income, and they have expenses on that as well - telephone,  
6 office, staff, all the kinds of things that an independent  
7 contractor would have.

8 Q. So what's shown here is the income they received  
9 from State Farm?

10 A. That's right.

11 Q. But these aren't profitability?

12 A. This doesn't show what the agent took home at the  
13 end of the day, but the overall trend here shows that the  
14 gross income for our agents went up from \$250,000 to almost  
15 \$350,000 at the end of 2004.

16 Q. This was during the period that the limitations  
17 were in effect?

18 A. Yes.

19 Q. Why did the agents income go up during this  
20 period?

21 A. Well, in part, of course, because of the premium  
22 increases. Since agent income in auto and fire insurance is  
23 based on a percentage of the total premium collected, it  
24 would go up for that reason. But that's not the whole story  
25 here. Agents and the company together did a tremendous job

1 of preserving on-board business during this period time,  
2 even during these periods of increases. So, the retention  
3 of business played quite a very important part in this as  
4 well.

5 Q. What was State Farm's financial condition in 2003  
6 and 2004?

7 THE COURT: Well, I'm happy to say it was much  
8 improved. In 2003, we had an operating profit of about two  
9 and a half billion dollars, a decided turn-around. And in  
10 2004 we had an operating profit that came as a result of  
11 actually an underwriting gain and investment income of  
12 almost five billion dollars.

13 Q. And --

14 A. Excuse me. It was just over five billion.

15 Q. And to what do you attribute these profit figures?

16 A. Oh, very definitely, the things that I enumerated  
17 earlier worked. The kinds of actions that we took were  
18 prudent, and in combination they helped us gain this  
19 turn-around.

20 Q. As of the end of 2004, Mr. Wright, when you  
21 retired, what limitations on production of new business were  
22 still in affect?

23 A. Well, almost all of the limitations had been  
24 removed around the country. There were only three  
25 jurisdictions where there were any left. In Texas we had

1 some restrictions there remaining, in Louisiana, and in  
2 Florida we had some long-standing restrictions and fire  
3 insurance because of the hurricane.

4 Q. And in the rest of the states?

5 A. The rest of the states had all been removed.

6 MR. REICHLER: I have no further questions, Your  
7 Honor. Thank you, Mr. Wright.

8 THE COURT: Mr. Garner.

9

10 CROSS-EXAMINATION

11 BY MR. GARNER:

12 Q. Mr. Wright, you are here testifying on behalf of  
13 State Farm on the subject of restrictions on sales; is that  
14 right?

15 A. I'm here testifying in a number of areas. I guess  
16 this morning, Counsel, that would be correct.

17 Q. And at the time that you were employed by State  
18 Farm -- Let me ask you this. Do you remember when your  
19 deposition was taken in, I think, late 2003?

20 A. In December. I can't remember the exact date.

21 Q. And at that time were you knowledgeable about  
22 restrictions on sales?

23 A. I believe I answered whatever questions you posed  
24 of me.

25 Q. Mr. Wright, please answer my question now. At

1 that time, in 2003, were you knowledgeable about  
2 restrictions on sales?

3 A. Yes, I believe I was.

4 Q. Were you one of the people at State Farm that was  
5 most knowledgeable about that subject?

6 A. Well, I don't know that I have ever been asked to  
7 provide that kind of a ranking, but I was certainly involved  
8 counselor in the discussions that were ongoing with zones  
9 about what they would be producing. Myself, I testified  
10 yesterday or the day before that I had the responsibility,  
11 along with the chief administrative officer for the senior  
12 vice-president. So, once a quarter I was reviewing their  
13 plans and reviewing their progress. So, with regard to the  
14 production and the profit and loss figures.

15 Q. You are familiar with the decision-making process,  
16 then, as to how State Farm imposed restrictions on sales?

17 A. I am familiar with the broad strokes of it, not  
18 the minute details.

19 Q. What exactly was your role in making -- strike  
20 that. Did you have a role in making a decision with respect  
21 to imposing restrictions on sales in any particular  
22 jurisdiction?

23 A. My role, along with --

24 Q. Mr. Wright, it's a yes or no question. You may  
25 explain after you give us the yes or no.

1       A.       I'm sorry.  I'm really not trying to --

2               THE COURT:  We know you are not, sir.  Just  
3 proceed to answer in the way that Mr. Garner mentioned.

4               THE WITNESS:  Will you restate the question?

5               BY MR. GARNER:

6       Q.       Did you have a role in the decision whether to  
7 impose restrictions on sale in any particular jurisdiction?

8       A.       I think I would have to answer that yes.

9               THE COURT:  Now you may explain if you wish.

10              THE WITNESS:  Okay.  Because we were looking at  
11 these overall targets with the zones, when a zone came back  
12 with less than that, zero to three percent operating profit  
13 that we were requiring, that we were targeting as part of  
14 their plan or less than the five percent figure in fire  
15 insurance that we were targeting, we sent the senior  
16 vice-president back to the well, as it were, to do some more  
17 work.  I was in effect involved because we were telling  
18 them, hey, you are not getting the job done that we are  
19 requiring; therefore, you are going to have to do something  
20 further, and inevitably that involved limitations to  
21 production.

22       Q.       Now, you just testified about certain targets.  
23 So, is it fair to say that in determining whether to impose  
24 restrictions on sales of insurance in any area, that there  
25 was a standard or a criterion that the zones were supposed

1 to meet?

2 A. Yes.

3 Q. And if somebody said that there wasn't, that  
4 wouldn't be true?

5 A. Yes.

6 Q. Yes, it wouldn't be true? Just to be clear.

7 A. It would not be true.

8 Q. And there was a procedure that was followed, where  
9 the zone attempted to meet that criterion and then send it  
10 upstairs for review by you. Is that the procedure,  
11 generally, and you reviewed it -- you and your cohorts  
12 reviewed it to see if it met the goals?

13 A. We actually -- yes. And I will explain that  
14 again, if I might.

15 Q. Please do.

16 A. We actually talked with the senior vice-president  
17 on a regular basis and always on a quarterly basis .

18 Q. And when the zone sent it upstairs, if I can use a  
19 vernacular, for review by you, was that in paper form? Was  
20 there a document that they sent that showed the proposed  
21 restrictions?

22 A. Usually, yes. Usually, there was some form of  
23 documentation that was submitted along with this. These  
24 conferences that we had with the zone vice-presidents in  
25 almost every instance were teleconferences, so there were a

1 lot of things verbalized along the way.

2 Q. By the way, the targets or standards of criteria  
3 that you mentioned for profitability, did the company set  
4 those forth in writing for the zones to review?

5 A. I believe -- yes, I believe that there were  
6 instances where we put these targets down in writing and  
7 explained them to the senior vice presidents.

8 Q. And the restrictions were reviewed, you say, on a  
9 quarterly basis; is that correct?

10 A. No, I'm not just talking about restrictions, I'm  
11 talking about the overall progress of the zone, and I had  
12 earlier testified that there were a number of things that we  
13 were doing, so I couldn't say yes to that question the way  
14 you posed it.

15 Q. The big dog is off the porch. What does that  
16 mean?

17 A. Well, that was a campaign, a slogan that was kind  
18 of coined by our chairman at a convention in 1998.

19 Q. And we all know that new business is more risky  
20 than old business?

21 A. That's correct.

22 Q. And that campaign slogan, the big dog is off the  
23 porch, initiated a very aggressive effort by State Farm to  
24 grow auto insurance business; right?

25 A. That's correct.

1 Q. And that --

2 THE COURT: What do you mean by roll auto  
3 insurance?

4 THE WITNESS: By --

5 MR. GARNER: Grow. To grow the auto insurance.

6 THE COURT: Oh, grow. Excuse me.

7 BY MR. GARNER:

8 Q. It was an aggressive growth plan, and it began in  
9 the late 90s; is that right?

10 A. That's correct.

11 Q. And that program continued into the early 2000s,  
12 didn't it?

13 A. That's right.

14 Q. And in fact, the company grew too fast, didn't it?

15 A. Well, in retro -- Yes. And if I can explain? In  
16 retrospect, we probably took on too much business at that  
17 point in time. Earlier I testified to the fact that you  
18 don't always know, as you are taking business on, whether or  
19 not it's going to be profitable, and the same is true when  
20 you set a rate. With market conditions changing all the  
21 time in the marketplace, you don't know when you set those  
22 rates whether or not you are going to be more or less  
23 competitive with your competitors. You don't have a sure  
24 way of knowing whether or not you are going to take on more  
25 or less business. So, --

1 Q. So when you --

2 A. -- in retrospect, Counselor, we may have grown too  
3 fast, but we certainly didn't know at the period of time we  
4 were doing this that it was going to create these kinds of  
5 loss problems.

6 Q. In fact, isn't it true that when State Farm  
7 announced that it was imposing restrictions on sales, that  
8 Mr. Rust said that one of the reasons for that was the  
9 unprecedented growth that the company had had under the big  
10 dog off the porch program?

11 A. Yes.

12 Q. So that was one of the reasons that you needed to  
13 impose restrictions on sales was that you had grown too  
14 fast?

15 A. Yes.

16 Q. And that's something that the company did  
17 voluntarily?

18 A. Yes. Counselor, may I just say something about  
19 growth that I think will help us all in terms of  
20 understanding growth?

21 Q. Well, let me move on, and maybe Mr. Reichler  
22 can --

23 MR. REICHLER: Well, Your Honor, if the witness  
24 has asked for an opportunity to explain his answer, --

25 THE COURT: No, I don't think he had. You may

1 address this in redirect.

2 MR. REICHLER: Thank you, Your Honor.

3 THE COURT: Let's get on with the  
4 cross-examination and complete it as expeditiously as we  
5 can.

6 BY MR. GARNER:

7 Q. And the company decided in the late 90s or the  
8 early 2000s to go into the sale of mutual fund, did it not?

9 A. Yes.

10 Q. And they weren't profitable during that period of  
11 time, were they? The mutual funds sales lost money, that  
12 operation?

13 A. Yes, that's true, but I think I should comment on  
14 that at this point in time, if I might.

15 THE COURT: Yes, you may.

16 THE WITNESS: We never intended to make money in  
17 mutual funds the day that we entered into that program. It  
18 was always understood that it would take us a number of  
19 years in that line before we would be able to make a profit.

20 Q. So those losses were foreseeable?

21 A. Yes.

22 Q. And the company went into the banking business in  
23 the late 90s or the early 2000s; correct?

24 A. I think the banking was a little bit earlier than  
25 the mutual funds. Mutual funds we didn't actually start

1 writing until 2001. Banking was earlier.

2 Q. And the bank lost money, foreseeably, into the  
3 early 2000s?

4 A. That's correct.

5 Q. During the late 1990s, the company enjoyed  
6 substantial gains in the stock market, didn't it?

7 A. Yes.

8 Q. Couldn't it foresee that the stock market at some  
9 point was going to go down and provide for that?

10 A. I surely wished that we all had been able to  
11 figure out when the stock market was going to go down,  
12 Mr. Garner.

13 Q. Did you ever hear the expression what goes up must  
14 come down?

15 A. Yeah, but I don't know that anybody predicted that  
16 it would go down the way it did and when it did.

17 Q. The company didn't provide adequate reserves for  
18 that?

19 A. I've already testified, Mr. Garner, that our  
20 surplus was adequate. I simply said that we were in a  
21 position where we couldn't continue the trend and we  
22 couldn't continue to take on the volume of new business we  
23 were taking on.

24 Q. During the early 2000s, State Farm did not  
25 experience any natural disaster, such as hurricanes or

1 earthquakes that caused catastrophic losses for it, did it?

2 A. In which year?

3 Q. 2000 to 2002.

4 A. I couldn't answer that without having figures  
5 available. And the reason, Mr. Garner, is that in the  
6 catastrophe world, there are times when you can lose a  
7 billion dollars in no-name catastrophes, with hail and other  
8 kinds of things that never make the papers. So there may  
9 not have been a massive hurricane or an earthquake during  
10 that period of time, but without looking at the figures, I  
11 can't tell you whether or not we were experiencing high  
12 catastrophes or not during that period.

13 Q. Is your answer you don't know?

14 A. With the qualifications I have added, yes.

15 MR. GARNER: Nothing further.

16 THE COURT: Mr. Reichler.

17 MR. REICHLER: No questions, Your Honor.

18 THE COURT: With nothing further, Mr. Wright is  
19 excused. Thank you.

20 THE WITNESS: Thank you, sir.

21 (Thereupon, the witness was excused from the  
22 witness stand.)

23 THE COURT: Mr. Reichler.

24 MR. REICHLER: Thank you, Your Honor. Our next  
25 witness on this topic is Mr. Barry Thomas.

1 THE COURT: I take it this is your last witness.

2 MR. REICHLER: It is, Your Honor.

3 (Pause)

4 THE DEPUTY CLERK: Raise your right hand, sir.

5 Thereupon,

6 BARRY THOMAS,

7 having been called as a witness for and on behalf of the

8 Defendant, and having been first duly sworn by the Deputy

9 Clerk, was examined and testified, as follows:

10 MR. REICHLER: Your Honor, with the Court's

11 permission, I would like to turn the podium over to my

12 esteemed partner, Mr. Martin.

13 THE COURT: Very well.

14

15 DIRECT EXAMINATION

16 BY MR. MARTIN:

17 Q. Good morning, Mr. Thomas.

18 A. Good morning.

19 Q. Can you please state your full name for the  
20 record?

21 A. Yes. My name is Barry Lamar Thomas.

22 Q. Mr. Thomas, are you currently employed?

23 A. Yes, I am.

24 Q. Who is your employer?

25 A. I'm employed by the State Farm Mutual Automobile

1 Insurance Company.

2 Q. And what's your current position?

3 A. My current position is the director of  
4 underwriting for property and casualty business.

5 Q. How long have you been in this position?

6 A. It's been just over four years now.

7 Q. And before that, what was your job within State  
8 Farm?

9 A. Prior to that, I was a fire division manager for  
10 the state of Florida, responsible for homeowners business in  
11 that state.

12 Q. For how long did you hold that job?

13 A. I was there just about seven years.

14 Q. What other positions have you held in your career  
15 at State Farm?

16 A. Prior to the position in Florida, I worked in  
17 various other management and supervisory and underwriting  
18 positions in a similar line of work within the states of  
19 Tennessee and Kentucky.

20 Q. Let's go back to your current job, if we can.  
21 What are your primary responsibilities in your current  
22 position?

23 A. The things that I get involved with in my current  
24 position would be working with a group of zone underwriting  
25 consultants that are responsible for working directly with

1 our operations centers and zones around the country relative  
2 to potential issues pertaining to underwriting of automobile  
3 insurance and also homeowner insurance.

4           THE COURT:  Would you state for the record, as  
5 precisely as you can, what is meant by underwriting?

6           THE WITNESS:  Sure.  Underwriting would be the  
7 process of reviewing information, applications for issuance  
8 for insurance.  The person actually reviewing that process  
9 would be considered underwriting the information on the  
10 application to determine if it's acceptable for coverage for  
11 State Farm.

12           BY MR. MARTIN:

13        Q.     Mr. Thomas, are you familiar with restrictions on  
14 agents' ability to submit new business that are currently in  
15 effect in the state of Texas?

16        A.     Yes.

17        Q.     Briefly, what are they?

18        A.     In Texas, briefly, we have restrictions based on  
19 the geographic part of the state; we have restrictions in  
20 the Dallas Metroplex area, Fort Worth included; we have  
21 different guidelines for the sea coast area also.

22        Q.     And are there restrictions in effect with respect  
23 to the rest of the state?

24        A.     Yes, there are, but not to the extent that they  
25 are in the other two areas.

1 Q. What is the nature of the restrictions in the rest  
2 of the state?

3 A. It varies a little bit from area to area, but  
4 generally there is like an ability to write an additional  
5 ten percent or to grow ten percent of the book of business  
6 in those areas.

7 THE COURT: Ten percent of the what, sir?

8 THE WITNESS: Ten percent of their policy count.  
9 If they had 1,000 policies in force, they could grow ten  
10 percent above that.

11 Q. Mr. Thomas, through what State Farm entity are the  
12 products currently limited in Texas offered?

13 A. It would be called the State Farm Lloyd's Company.

14 Q. And is the same true with respect to the  
15 limitations that were in effect in 2004?

16 A. Yes.

17 Q. And in 2003?

18 A. Yes.

19 Q. 2002?

20 A. Yes.

21 Q. Is State Farm Lloyd's a separate incorporated  
22 entity from State Farm Mutual Automobile Insurance Company?

23 A. Yes, it is.

24 MR. MARTIN: Thank you, Mr. Thomas. No further  
25 questions, Your Honor.

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

CROSS-EXAMINATION

BY MR. HILLMAN:

Q. Mr. Thomas, good afternoon, sir.

A. Good afternoon.

Q. Is State Farm Lloyd's, if you know, a wholly-owned subsidiary of State Farm, of any other State Farm entity?

A. Yes.

Q. And what is it a wholly-owned subsidiary of?

A. State Farm Mutual.

Q. What is the full name of State Farm Mutual?

A. State Farm Mutual Automobile Insurance Company.

Q. Do you know anything about -- Well, strike that. Do you know if decisions made by State Farm Lloyd's are influenced in any way by State Farm Mutual?

A. The decisions made by State Farm Lloyd are those in fact made by Lloyd's themselves.

Q. Do you know if there is a process in which State Farm Lloyd's or by which State Farm Lloyd's consults with State Farm Mutual before it makes decisions?

A. There likely would be times when that would happen.

Q. Do those times include underwriting decisions?

A. Yes.

Q. With what frequency does State Farm Lloyd's

1 consult with State Farm Mutual concerns making underwriting  
2 decisions?

3 A. I couldn't give you specifically how often. It  
4 wouldn't be very often since the decisions actually rest in  
5 the Texas area for State Farm Lloyd's.

6 Q. If the decision was a decision which was  
7 considered by State Farm Mutual to be of significance, would  
8 you believe that State Farm Mutual would be consulting with  
9 State Farm Lloyd's about that underwriting decision by State  
10 Farm Lloyd's?

11 A. It possibly would.

12 Q. Is it likely that it would?

13 A. Depending on the situation.

14 Q. Can you describe any situations in which State  
15 Farm Mutual has consulted with State Farm Lloyd's concerning  
16 underwriting decisions made by State Farm Lloyd's?

17 A. I would say with respect to some decisions back  
18 when there was some mould concerns in Texas, there were some  
19 conversations probably at that particular time.

20 Q. Would you characterize the mould situation as one  
21 of importance?

22 A. Yes, I would.

23 Q. Are there other situations in which consultations  
24 were held by State Farm Lloyd's with State Farm Mutual  
25 before it made underwriting decisions, besides the mould

1 situation, even if you can't think of specifics?

2 A. Without saying specifically, I'm not sure.

3 Q. There may have been, but there may not have?

4 A. I'm not sure.

5 Q. Now, the restrictions that are in -- Well, strike  
6 that. There were restrictions in effect in the 1990s with  
7 respect to agents' ability to market policies to the public  
8 in various states; correct?

9 MR. MARTIN: Objection, Your Honor. Goes beyond  
10 the scope of the direct.

11 THE COURT: I'll permit this preliminarily on  
12 cross-examination. I'll give the benefit to the  
13 cross-examiner.

14 THE WITNESS: Would you repeat the question,  
15 please?

16 MR. HILLMAN: Ma'am Reporter, would you repeat the  
17 question, please?

18 (Thereupon, the last question was read.)

19 A. Yes, that's correct.

20 Q. Okay. Drawing your attention to the more recent  
21 time in the period 2001 or 2002 through 2004, there were  
22 also restrictions imposed on agents' ability to write new  
23 policies, State Farm policies in various states; correct?

24 MR. MARTIN: I think he said that.

25 THE COURT: Yes, I think that we are now -- I

1 thought that you were going to go back into Texas, but this  
2 is beyond --

3 MR. HILLMAN: Your Honor, --

4 THE COURT: -- the direct.

5 MR. HILLMAN: Your Honor, it's dangerous to go  
6 back into Texas sometimes.

7 THE COURT: Pardon.

8 MR. HILLMAN: Dangerous to go back into Texas  
9 sometimes, Your Honor. I'm going to move on for that  
10 reason.

11 Mr. Thomas, you heard Mr. Wright testify  
12 concerning various rationales for the determination by State  
13 Farm to impose restrictions on agents rights to solicit  
14 insurance, did you not, sir?

15 MR. MARTIN: Objection, Your Honor.

16 THE COURT: Grounds?

17 MR. MARTIN: Two-fold. The witness was not  
18 present, and it is also beyond the scope of the direct.

19 MR. HILLMAN: Well, I'll with raw that question,  
20 Your Honor.

21 THE COURT: All right.

22 BY MR. HILLMAN:

23 Q. The restrictions that were in effect at the  
24 beginning of 2002 by State Farm throughout the country, were  
25 they largely restrictions that were not related to

1 catastrophic events, such as hurricanes and earthquakes?

2 MR. MARTIN: Objection, Your Honor. Beyond the  
3 scope.

4 THE COURT: Sustained.

5 MR. HILLMAN: I have one more question.

6 Do you know if one of the reasons why State Farm  
7 imposed restrictions in the period 2002 to 2004 was in an  
8 effort to influence insurance agencies to increase rates?

9 MR. MARTIN: Same objection, Your Honor.

10 THE COURT: Sustained.

11 MR. HILLMAN: I have no further questions. Thank  
12 you.

13 MR. MARTIN: Your Honor, may I just have 30  
14 seconds?

15 THE COURT: Yes.

16 (Brief pause.)

17 MR. MARTIN: No further questions, Your Honor.

18 THE COURT: You may be excused, sir. Thank you.

19 (Thereupon, the witness was excused from the  
20 witness stand.)

21 THE COURT: Mr. Reichler.

22 MR. REICHLER: Your Honor, we have no further  
23 witnesses. That concludes the presentation of defendants'  
24 case on the subject of the limitations on sales.

25 THE COURT: Is there rebuttal, Mr. Garner?

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

MR. GARNER: No rebuttal witnesses, Your Honor.