ORAL ARGUMENT – 04/14/04
01-0540
STATE FARM V. LOPEZ

SHANKIN: Five policy holders of State Farm want a jury to determine how much in dividends State Farm should have paid every year from 1994 to present. And then the TC to order payment of those dividends.

Plaintiff's counsel admits that the TC's order did not comply with Bernal. There was no trial plan and there was no rigorous analysis. There was no analysis at all. The class was certified based on counsel's representation, but it should be done based on the pleadings and then any problems that arose should be dealt with later.

But on behalf of State Farm and its only Texas resident director during the period, Wendy Graham, I'm here to urge you to order dismissal, not remand for compliance with Bernal. The plaintiffs cannot proceed even individually with this case. They lack standing and for this and other reasons, the TC lacks jurisdiction.

We've had a plea to the jurisdiction on file for 5 years. It was set and heard before the certification hearing. It's never been ruled on. It's time to call the question in this case.

O'NEILL: Is it procedurally before us? I hear the merits and we're talking a lot about the merits in the briefing. But procedurally can we reach the merits?

SHANKIN: We can certainly reach jurisdiction. As the court held in Texas Ass'n of Business, jurisdiction comes first. It can be raised even first time on appeal. You can sua sponte by the court. And if the TC has no jurisdiction it shouldn't have proceeded at all. And that issue, whether the TC had jurisdiction, has been consistently presented and preserved and ruled on. So you're certainly free if you agree with my argument that in fact the plaintiffs lack standing to so hold and order the case dismissed for want of jurisdiction.

And I want to argue that under Novack v. MD Anderson you have to take up jurisdiction first, including plaintiff's standing even in class action. That was a class action against MD Anderson. And one person alleged on behalf of a class of all people who received the fundraising letter from MD Anderson, that they solicited funds by _____ cure rate that was higher than they delivered.

This court held that because the named representative lacked standing, he had never sent in a check in response to the letter, the case had to be dismissed, not merely no certification. Don't remand to see if they can find another plaintiff who might have standing but dismiss. Because the only named plaintiff lacks standing.

And that's the kind of issue that I want to address here.

HECHT: Do we have to first determine that Illinois law applies?

SHANKING: Not from the standing argument. That is a separate jurisdictional argument, and on that argument I want to rest on our brief. We fully briefed it with the addition of two cases that have been recently decided that bear on it.

HECHT: You say there is no standing even under Texas law.

SHANKIN: There is no standing under any law. What MD Anderson holds is the standards of threshold inquiry. And so we have to go through the causes of action and see if the named plaintiffs have standing for those causes of action. And the first one they allege is just what Mr. Novack alleged -fraud. And they lacked standing for exactly the same reason that Mr. Novack lacks standing. They did not rely on the alleged misrepresentation.

OWEN: Is that truly standing or is that just a missing element of their cause of action?

SHANKIN: It is both. It is why this court in MD Anderson held they lacked standing. Because on the face of it they admitted they did not have this central element. The standing inquiry is, is the plaintiff pleading a recognized legal duty that is applicable on the facts pled, and a cognizable legal injury that is causally connected to the asserted legal duty?

PHILLIPS: This theory of standing is not the same theory of standing. But in Tabb we said you could bring up at anytime motion for rehearing in the SC or collateral attack. Because our whole doctrine of omitted elements would go by the board if that's right.

SHANKIN: I'm not sure that I see that the doctrine of omitted elements would have to go by the board.

PHILLIPS: Well if you didn't mention this in the TC and it went to trial on fraud without a reliance issue and the jury answered favorably on various issues and a judgment was entered and you didn't raise a peep, you're not going to be able to bring it up in our court.

SHANKIN: Then in that case you would have to decide whether the law of standing and the law of omitted elements could stand together. In this case you don't have that problem. It's been properly presented and preserved.

OWEN: What about breach of fiduciary duty?

SHANKIN: No such legal duty between an insurance company and its policyholders. It's only a matter of contract with of course the limited judicially created exception for claims handling.

Similarly for malicious suppression of dividends is the third cause of action. That's a duty that only applies when you can have majority shareholders.

O'NEILL: You're not arguing those theories under standing though are you?

SHANKIN: Yes. In addition, I am also arguing that they cannot possibly meet the class

certification requirements. That's fully briefed.

O'NEILL: How much into the merits can we get in determining class certification? It strikes me that if you're challenging the cause of action that's brought, again standing being a separate issue, that you would typically do that by summary judgment. How much of the merits can we get into in this procedural posture?

SHANKIN: You've not yet answered that question. You haven't drawn the line. You've indicated in Union Pacific that it's less searching than in a trial on the merits. The inquiry into the merits for certification purposes is less searching, but that you have to make it to determine the applicability of the class certification criteria. And you haven't said how you would draw the line when you have to draw the line.

I would say to you in this case it's easy to draw the line because the things that mean that there cannot be a class certification are not in dispute. There is no ambiguity about them. The only common claim that's asserted is the claim based on the policy and its language. On the face of the contract with no ambiguity it says that they will participate to the extent and upon the conditions fixed and determined by the board of directors in such dividends as the board of directors fixes and determines. And so you don't have to go very far into the merits on the face of that instrument to see that they can't have a claim of the right for payment of dividends. And if they have no claim to the right for it they can't have one that is typical of a class. The concept of a typical class claim is typical of a valid, a potentially valid claim. You don't have to get to the point of saying well this is a disputable issue and now we have to decide whether they really have such a contract claim.

So however difficult the line drawing might be in some case, it's not difficult in this one.

O'NEILL: I don't understand that because that seems very circular. If there is no such claim, then there's no such claim for anyone. And it is typical of the class. So again, why would not summary judgment be the more proper vehicle to do this?

SHANKIN: Because of the extraordinary procedure of class certification that we do the class certification first, send the notice out to, in this case millions of people and have a proceeding that could well in a court which has declined to rule on our plea to the jurisdiction and declined to rule on our special exception to the contract issue, also send the case to trial, have a large verdict and judgment, which we of course are confident on these grounds would ultimately be overturned, but with all the press and supersedeas problems. It's because class actions are different that the rule that you would say, well let's just deal with this in summary judgment is a bad rule for the system.

O'NEILL: But you could have filed summary judgment on the merits.

SHANKIN: We could have filed summary judgment. We didn't need to because the facts here weren't in dispute. This is true on the face of their pleading. And we couldn't get a ruling on the special exceptions or the jurisdiction. This is the thrust of the point I want to make, that when the lack of the ability to assert a valid claim is so clear that it falls under standing law doesn't make

out something that the plaintiff had standing to bring, that ought to be treated as jurisdictional, decided first before class certification so that the extraordinary burdens that come with the class action do no have to be endured.

WAINWRIGHT: Why shouldn't we remand, send it back down to the TC to rule on special exception? Ordinarily if there is a problem with the pleadings, the TC gives the plaintiff the chance to amend.

SHANKIN: If it could be fixed that would be an appropriate thing to do. It can't be fixed. The contract is in. We have the contract. It says what it says on the face. The Texas Dept. of Ins. wrote the contract. Its rules say such a contract cannot promise dividends. We know the contract doesn't promise dividends. No mater how any assembly of policyholders re-pleads their action they will not plead a class action. Now you are correct that it is possible that on repleading - that by pleadings some policyholders of State Farm might be able to make out on individual fraud claim. They might be able to say some agent of State Farm told me something that's not in the policy that made me think I was going to get dividends. But that's not the case here. Each of these five plaintiffs has admitted they did not rely - that the only promises were in the policy and they did not rely on them. They didn't even know they were going to get dividends or that that was an issue until they either got a check or were told about it by their lawyer. They bought insurance, not a promise for dividends.

BRISTER: So should we make the rule - to do this rigorous investigation you've got to find out what the facts are. A trial judge has got to hear the summary judgment before they decide certification, just like the trial judge has got to decide choice of law before they decide certification.

SHANKIN: It's clear to me they do have to decide such matters as choice of law with the legal issues involved.

BRISTER: For sure you can't decide the class action upon one assumption about what's uncontested and a later summary judgment on something else. It's going to be one rule for the case.

SHANKIN: There's going to be one rule for the case.

BRISTER: But if we had such a rule, then we would have to remand and say go file a summary judgment, prove to us that in fact it's uncontested and then raise your objection of certification.

SHANKIN: We believe it has proven it's uncontested.

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AG

LAWYER: Insurance regulators like my client, the Commissioner of Insurance of Texas, want to make sure that a company is financially able to pay all claims that become due. The imprudent payment policyholder dividends will adversely affect that ability. In Texas insurance

companies are expressly prohibited from promising dividends to their policyholders.

O'NEILL: What in your opinion would be a proper method by which someone could challenge something like this, or do you say a policyholder never can anywhere?

LAWYER: I do not believe a policyholder can challenge this type of decision in the courts.

O'NEILL: Presume their's a valid claim. Presume there are excess surpluses that should be declared. Let's just presume that it's a slam dunk for the policyholder. How would they assert that claim? Do they file with the Dept. of Ins? Is this a primary jurisdiction question?

LAWYER: No. This is an exclusive jurisdiction question. I believe that in fact the policyholder has no recourse even to the commissioner. The commissioner has an oversight of whether or not the individual company has decided to pay an appropriate amount of dividends given the rest of their financial circumstances. But this is not an issue that an individual policyholder could bring to the commissioner.

PHILLIPS: How are the directors chosen for these companies? Is it a self perpetuating board, or do policyholders ever get to vote on the board?

LAWYER: Policyholders have one vote per each policy. And there is an annual election. And of course they can always choose to have some other kind of insurance. What they are buying is insurance.

PHILLIPS: Theoretically the policyholders could start communicating with each other through the internet, or mail, or mass meetings, and elect a board of directors with a different dividend theory.

LAWYER: Correct. That would be the dividend of the entire company. That would be under generally the jurisdiction of the commissioner of insurance of Illinois. Because that is where the company is. It operates in all 50 states and we supervise the floor(?). We only supervise the part that have been paid in Texas.

PHILLIPS: But as far as how those dividends are allocated among states, the board of directors of a whole mutual company doesn't approve that?

LAWYER: Yes. They make the initial decision. And the oversight would be with the Illinois commissioner.

HECHT: You say that there's no claim for not paying enough dividends. What is your position on whether there is a claim for fraud? If the company or some agent of it actually promised a particular divided to a particular person, do you say there's a cause of action there or not?

LAWYER: Yes. There's a cause of action for fraud against the agent. There may be a

cause of action with the commissioner for the agent's license to be disciplined. But that is an individual case by case situation.

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RESPONDENT

PONCIO: I think what we have here, as much as the court has addressed is, we have a cart before the horse type of argument on behalf of the petitioners. What we've seen is at each level they've attempted to expand their argument to make it more inclusive of other arguments that were not raised below in the TC or could not have been raised properly at the TC, particularly dealing with an issue of class certification. Now we're going on to whether the dept. of Ins. has primary jurisdiction or exclusive jurisdiction that was just argued. Whether this court can address the issues of whether there can be a claim of fraud or breach of contract that can be brought up before this court.

HECHT: Why shouldn't those issues be resolved before certification?

PONCIO: If opposing counsel had brought up those issues before, then that would have been proper.

HECHT: Well there's a plea to the jurisdiction they say.

PONCIO: Yes. But those specific issues were not brought up at the TC, and I think that the limit of jurisdiction of this court and the CA with regard to those specific arguments was limited to the class certification issue, which I think even if it had been addressed by the court, I think the breach of contract claim and a fraud claim could have been brought and proceeded with both at the TC, CA and this level.

HECHT: But you agree that before the class is certified those kinds of issues ought to be resolved. Otherwise it's a waste of everybody's time.

PONCIO: I don't agree that they necessarily should or ought to be resolved. Because what the class action law holds is that essentially if there's some evidentiary foundation and the court looks at the pleadings, in class certification law the court could presume that the class can proceed on that. Based on the assumption under class certification law that the court can always later amend, decertify its class if it determines that in fact that cannot proceed.

So if in fact there was class certification in a particular case it's affirmed by the CA, brought before this court, that is affirmed in terms of the class certification. We go back, remand it as J. Brister had discussed, then it can be remanded. The TC at that time can then exercise its power to determine whether in fact it can go forward or not go forward. If in fact it determines it cannot go forward, then of course we go up the ladder again in a summary judgment type context. But I think the type of argument they are raising now is exactly what I started out arguing. It's the cart before the horse.

O'NEILL: In State Farm v. Superior Court, was that a nationwide certified class?

PONCIO: I believe so. That's the additional case that they cited to this court.

O'NEILL: And the court there determined that Illinois law applied, the business judgment rule.

PONCIO: Our argument is that that particular argument does not apply. That in fact Illinois law...

O'NEILL: I understand. But if this is a nationwide class and that determination has been made, how can we have a separate Texas class?

PONCIO: I believe that we are proceeding strictly against the Texas entity.

O'NEILL: But if another court has declared a nationwide class doesn't the Texas action become subsumed in the nationwide class?

PONCIO: I don't believe so.

O'NEILL: Why not?

PONCIO: I believe that we're interpreting Texas law as it applies. Illinois applies under Texas law. And I don't agree with their interpretation of Illinois law.

O'NEILL: If this case had been certified as a nationwide class, I would presume you would be arguing that that would encompass any other state court actions. Then why doesn't the reverse work?

PONCIO: That's exactly why we limited our argument to strictly Texas policyholders. But we argued, as we've argued below, that that case does not apply in our case. The California interpretation that they raised even at the TC level simply did not apply, and I believe the court implicitly agreed with us.

WAINWRIGHT: Wouldn't it be anomalous for Texas to say that Texas law applies to govern the internal affairs of this entity when as J. O'Neill has pointed out, a different state court has said that Illinois law applies to the internal affairs of this company? Wouldn't that create inconsistent and problematic rulings?

PONCIO: I don't agree with that. Texas courts are allowed to defer to other opinions to the extent they believe they don't conflict with our interpretations. But I don't think that we have to assume that a California court has jurisdiction over a Texas court, or a Texas case, and that we necessarily have to follow their interpretation.

WAINWRIGHT: Then what should the Texas State Farm entity do if we were to say that Texas

law governs its internal affairs? Should they follow the California court, or the Texas court and which one will it be subject to contempt proceedings in?

PONCIO: I don't think they are going to be subject to contempt proceedings. I think that rather in Texas courts, that the certification would be affirmed. We would go back to the TC and they would raise those very arguments, where the Texas court would then be enabled to interpret that, the CA would be able to interpret that and eventually this court would be able to interpret that. But I think again, what we're doing is we're taking arguments out of order and we would then be nixing the class certification law to jump forward to an argument on the merits when the merits aren't particularly before this court at this point.

WAINWRIGHT: So you don't believe the choice of law determination should be made before class certification?

PONCIO: Not necessarily.

WAINWRIGHT: It wasn't in this case.

PONCIO: No.

SCHNEIDER: Do you contend that there was a rigorous analysis of the trial plan in this case at the TC level?

PONCIO: We concede there was not a trial plan. We do believe, however, that there was a rigorous analysis as was found by the CA. The CA in reviewing this said, We believe that there was evidence of a rigorous analysis by the TC.

HECHT: What was that evidence?

PONCIO: A review of the multiple briefings that occurred at the TC level. A review of the evidence that was presented at the hearing by Mr. McKetta, myself, Mr. Roy Dale and his firm. Afterwards a review before determining whether or not to certify the class. If it wasn't something that was done as is want to do in some situations in a one day proceeding, or in fact ½ day proceeding where it's automatically certified. That was not done in this case.

SCHNEIDER: How could you have a rigorous analysis and the TC not determine what state law applied?

PONCIO: I think the court did look at that and made its own determination. It was not a part of the class certification order. But that was argued below. The Illinois statute was reviewed. They raised the same arguments about the Illinois statute. It was briefed. The Texas Business Corporation Act argument was raised below. It was briefed. And in our view the court sided with our argument.

WAINWRIGHT: Is that documented in the record?

PONCIO: Yes.

WAINWRIGHT: Is there documentation in the record of the TC's ruling on the choice of law question?

PONCIO: I don't recall.

WAINWRIGHT: It's certainly not in the order?

PONCIO: I don't believe it was.

SCHNEIDER: Also I noticed that you don't have - the TC didn't specify under what section, whether it was 42(b)(1)(a), or 42(b)(1)(b), or 42(b)(4), and did not certify that. How would you know what the trial plan would be? If I were a trial judge, it seems like I would want to know that before I started the trial with such a big case.

PONCIO: And that's what we argued. First of all, we argued that the defendants, or the petitioners in this case, waived that argument. They never addressed it. They never asked for it. And the CA agreed saying that those arguments were waived. But in the unlikely event, or event that this court decides that a trial plan is necessary, in our view it should be remanded so that the court can consider a trial plan or set out whatever this court feels is lacking. Rather than a dismissal on the merits of the claim which is what the petitioners are asking for in this case.

O'NEILL: How do you deal with the Texas Insurance Code, §5.07 that says any payment of dividends or distribution has to be approved. It can't take effect until the Texas Dept. of Ins. has passed on it?

PONCIO: I think what happens is that the TC makes the determination of 1) whether a dividend should have been paid at all; 2) some recommendation of what that dividend should be that then assuming that there is some recommendation is reviewed by the Dept. of Insurance it then can go back to the TC for final approval or entry of a judgment to that effect. But I think under that argument regards the Texas Dept. of Insurance, that the TC can make the recommendation, the state can then approve it or disapprove it if in fact that is what is required and then it can go back for a final entry of judgment. Not something that one branch is mandating of another branch it that should or should not do.

OWEN: But you conceded it has to be done taking into account the nationwide picture, not just the Texas piece?

PONCIO: I don't agree with that. Because what we're dealing with is the state entity. I forget which amicus briefing says that because State Farm has all these subsidiaries, that the money for a state entity, for the State Farm state entity should be able to be held and used to support these other entities in these other states or subsidiaries. I disagree with that.

OWEN: The Illinois Commission's brief.

PONCIO: That's right. What they are asking is that Texas courts look at the rights of other states. Texas courts are here to protect Texas policyholders. We don't believe Texas policyholders are given their contractual rights in this case and that we should be able to proceed in that context.

One argument I don't understand is that the Texas Dept. of Insurance just argued that we could proceed against the agent for breach of contract claim to receive whatever rights the policyholders are entitled to.

HECHT: She said fraud. I asked her about fraud.

PONCIO: With regard to fraud, if in fact a Texas policyholder should proceed against the agent for fraud, I believe that the current law is that a company is essentially liable for the acts of the agent particularly under certain enumerated areas under the Texas Ins. Code.

HECHT: Do you claim any such fraudulent misrepresentations in this case?

PONCIO: Yes. We claimed fraud in general.

HECHT: Specific statements made by agents or the policy...

PONCIO: Under the policy itself.

HECHT: But not specific statements made by agents?

PONCIO We have not gotten to that level of evidence yet. With that, we argue that this court is without jurisdiction at this point, or should ignore the jurisdictional arguments that have been raised because they were not pled below, that the petitioners are putting the cart before the horse in asking this court to reach the merits of the claim which should not be reached at this point, that in fact they have waived a number of their arguments, and that this class certification should be affirmed or alternatively as we've requested that it should be remanded for whatever further findings this court deems is necessary.

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REBUTTAL

SHANKIN: J. O'Neill. On Ms. Pedigrew's behalf, I want to try to deal with the question you asked about insurance code 5.07 and opposing counsel's response. I take in his response that the court would decide what a reasonable dividend is and submit that to the Dept. of Insurance board's review and approval illustrates Ms. Pedigrew's point about the separation powers problem. That as the judicial branch submitting its decisions to the executive branch for their review and determination. And it's her contention that that violates their exclusive jurisdiction.

Let me turn to the parts of the argument that I think overlap more directly with what I have brought to you. In answer to your question about Hill. Yes, it is a nationwide class and

contrary to opposing counsel's assertion it is against the very same national State Farm Mutual Automobile Insurance Company that this case is against. So if and to the extent a decision, a valid decision by the California intermediate court now final, too late to appeal it to the California SC, is an adjudication of that law issue, then it would be binding on Texas's...

O'NEILL: I don't think I've seen any briefing on that. I would sure like some. Because if there's been a nationwide class certified, I'm interested in what our job is at that point.

SHANKIN: There has not been briefing on it. We have the problem here of the 5-year moving target. The case has gone on so long, and this happened in the middle of it, the certification order was of course not a recorded decision. I believe opposing counsel lodged in this court an unreported version on the Lexus or Westlaw version of the case. But that was after the briefing on the merits. So there hasn't been a briefing on that issue. And this new decision of the California intermediate court about the Illinois law is really quite new. It only became final last month and we then lodged it. So there hasn't been briefing on that proposition.

O'NEILL: If an intermediate court of another state has certified a nationwide class, does that preclude us from acting?

SHANKIN: I think it is a fair question. I'm not quite sure whether the answer is yes or no, or maybe. I do think the answer is yes to the question of whether it's dispositive of the internal affairs doctrine. The reason the two are different is obviously the class certification issue is a procedural issue in both forums. The internal affairs doctrine is a dispositive law issue. And as, J. Brister has indicated, you all do seem to have decided from Shine that choice of law questions ought to be decided first before the class certification _____ class actions. So whether this is a jurisdiction matter or a choice of law matter really ought to be decided first.

O'NEILL: My question is even more narrow. Even if that California decision is binding in terms of choice of law, it doesn't strike me that if there's a nationwide class certified and the California court applying Illinois law that a Texas court could proceeding simultaneously down the same road.

SHANKIN: I believe J. Posman of the 7th circuit reached that conclusion, and said we're not going to let multiple class actions take a crack at the same issues.

HECHT: But in point and fact it happens all the time.

SHANKIN: In point and fact it happens all the time and I don't think it's been sorted out definitively. I don't know if this court is focused enough on that issue to want that one to be the focus of its decision, but if it does we obviously would be delighted to submit briefing.

WAINWRIGHT: Did you say the decision of the intermediate California state court would be binding on us?

SHANKIN: I believe it would be an adjudication of the law issue.

WAINWRIGHT: It would be binding adjudication?

SHANKIN: It's an adjudication as against State Farm Mutual Automobile Ins. Co. I guess I'm not sure where that places the court.

OWEN: That wasn't in the class action though. Is the intermediate really in the Hill class action?

SHANKIN: It is. Because of their extraordinary writ procedure, it's styled as a case against the superior court, which was the TC.

OWEN: Was it an opt-in or opt-out class in California?

SHANKIN: I don't know the answer.

As to how could a policyholder make such a claim if we assumed that in fact a national mutual insurance company had excessive surplus, how could a policyholder make such a claim? And the answer is not in court. This issue comes up regularly, every 20 years or so in courts around the nation, and for a full century every court that has addressed the issue has concluded policyholders have no such claim in court. Now they've dismissed on a wide variety of grounds.

O'NEILL: Is there such a claim before the insurance commission?

SHANKIN: In Texas, I hear Ms. Pedigrew(?) assert no, that the only claim would be - the only authority of the commission is to make sure that a proposed distribution in Texas is not too large to impair solvency. It's setting a floor on the surplus, a ceiling on the distribution of dividends. But not the other way around. And if in any other state's law, the law that controls the otherwise class of internal affairs of deciding dividends is the law of the state of domicile, in this case Illinois, and if Illinois law allows any suit for dividends it is the suit that is described in §201 that's in our brief, which is a suit that can only be brought by the Illinois commissioner by and through the Illinois AG. Now it is not clear whether even that statute really is intended to provide for a suit to compel the board of directors to declare more dividends than they had thought. But if there is any court action at all available, in 100 years of jurisprudence to compel a mutual insurance company to distribute more in dividends than the board in its discretion thinks is prudent, for State Farm that will be the lesson.