Litigation Update

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COURT DECLINES CHANCE TO CLAMP DOWN ON CLASS ACTION CERTIFICATIONS

(State Farm Mut. Automobile Ins. Co. v. Lopez)

The Texas Supreme Court has passed on an opportunity to clamp down on the excessive number of class action lawsuits being certified by state trial courts. It declined to grant review in a case in which the lower court certified a class action in what is clearly a frivolous lawsuit filed solely for the purpose of extorting a settlement.

The decision not to hear *State Farm Mut. Automobile Ins. Co. v. Lopez* was a setback for WLF, which had filed a brief urging review. The defendant has filed a petition for rehearing; WLF has pledged to file in the case once again if rehearing is granted.

The lower courts have certified a class of several million automobile insurance policy holders; no trial has been held to date. In urging that review be granted, WLF argued that the case is frivolous, that class certification was wholly inappropriate, and that the only people that can hope to benefit from class certification are the plaintiffs' lawyers.

"Members of the plaintiffs' bar have been getting rich by filing unfounded class action lawsuits against deep-pocketed defendants," WLF Chief Counsel Richard Samp said after reviewing the court's one-sentence decision not to hear the case. "Once a trial court certifies a case as a class action, defendants are under intense pressure to settle, because the risk of facing an all-or-nothing verdict presents too high a risk, even when the probability of an adverse judgment is low. But when courts certify large classes involving plaintiffs who have suffered no appreciable damages, the only people who can possibly benefit are the plaintiffs' lawyers," Samp said.

The case before the Texas Supreme Court involves State Farm Mutual Automobile Insurance Co., which writes automobile insurance on a nationwide basis. State Farm is a mutual company and thus has no shareholders. Rather, any capital surplus not needed for reserves is eventually paid back to policyholders in the form of a rebate of a portion of their premiums. The plaintiffs are Texas policyholders who contend that State Farm has paid inadequate rebates in Texas in every year since 1994. They are asking the Texas court to require State Farm to pay out much of its surplus to policyholders.

The suit is patently frivolous. Under the common-law "internal affairs" doctrine, a corporation's internal affairs are governed by the laws of the state in which the company is

incorporated (Illinois, in the case of State Farm). Illinois law provides that private citizens may not sue insurance companies for inadequate dividend payments; rather, only the Illinois Director of Insurance may do so. Accordingly, Texas courts lack jurisdiction to hear this case.

The trial court nonetheless certified a huge class action; the plaintiffs now are representing all Texas residents who were State Farm policy holders at any time since 1994. The court of appeals affirmed the certification order; it held that Texas courts did indeed have jurisdiction to hear this type of case, and that the trial court did not err in certifying such a large class without explaining how it thought such an unwieldy case with so many plaintiffs could ever be tried.

In its brief, WLF argued that the lower court's certification of a class action in defiance of the "internal affairs" doctrine could well affect the willingness of insurance companies to continue to do business in the State and the ability of Texas consumers to continue to obtain competitively priced insurance. WLF noted that the decision below would countenance courts in each of the 50 states deciding for themselves whether interstate mutual insurance companies have paid adequate dividends to policyholders in each state, a situation that inevitably would lead to conflicting verdicts.

WLF also argued that trial courts should not be permitted to certify a class action without simultaneously explaining how they intend the trial to proceed. WLF noted that many certified class actions are so unmanageable as to be untriable; the inevitable result of such certifications is to require defendants to enter into a settlement, even when (as here) the case is frivolous, WLF argued.

The Texas Supreme Court's decision denying review suggested that the court believed that the appeal was premature -- that any appeal from the class action certification should come after a trial has been completed. WLF had argued that immediate review was warranted both because the court of appeals decision directly conflicted with existing Texas Supreme Court case law and because of the importance of the issues raised.

WLF is a public interest law and policy center with supporters nationwide, including many in Texas. It devotes a substantial portion of its resources to promoting tort reform and reining in excessive litigation.

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For further information, contact WLF Chief Counsel Richard Samp, (202) 588-0302. A copy of WLF's brief is available on its website, www.wlf.org.