Automobile Insurance

Texas Statute Forbidding Auto Insurers from Owning Auto Repair Shops Held Constitutional Since It Did Not Violate the Dormant Commerce Clause

Parts of that Texas Statute Do Violate the First Amendment Free Speech Clause

Allstate Insurance Co. & Sterling Collision Centers, Inc. v. Greg Abbott, In His Official Capacity as Attorney General of Texas, __ F.3d __, 2007 WL 2192895 (5th Cir., August 1, 2007) (revised August 22, 2007)

Case at a Glance

In 2000, Allstate entered the auto-body repair business by acquiring Sterling, a multi-state corporation for the auto repair shops. In 2003, the state legislature passed a statute prohibiting insurers from owning or acquiring an interest in an auto repair facility. However, the statute did not apply to shops an insurer already owned. Nevertheless, it established a set of rules for governing that group of shops. Most significantly the statute required an insurer who owned any such shop to offer the same referral arrangement used with its "tied body shop" with respect to at least one body shop with which it was not affiliated. Allstate sued in state court. Texas removed to federal court. After a bench trial, the district court held that the statute did not discriminate against interstate commerce either by intent or by effect. Hence, the dormant Commerce Clause in the United States Constitution was not violated. However, that court also held that the statute's speech provisions violated the First Amendment, since the statute was insufficiently narrow and deprived consumers of potentially beneficial information. A three-judge panel of the Fifth Circuit affirmed in a lengthy opinion.

Summary of Decision

Facts. By the turn in this century, Allstate had concluded that there was substantial inefficiency and dishonesty in the retail car repair market. It decided to experiment with having itself own auto-body repair shops. Hence, it bought Sterling Collision, which operated about 60-auto body repair shops in 14 states, including 15 shops in Texas. Allstate planned to improve the facilities and expand the number of shops. Allstate predicted it could minimize charges for unnecessary or overpriced repairs.

Allstate already had relationships with several local body shops in Texas through a program it named "Priority Repair Option" ("PRO"). Under that program, Allstate recommended PRO shops to claimants—insureds and others. If those shops maintained a specified level of quality and efficiency. If the claimant used a PRO shop, Allstate directly purchased the repair service and somehow guaranteed it. Allstate had found that most PRO shops had a lower average repair cost than non-PRO shops. Allstate was "still troubled by the prevalence of fraud and inefficiencies in repair work (even in PRO shops)," and it wanted to gain an advantage over competitors that used routine similar programs[.]" Consequently, it "decided to explore auto body shop ownership as an additional strategy for cost savings." Therefore, it acquired Sterling.

Allstate arranged for its telephone service representatives to use a script in dealing with claimants. They offered Sterling explicitly and referred policyholders to PRO shops only when asked. The text of the script begins by stating to the claimant that "You are always free to chose any repair shop and are under no obligation or requirement to use a shop we recommend[.]" The script goes on to say that Allstate would like to make the claimant aware of the benefits of "Sterling Auto Body Centers, which are affiliated with the Allstate corporation. The script goes on to say that these centers are "highly respected and provide exceptional customer service." Then says that Sterling will provide a "lifetime guarantee as long as you own your vehicle both parts and labor." The script goes on then to mention other minor benefits in using Sterling regarding handling of paperwork, guaranteed completion dates, professional cleaning, and car rental arrangements. (Sterling "will pay for additional rental expenses if the guaranteed delivery date is missed.")

In addition to using the script, Allstate eliminated its PRO relationship with shops located near a Sterling

shop. The plan was to funnel repair opportunities naturally. A segment in the business population did not joyfully embrace this commercial idea.

In 2003, the Texas Legislature considered and passed H.B. 1131. It has been codified as § 2307 of the Texas Occupational Code. The statute took effect on September 1, 2003. (The 5th Circuit panel mostly calls this law "H.B. 1131," and their example is sometimes followed here.)

The legislative history proved important in the action Allstate brought against the state. "Transcripts of the legislative hearings on the bill reflect both consumer protection and local industry concerns." People affiliated with body shop trade groups detailed what they called the danger of insurance company ownership of auto body repair shops. These witnesses all claimed to warn of "the conflict of interest inherent in such arrangement, arguing that it raised the risk of illegal customer steering." (This practice was already prohibited by sections of the Texas Insurance Code.) Witnesses predicted that body shops tied to insurers would "cut corners in an effort to reduce repair costs." Other witnesses testified that there would be an adverse impact on the local body shop industry.

Given the court's portrayal of the testimony, it is clear that most of the witnesses opposed the Allstate-Sterling pattern. Nevertheless, several Allstate representatives also testified. They attempted to "assuage fears about illegal steering and to frame the bill as an obstacle to consumer choice." ("Some types of steering are made illegal by sections of the Texas Insurance Code," said the court.)

The way the court portrays the testimony, it is reasonably clear that those who opposed the Allstate-Sterling pattern dominated. Nevertheless, the legislative history was opaque. "It is difficult to say from the legislative history what primary factor motivated the passage of the legislation. We have the not unusual situation where both sides find passages from the legislative history supporting their view of a predominant reason for the legislation." This observation is important to part of the court's decision.

The new statute prohibited insurers from acquiring or owning interests in auto repair facilities. At the same time, however, if an insurer already owned facilities and they were open for business at the time of the passage of the bill, then they were exempted from the bill. See Tx. Occ. Code § 2307.002. With respect to permitted facilities, the statute established a set of rules governing marketing. Section 2307.006(11) stated this: "An insurer may not enter into a favored [referral arrangement] exclusively with tied repair facilities." The law does not require that an insurer treat all body shops the same, however. It requires only that if an insurer extends an invitation to a consumer-claimant to use a referral program involving both a tied shop and at least one non-tied shop so that the insurer is operating a dual (at least) dual referral program, then tied and non-tied shops are all treated the same in insurer's presentation. See § 2307.009.

The statute created a private cause of action for any person "aggrieved" by a violation of the statute if the violation of the statute was serious, a court could impose a civil penalty, and that penalty would go to the Comptroller Public Accounts for deposits in the State's General Revenue Fund. (The Comptroller was a co-defendant with the Attorney Genera in Allstate suit.) The statute imposed no criminal penalties.

Procedure. Allstate sued in state court in Dallas County under the Texas Declaratory Judgment Act. Significantly, under this statute, "the Attorney General is a necessary party where the validity of the statute is at issue." Since he was sued only in his official capacity, the court has jurisdiction. After all, "the state is the real party in interest."

The State removed the case to federal court, thereby waiving its Eleventh Amendment Immunity. *Lapides v. Board of Regents of the University System of Georgia*, 535 U.S. 613, 620 (2002). Nevertheless, the State Defendants' argued that the dispute that is not a "case or controversy" under Article III of the United States Constitution. The panel rejected this argument.

Plaintiffs must satisfy three criteria in order to establish a case or controversy sufficient to given a federal court jurisdiction over the plaintiffs' claims. First, the plaintiffs must show that they have suffered, or are about to suffer, injury as a result of the statute. Second, there must be a causal relationship between the conduct complained of and the injury. Third, "'it must be likely, as opposed to merely speculative, that the injury will be redressed by a favorable decision.'" *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560 (1992).

The State Defendants conceded that Allstate had

suffered an injury, but they alleged that the people who were defendants were not involved in the causation process and that the actual people who were defendants could not redress Allstate for its injury. *Okpalobi v. Foster*, 244 F.3d 405, 426-27 (5th Cir. 2001) (en banc). Both of these arguments fail, of course, because the people who were named as defendants were present as parties only symbolically. Texas is the real party in interest. "Because the state itself is a party, causation and redressability are easily satisfied in this case. Causation is satisfied because the State passed H.B. 1131, a law which threatens Allstate with private civil action and civil penalties it continues with the business process to acquire additional Sterling Body Shops. A declaration of unconstitutionality directed against the State would redress Allstate's injuries because it would allow Allstate to avoid these penalties and lawsuits." See, *Franklin v. Massachusetts*, 505 U.S. 788, 790-91 (1992).

Decision: Commerce Clause Challenge. The challenge to the judgment of district court concerning the constitutionality of this statute are review de novo. To the extent that facts are relevant to the constitutional question, they are reviewed for clear error. There were few disagreements about the facts.

Statutes violate the dormant Commerce Clause when they discriminate against interstate commerce in either of two ways: by purpose or by effect. *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 270 (1984). The statute under challenge does not discriminate in either of the foregoing senses, the statute is valid, "unless the burden imposed on interstate commerce is 'clearly excessive' in relation to the putative local benefits."

Was the statute (H.B. 1131) passed by the legislature with a discriminatory purpose? The burden of proof with respect to issues like this is on the party challenging the statutory provision. *Hughes v. Oklahoma*, 441 U.S. 322, 336 (1979).

The United States Supreme Court has identified several questions relevant to determining whether "purposeful discrimination animated a state legislature's action[.]" There are these:

> Does a clear pattern of discrimination emerge from the effects of the state's legislative action?
>
> Does the historical background of the passage of the statute indicate discriminatory intent? (The answer to this question may "take into account any history of discrimination by the decision-making body[.]"
>
> What was the specific sequence of events leading up to the passage of this statute, including legislative and/or political departures from normal procedures?
>
> What was the legislative and/or administrative history up to the passage of the statute, including statements by decision-makers in connection with the legislative process?

Village of Arlington Heights v. Metropolitan Housing Development Corp., 429 U.S. 252, 266-68 (1977).

The panel held that district court did not clearly err in rejecting Allstate's conclusion and argument that H.B. 1131 was purposefully discriminatory as passed. Allstate did not demonstrate with a clear and consistent pattern of discriminatory action by the Texas Legislature. In addition, "Allstate failed to establish a history of hostility towards Allstate singularly or towards out-of-state companies in general." There was no proof of the Legislature departing from usual pre-passage procedures. There were hearings; some legislators met with Allstate executives on several occasions; Allstate testified at the hearings. The State Senate "stripped provision requiring complete divestiture of Allstate's ownership interest in Sterling." A few protectionists—even discriminatory—remarks but a few legislators did not invalidate the statute.

To be sure, the legislature had some purpose. Its purpose was "a legislative desire to treat differently two business forms—independent auto body shops[,] on the one hand[,] and insurance-company-owned auto body shops on the other—a distinction based not on domicile but on business form." See, *Ford v. Texas Department of Transportation*, 264 F.3d 493 (5th Cir. 2001) (dealerships tied to car manufacturers).

Does the statute have discriminatory effect since "it favors in-state body shops and will cause the services to shift from an out-of-state provider (i.e., Sterling) to in-state providers?" The answer is *No.* While it is true that the statute under consideration

impacts an interstate company, that fact does not—by itself—establish discrimination interstate commerce. To establish this effect, a number of factors need to be present: Barriers against categories of interstate businesses, prohibiting the flow of interstate goods for services, placing at a cost upon interstate goods or services, distinguishing between instinct and out-of-state companies or the retail market. *Exxon Corp. v. Maryland*, 437 U.S. 117, 126 (1978).

Allstate recognized that the *Exxon* case was an unsuccessful challenge to the dormant Commerce Clause. It relied, however, upon a footnote: "If the effect of a state regulation is to cause local goods to constitute a larger share, and goods with an out-of-state source to constitute a smaller share, of the total sales in the market . . . the regulation may have a discriminatory effect on the interstate commerce" *Id.* at 126, n. 16. The Fifth Circuit held that Allstate's argument did not work, since the statute to "not require Allstate to shut down any Sterling stores." Indeed, H.B. 1131 requires that "similarly situated in-state and out-of-state companies are treated identically." Neither in-state nor out-of-state insurers may acquire a body shop and the statute raises no barriers whatsoever to out-of-state body shops entering the Texas market[,] so long as they are not owned by insurance companies. In addition, the statute contains no prohibition on the flow of interstate goods or services; the statute imposes no additional costs upon interstate goods or services; and the statute does not distinguish between in-state and out-of-state companies in the retail market. Significantly, the panel observed "that it was of no consequence that no Texas insurer was affected by the new statute."

Were the requirements of the statute "'clearly excessive in relation to the putative local benefits'"? *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 1421 (1970). Allstate argued that the statute deprives Stern of the access to the Texas Collision Repair Market. The panel held that the argument failed because the dormant Commerce Clause protects the interstate market, as opposed to protecting interstate firms. Significantly, H.B. 1131 "does not prohibit other interstate repair chains or non-resident auto dealers not owned by insurance companies from operating in, or entering, the Texas market." Indeed, evidence presented at the trial showed that there were several such interstate repair shops operating in Texas. Besides, the legal standard for invalidating a state statute is that it be *clearly* excessive from the point of view of protecting local benefits. It is not the function of district courts to "'second-guess the empirical judgments of lawmakers concerning the utility of legislation.'" Statutes protecting putative local benefits are upheld "'so long as an examination of the evidence before or available to the law maker indicates that the regulation is not wholly irrational in the light of its purposes.'" See, *C.T.S. Corp. v. Dynamics Corp. of Am.*, 41 U.S. 69, 93-94 (1997) quoting *Exxon*, 437 U.S. at 127 (*Kassel v. Consolidated Freight Ways Corp.*, 450 U.S. 662, 680-81 (1981).

The panel observed that reasonable legislators could support H.B. 1131, that there was an exploration of evidence and attitudes before the legislature. In addition, "Allstate has not established that the burden on one interstate firm constitutes a burden on interstate commerce that clearly outweighs [the] local benefits [with which the legislature was reasonably concerned]."

First Amendment Challenge. Appellate review allocations of violations of free speech constitute mixed questions of fact and law and are reviewed de novo. Allstate alleged that certain sections of H.B. 1131 violated the First Amendment protection of truthful and non-deceptive commercial advertising. There were four significant challenges. Section 2306.006(3) of the Texas Occupation Code prohibits an insurer from engaging in joint marketing programs with tied repair facilities. Section 2306.006(4) prohibits insurers from providing recommendations, referrals, or descriptions to tied repair facilities which are not provided to at least one non-tied repair facility. Section 2306.006(6) prohibits tied repair facilities from using the insurer's name in a manner different from what that insurer permitted for other facilities which have referral arrangements. Section 2306.006(9) prohibits insurers from recommending that policyholders have their vehicles repaired at tied repair facilities except to the extent that it recommends other such facilities. These rules are designed to and in fact do apply to the Sterling Shops which existed at the time the legislation passed and which are authorized to continue operation under the statute.

Commercial speech is protected from governmental regulation when the speech is not false, not deceptive, or not misleading. *Zauderer v. Office of*

Disciplinary Council, 471 U.S. 626, 628 (1985). The United States Supreme Court has established a test for determining whether specific commercial speech regulation is statutorily permissible. First commercial speech must not concern unlawful activity or it must not be misleading. Second, the governmental interest must be substantial. Third, the regulation must directly advance the governmental interest asserted. Fourth, regulation must not be more extensive than necessary to serve the governmental interest. See *Central Heights and Gas & Electric Corp. v. Public Service Commission of New York*, 447 U.S. 557 (1980). And *Tompson v. Western States Medical Center*, 535 U.S. 357, 367 (2002). The panel held that all of these factors were not met, even though there was a legitimate state interest. Perhaps most interestingly the panel found that the claim in the Allstate script stating that the Sterling shops are "highly respected and provide exceptional customer service, was not misleading. The panel was impressed by the fact that the majority of claimants, who had heard the script, elected to use someone other than Sterling.

Upon these grounds, the district court had found the aforementioned four sections of the statute to be facially invalid. The Fifth Circuit affirmed. "It [wa]s not the content of a specific Allstate script at issue which guide[d] our analysis above, but rather the failure of the State Defendants to suggest a single circumstance in which these provisions, which ban non-misleading and truthful advertising, could be constitutionally applied. The Supreme Court has recently invalidated provisions containing similar blanket bans on advertising." See, *Tompson*, 535 U.S. at 371-77.

Comment

It is of minor interest to note that Automotive Service Association and Consumer Choice for Autobody Repair intervened in the case. Allstate, was of course the principal appellant based on the decision below concerning the dormant Commerce Clause, while the state officials were cross-appellants with respect to the First Amendment issues. The two intervenors aligned with the State of Texas in every respect. This is why the phrase "State Defendants" was used. After all, the named defendants were not additional defendants but statutorily icons for the state.

It is also of minor interest that Ken Starr was one of the appellate lawyers for Allstate. He argued the case before the Fifth Circuit panel. One wonders if he will argue this case before the Fifth Circuit en banc, and then before the Supreme Court of the United States, assuming those events take place.

One comes away from reading this case wondering whether Allstate's case could have been presented differently, and perhaps more convincingly. It seems to me that they needed an economic model which would show that body shops "tied" to honorable insurance companies would render accident repairs quicker, cheaper, and better. This is the sort of things thoughtful and well disciplined economists can do well, if the investigation and accounting have been done well. There was not even a hint of this type of evidence in the opinion.

Another problem is that the panel observed that the dormant Commerce Clause is to protect markets, not particular firms. That distinction is hard to make, if there is just one firm in a market. The key to the panel's argument is that they counted the market as *all body repair shops*. That should not be thought of as the market. The market was *all body repair shops controlled by insurance companies*. It was precisely that market which the body-shop trade groups was trying to prevent from birthing. It is a separate market not because of what they do—what services they offer–but because the pricing of parts and services will be entirely different, as well the data generated by the doing of the work and reporting it to the insurer. That will impact auto insurance substantially, and probably for the public good. // Quinn