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INSURANCE LITIGATION Reporter™

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Procedure/Class Actions

The Texas Attorney General is Not Required to Recruit Policyholders to Be Class Representatives When Suing Insurers under State Statutes

Prerequisites to Class Certification Apply to the Attorney General, Albeit in a Relaxed Manner

Farmers Group, Inc. v. Lubin, ___ S.W.3d ___ 2007 WL1225080 (Tex. April 27, 2007).

Case at a Glance

Class action prerequisites of numerosity, commonality, typicality, and adequacy apply to class action suits brought by the Texas Attorney General under the Texas Insurance Code, but they apply to damage claims asserted by the Attorney General, rather than to the Attorney General personally. Thus, the Attorney General need not recruit policyholders as class representatives.

Summary of Decision

Background. Texas Legislature amended the Insurance Code in 1973 to allow attorneys general to bring class actions on behalf of the buyers of insurance policies. This case was the first one in which an Attorney General tried.

Procedure. The action resulted from an investigation by the Texas Department of Insurance. The investigation found that Farmers was making inadequate disclosures to homeowner's buying its insurance and was discriminatory in its rating practices. The Commissioner of Insurance issued a cease-and-desist order, and initiated an administrative proceeding to collect penalties. The Attorney General separately filed this class-action based on the Insurance Commissioner's findings. Farmers responded as a party to both actions, but it also announced that it was going to withdraw from the Texas Homeowners Insurance Market.

"In these dire straights, the parties turned from litigation to negotiation." The parties reached global settlement within a few weeks. Farmers signed a class action settlement requiring Farmers to reduce its base premiums, adopt uniform discounts, offer refunds to non-renewing policyholders, discontinue certain tying practices, and pay the state $2 million in attorneys' fees and costs. The agreement was terminable by either party if more than two percent of the class members opted out. The settlement was valued at $117 million, "the largest property and casualty insurance settlement in the state's history."

The parties then applied to the district court. They wanted two things. They wanted the class certified, and they wanted the settlement approved. There were those in the state who did not want either. Five policyholders intervened, objecting to both certification and settlement approval. The district court granted certification and approved the settlement, on a preliminary basis. The intervenors filed an interlocutory appeal, and the case went to the Austin Court of Appeals, which reversed. Finding that the Attorney General must strictly comply with class certification requirements, the court of appeals held that the Texas Attorney General's failure to name individual class members as representatives precluded class certification.

Texas Supreme Court granted interlocutory review and reversed. Although agreeing that courts must rigorously analyze whether a party has strictly complied with all requirements for class certification., the supreme court reasoned requirements cannot be applied in a way that renders Attorney General class actions impossible, a result that would frustrate the Legislature's intent. Accordingly, the court ruled that standard class action requirements must be applied generally to the claims asserted by the Attorney General, not the Attorney General himself.

Insurance Code Class Actions. The Texas Insurance Code provides for three different types of class actions. The Department of Insurance may bring

administrative class actions for (but only for) premium refunds. The Attorney General may bring a judicial class action, and the attorney may recover damages and attorneys' fees. And, "a member of the insurance buying public," who has been damaged by an unlawful practice, may bring a class action and recover both damages and attorneys' fees. "[A]dministrative class actions take precedence [over the other two]; no judicial class action can be brought once the administrative class action has started." (See § 541.251(b) of the Texas Insurance Code, which was formerly art. 21.21, § 17(e).) Under the Code, the Department of Insurance may request the attorney general to bring a class action. Hence, the Code "unquestionably authorizes an Attorney General to file a class action[.]"

The issue before the supreme court was what an Attorney General must show in order to bring a class action under the Insurance Code. The state asserted that the Attorney General is *parens patriae* with respect to the citizenry and hence may file a class action without meeting the normal certification requirements, to wit: numerosity, commonality, typicality, and the adequacy of representation, a/k/a "the four certification prerequisites." The appealing intervenors challenged this view and argued that the Attorney General must meet all of the normal certification requirements, "even though this would require the Attorney General to recruit policyholders (such as themselves) as class representatives."

Parens Patriae (literally: "parent of the country"). The Texas Supreme Court declined to "engraft" the *parens patriae* doctrine on the [Insurance] Code for several reasons." First, "the words 'parens patriae' appear nowhere in the Code's class action provisions or in their legislative history." Second, parens patriae actions are theoretically related to class actions, but they are not one-and-the-same. The former is an alternative to the latter, not a species of the latter. Third, the Texas Supreme Court has generally invoked *parens patriae* only with reference to persons unable to protect themselves, such as children or the mentally ill. Such is not the case here. Fourth, and finally, "the doctrine has been invoked in other states to authorize government suits against makers and sellers of tobacco, lead paint, and guns." Finding no evidence that the Texas legislature had permitted similar use of *parens patriae*, the court refused to "authorize a broader role for the Attorneys General than the Legislature has."

Said the Court: "In sum, while *'parens patriae'* might be useful shorthand for referring to class actions brought by an Attorney General, the term is so vague and carries so much baggage that it obscures rather than clarifies our analysis. Accordingly, we decline to import it into the Insurance Code."

The Insurance Code. However, Justice Brister, for the court, rejected the idea that the Texas Attorney General can function as class counsel, only if at least one policyholder has been recruited as the class representative. He did so for several reasons.

- First, nothing in the Code says an Attorney General acts only as class counsel. Instead, the Code, given its language, probably authorizes attorneys general to file suits in their own right, "rather than merely acting as counsel for private citizens who want to do so."

- Second, under the Insurance Code, these actions are brought "upon the request of the Department [of Insurance], not individual consumers." Requiring an Attorney General to get the consent of individual policyholders to act as class representatives therefore "would fundamentally change who the statute authorizes to request filing."

- Third, "requiring an Attorney General to recruit individual representatives would be impractical." The point being made here is not actually a point about practicality. Instead, it is a point about conflicts of interest. Under the Texas Constitution, an Attorney General represents the state. It is to the state that his duties as an attorney run. If the Attorney General were representing private citizens in a class action, he would have a duty of loyalty to his private clients. See Rule 1.02 of the Texas Disciplinary Rules of Professional Conduct, relied upon by Justice Brister. Hence, "[i]mposing such a recruitment would inevitably restrict the 'broad discretionary power" attorneys general need to carry out their constitutional duties.

At the same time, the court rejected the Attorney

General's argument that an Attorney General does not ever need to meet any of the general class requirements. The state based its argument on § 541.256 of the Code (formerly art. 21.21, § 18(a)) which requires the four prerequisites only when "one or more members of a class. . . sue. . . as representative parties." Since the Attorney General is authorized to bring class actions without a class representative, the Attorney General maintained, the statutory prerequisites should not apply.

This argument was rejected, as usual herein, for several reasons. First, the language in the Code comes from Rule 23(a) of the Federal Rules of Civil Procedure. The federal rule applies to *all* parties, and "it would be surprising if legislators incorporated this word-for-word with the intention that it *not* apply to some." Second, the Code authorizes class actions "if the usual and widely-used prerequisites are satisfied," and if the action is one of the types which are maintainable. The court found it unlikely that the Legislature would require that the usual prerequisites be "satisfied," if it did not intend them to be applicable. Third, the Insurance Code authorizes the Attorney General to bring a "class action." The four prerequisites "define what a class action is." They are part of the definition of the phrase "class action." Consequently, they are "not simply procedural hurdles[.]"

At the same time, the opinion indicates that the majority "does not mean these prerequisites must apply in precisely the same way as in other class actions." In an official capacity, an Attorney General is never a policyholder, and thus cannot satisfy the Code's traditional class representative requirements, the court observed. But the Code also authorizes an Attorney General to file suit alone. Refusing to construe the Code in a way nullifies the Code's authorization of class actions by the Attorney General, the court held that the typicality, adequacy, and other prerequisites for all class actions must be applied to the damage claims asserted by an Attorney General, rather than to that official personally.

Court of Appeals Argument. The Court of Appeals had held that private class representatives were required in order to "measure the fairness of the settlement and to avoid possible conflicts in the Attorney General's dual roles." The dual roles appear to be (i) the Attorney General's representing the class and (ii) Attorney General's public duties to all Texans. This particular set of dual roles, in the supreme court's view, does not create the type of conflict which would disqualify the Attorney General from representing the class. (Of course, it is possible for an Attorney General to have disqualifying conflicts, but this case is plainly not one of them, said the court.

Constitutional Argument. The intervenors argued that permitting the Attorney General to have standing to bring class actions without a class representative would be unconstitutional. The court rejected this view. Both the national Congress and the Texas Legislature have passed acts in which Attorney Generals can institute lawsuits for injuries done to citizens. The right of "due process may require individual notice and opt-out rights, or other procedures that protect the interests of absent parties." It is difficult to see why the Attorney General would "necessarily fail those requirements." It is also unclear why the presence of private class members would necessarily improve the probability that these requirements are met.

Justice Hecht's Concurring and Dissenting Opinion

Dissent. Judge Hecht rejects the idea that the four prerequisites apply to class actions brought by the Attorney General. According to Justice Hecht, they do not apply, and this can be proven by the plain statutory language of the Insurance Code.

Justice Hecht articulates several additional reasons for his view. First, the fact that the language of the Insurance Code tracks federal Rule 23 does not entail that the Legislature intended to embrace the four prerequisites. In addition, it is not true that the federal rules absolutely require that if a governmental agency brings a class action, there must be an individual class representative. "Federal courts have refused to apply Rule 23's requirements to enforcement actions brought by federal agencies simply because the remedies sought may affect classes or groups of individuals." Thus, to the extent that Rule 23 is instructive, it is inconsistent with the majority's position.

Second, the legislature did not require that the four prerequisites be "satisfied" under each and every situation. The language of the Code can be read to the effect that "the four prerequisites must be satisfied *when* they apply—when a class action is brought by

'one or more members of a class'—not when they do not—when a class action is brought by the Attorney General. According to Justice Hecht, this is what the plan text actually says.

Third, according to Justice Hecht, Justice Brister's position that the four prerequisites are part of the definition of the phrase "class action" cannot possibly be right. Justice Hecht observed that "a class action brought by the Attorney General is already an unusual creature, . . . and having provided for it, the Legislature was not obliged to structure the procedure to satisfy the Court's idea of what a class action should be."

Concurrence. Justice Hecht concurs with part of the majority opinion. Noting that judicial supervision of class vehicles, including settlements, should not be relaxed, merely because a class action is being brought by the Attorney General, he concluded that "the case should be returned to the court of appeals for consideration of the numerous other issues respondents have raised."

Comment

This case makes insurance regulatory history. It is not clear how important the case will be since attorneys general seem to bring very few of these kinds of actions. Perhaps their number will increase.

Except for impassioned devotees of the twists and turns of marginal class-action procedural law, the heart of this case is not very interesting. Exactly the opposite is true of *Citizens Insurance Company of America v. Daccach*, 217 S.W.3d 430 (Tex. 2007), another insurance class-action in Texas decided on March 2, 2007. In the end, *Daccach* too is about class-action procedural law. Nevertheless, the portrayal of the facts contains an extremely interesting sketch of current tendencies in some parts of the insurance business.

Citizens, Inc. has a wholly-owned subsidiary, Citizens Insurance Company of America (CICA). Their principal place of business is in Austin Texas. Citizens sells life insurance policies exclusively to people outside the United States, through foreign insurance agents. Purchasers reside in over 35 countries. The CICA policies allow policyholders to assign dividends and other benefits to offshore trusts. The trusts use benefits they received to purchase common stock in Citizens, Inc. In every year since 1996, there have been approximately 30,000 CICA policies in effect, and the annual premiums average approximately $2,000. This creates a cash flow to the insurer of $60 million a year, or so. Seventy-five percent, at least, of the policyholders have assigned their dividends and other benefits to the offshore trusts.

The CICA policies are not registered with the Texas Department of Insurance, the Texas State Securities Board, any other regulatory body in the United States, even though the common stock purchased, for example, by the trusts is listed on the American Stock Exchange. In addition, neither Citizens nor its sales representatives registered with any regulatory body anywhere in the United States. In addition, Citizens argues that the CICA policies are not subject to regulation in any of the countries in which policyholders reside.

The *Daccach* case raised a number of interesting issues. Did the Texas Securities Act apply? *Yes.* Would applying Texas law violate due process? *No.* Can *res judicata* preclude subsequent litigation of claims abandoned in original suit? *Yes.* Must a trial court, in performing a rigorous analysis on the requirements of class action, consider the risk that a judgment in the class action case before it may preclude subsequent litigation of claims that are not alleged, claims that are abandoned, or claims that are split off from the class action? *Yes.* Was the definition of the class proper in this case? *Not in the trial court, but corrected in the Court of Appeals.*

Why is the *Daccach* case so interesting? The reason is that the insurance industry has changed substantially in recent years, and this point applies not only to property and casualty insurance, but also to life insurance. The insurance industry now is much more closely aligned with banks and capital markets than it once was. Increasingly, insurers are trying to provide their customers with what is often called "financial protection." Life insurance companies are evermore frequently selling "investment-oriented products." These come in many different forms. Consider the single premium deferred annuity. Consider the rampant use of securitization—the securitizing of insurance risks of a variety of different sorts. Sometimes these are called "Act-of-God" bonds. Sometimes this device is used to insure the payment of debts and thereby constitute a form of credit enhancement, e.g., various sorts of student loans, for example. See Eric Briys and Francois de Varenne,

INSURANCE FROM UNDERWRITERS TO DERIVATIVES—ASSET LIABILITY MANAGEMENT IN INSURANCE COMPANIES (2001). See also, *M.P. III Holdings, Inc. v. The Hartford*, 2006 W.L. 2645156 (E.D.Pa., September 14, 2006), plus a number of related cases, some of which are in Delaware. // Quinn