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TEXAS COURT CLAMPS DOWN ON CLASS ACTION CERTIFICATIONS

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

The Texas Supreme Court this month issued a decision that clamps down on the excessive number of class action lawsuits being certified by state trial courts.

The court's decision in *State Farm Mut. Automobile Ins. Co. v. Lopez* was a victory for the Washington Legal Foundation (WLF), which filed a brief urging the court to overturn an unwarranted class certification. WLF argued that in many instances defendants are being forced by such certifications to pay large settlements, even though in many instances the suits are nonmeritorious and the cases are wholly inappropriate for class action status.

"Members of the plaintiffs' bar have been getting rich by filing unfounded class action lawsuits against deep-pocketed defendants. This decision represents a giant step toward ending that racket," WLF Chief Counsel Richard Samp said after reviewing the court's decision. "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 involved 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; under the certification order, the plaintiffs were deemed to represent 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 reversing the certification order, the Texas Supreme Court agreed with WLF that trial courts should not be permitted to certify a plaintiff class without simultaneously explaining how they intend the trial to proceed. "Requiring a certification order to contain a trial plan allows a reviewing court to meaningfully evaluate whether certification of the class conforms with all [the] prerequisites" imposed by rules governing class actions, the court explained. The court noted that State Farm had raised serious questions regarding whether common issues of fact and law predominated over issues unique to individual class members; whether the named plaintiffs could adequately represent the entire class; and whether Illinois law was applicable and thereby defeated the entire action. The court said that the certification order reflected a "certify now and worry later" approach that it had previously rejected.

In its brief, WLF also argued that the lower court's certification of a class 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 lower court decisions 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 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 posted on its web site, www.wlf.org.