No. 06-10500

In the United States Court of Appeals for the Fifth Circuit

ALLSTATE INSURANCE COMPANY and STERLING-COLLISION CENTERS, INC.,

Plaintiffs/Appellants/ Cross-Appellees,

v.

GREG ABBOTT, in his official capacity as Attorney General of Texas, and CAROLE KEETON STRAYHORN, in her official capacity as Texas Comptroller of Public Accounts,

Defendants/Appellees/ Cross-Appellants

AUTOMOTIVE SERVICE ASSOCIATION and CONSUMER CHOICE IN AUTOBODY REPAIR

Intervenors/Appellees/ Cross-Appellants

On Appeal from the United States District Court
Northern District of Texas, Dallas Division

APPELLEES' PRINCIPAL AND RESPONSE BRIEF OF GREG ABBOTT AND CAROLE KEETON STRAYHORN

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CERTIFICATE OF INTERESTED PERSONS

The undersigned counsel of record certifies that the following persons and entities as described in the fourth sentence of Rule 28.2.1 have an interest in the outcome of this case. These representations are made in order that the judges of this court may evaluate possible disqualification or recusal.

<u>Plaintiffs/Appellants/Cross-Appellees</u>

Allstate Insurance Company
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<u>Defendants/Appellees/Cross-Appellants</u>

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Non-Parties[1]

The Allstate Corporation
Allstate Non-Insurance Holdings, Inc.

____
Don Cruse
Attorney of Record for Abbott and Strayhorn
Defendants/Appellees/Cross-Appellants

[1] Counsel's representation that these nonparties have a financial interest is based on Allstate's Certificate of Interested Persons.

Allstate's Certificate of Interested Persons also lists "All members of the Texas Legislature that voted for the passage of H.B. 1131, including Senator John Carona and Representative Kino Flores." Allstate Br. iii. Counsel represents that he is unaware of any financial interest that a member of the Legislature may have in this litigation. *Cf.* Local Rule 28.2.1.

STATEMENT REGARDING ORAL ARGUMENT

The State Defendants (Greg Abbott and Carole Keeton Strayhorn) concur in Allstate's suggestion that oral argument could assist the Court, at least as to the commercial-speech issues involved in the cross-appeal. *See* FED. R. APP. P. 34(a)(1). The dormant-Commerce-Clause issues, by contrast, do not require oral argument to resolve. Allstate's theory is precluded by Circuit precedent and, in any event, is built on characterizations of the record that do not withstand scrutiny.

TABLE OF CONTENTS

Certificate of Interested Persons i

Statement Regarding Oral Argument iii

Table of Contents iv

Table of Authorities vii

Jurisdictional Statement 2

Issues Presented 4

Statement of the Case...6

Statement of Facts 8

A. The Insurance and Autobody-Repair Industries, and Allstate's PRO Program 8

B. Allstate's Purchase of Sterling 9

C. Soon After the Acquisition, Allstate Is Forced To Change Its Strategy To Send More of Its Claimants to Sterling To Keep Volume at a Sufficient Level. 11

1. Allstate used a new "script" that gave Sterling preferential treatment over other autobody shops that Allstate also approved through its PRO program. 11

2. Throughout this time, Sterling's quality remains below that of other PRO shops, yet Allstate continues to funnel its policyholders to Sterling. 13

3. Rather than continue to offer its policyholders a choice among PRO shops, Allstate began to sharply curtail the number of PRO shops in order to give its insureds a stronger incentive to choose Sterling. 14

4. Allstate also used confidential information gathered from other autobody shops through its insurance operations to tweak Sterling's practices. 14

5. The new alignment between the interests of Allstate and Sterling removed an advocate for the claimants and led to lower quality. 15

D. The Allstate-Sterling Merger Has Failed To Achieve Its Promised Efficiency Gains. 16

E. The Texas Legislature Enacts a Statute To Regulate This Vertical Integration Between Insurers and Autobody-Repair Shops....................17

Summary of the Argument....................19

Argument....................21

I. Standards of Review 21

II. The District Court Erroneously Struck Down the Speech Component of the Code of Conduct. 25

A. The District Court Applied the Wrong Legal Standard for a Facial Challenge. 26

B. Because Texas Law Prohibits Allstate and Sterling from Operating Other Than at Arm's Length, the Regulated Speech Is "Misleading" Under the Commercial-Speech Doctrine. 29

C. These Restrictions Merely Require Allstate and Sterling To Operate at Arm's Length. 32

D. In the Alternative, the Texas Statute Satisfies *Central Hudson*. 36

E. If Anything, the Texas Statute Is Analogous to the Disclosure Requirements Upheld in *Zauderer*. 36

III. The District Court Correctly Rejected Allstate's Claim Under the Dormant Commerce Clause. 39

A. The Texas Legislature Did Not Have a Discriminatory Purpose; the Law Was To Attack a Vertical Business Model Irrespective of Domicile. 39

B. The Statute Does Not Have a Discriminatory Effect. 43

C. The Statute Passes the *Pike* Balancing Test. 46

IV. In Any Event, the McCarran-Ferguson Act Defeats Allstate's Dormant-Commerce-Clause Claim. 47

A. Through the McCarran-Ferguson Act, Congress Has Carved State Insurance Regulation from the Dormant Commerce Clause. 47

B. The Texas Statute Fits Within Congress's Grant of Primary Authority to States. 49

C. A Broad Reading Also Fits How the Supreme Court Has Construed the "Reverse-Preemption" Provision of the Act. 52

Conclusion 54

Certificate of Service 55

Certificate of Compliance 56

TABLE OF AUTHORITIES

Cases

Anderson v. City of Bessemer City,
470 U.S. 564 (1985).. 22, 23

Blum v. Stenson,
465 U.S. 886 (1984)..39

Brazos Valley Coalition for Life, Inc. v. City of Bryan,
421 F.3d 314 (5th Cir. 2005)..27

Central Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n,
447 U.S. 557 (1980).. 27, 29

Exxon Corp. v. Governor of Maryland,
437 U.S. 117 (1978).. 42, 43

Ford v. Tex. Dep't of Transp.,
264 F.3d 493 (5th Cir. 2001)..33, 35, 36, 39, 42-44

Granholm v. Heald,
544 U.S. 460 (2005).. 48, 49

Group Life & Health Ins. Co. v. Royal Drug,
440 U.S. 205 (1979).. 49, 50, 51, 52

Hays County Guardian v. Supple,
969 F.2d 111 (5th Cir. 1992)..22

Hunt v. Washington State Apple Advertising Commission,
432 U.S. 333 (1977)..44

Int'l Truck v. Bray,
372 F.3d 717 (5th Cir. 2004)..44

Lewis v. BT Investment Managers, Inc.,
447 U.S. 27 (1980)..44

LLEH, Inc. v. Wichita County, Tex.,
289 F.3d 358 (5th Cir. 2002) 21-22

Maine v. Taylor,
477 U.S. 131 (1986)...22

McCreary County v. ACLU,
125 S.Ct. 2722 (2005)...41

Members of City Council v. Taxpayers for Vincent,
466 U.S. 789 (1984)...27

Metro. Life Ins. Co. v. Ward,
470 U.S. 869 (1985)...53

Meyers v. Texas,
454 F.3d 503 (5th Cir. 2006) (op. on reh'g)...3

Ohralik v. Ohio State Bar Ass'n,
436 U.S. 447 (1978)...33

Okpalobi v. Foster,
244 F.3d 405 (5th Cir. 2001) (en banc) 2, 3

Or. Waste Sys., Inc. v. Dep't of Envtl. Quality,
511 U.S. 93 (1994)...44

Parson v. Kaiser Aluminum & Chem. Corp.,
575 F.2d 1374 (5th Cir. 1978) 22

Peel v. Att'y Registration & Discip. Comm'n,
496 U.S. 91 (1990)... 22, 29, 32

Pike v. Bruce Church, Inc.,
397 U.S. 137 (1970)...46

Pittsburgh Press Co. v. Pittsburgh Comm'n on Human
Relations, 413 U.S. 376 (1973) 36

Prudential Ins. Co. v. Benjamin,
328 U.S. 408 (1946).. 47, 48

Pullman-Standard v. Swint,
456 U.S. 273 (1982)..22

S.E.C. v. Nat'l Secs., Inc.,
393 U.S. 453 (1969).. 50, 53

U.S. v. Lopez,
514 U.S. 549 (1995)..47

U.S. v. Orellana,
405 F.3d 360 (5th Cir. 2005) 23

Umphlet v. Connick,
815 F.2d 1061 (5th Cir. 1987) 27

Union Bankers Ins. Co. v. Shelton,
889 S.W.2d 278 (Tex. 1994) 39

United States Dep't of the Treasury v. Fabe,
508 U.S. 491 (1993)..53

United States v. South-Eastern Underwriters Ass'n,
322 U.S. 533 (1944)..53

United States v. United States Gypsum Co.,
333 U.S. 364 (1948)..22

Va. State Bd. of Pharmacy v. Va. Citizens Consumer Council,
425 U.S. 748 (1976).. 29, 30

Village of Hoffman Estates v. Flipside, Hoffman Estates, Inc.,
455 U.S. 489 (1982)..27

W. & S. Life Ins. Co. v. State Bd. of Equalization,
451 U.S. 648 (1981)..48

Young v. Am. Mini Theatres, Inc.,
427 U.S. 50 (1976)....29

Zauderer v. Office of Disciplinary Counsel,
471 U.S. 626 (1985).... 37, 38

Statutes, Rules, and Constitutional Provisions

McCarran-Ferguson Act, 15 U.S.C. §1011, *et seq*. 48

15 U.S.C. §1011.... 48-49

15 U.S.C. §1012(a) 49

15 U.S.C. §1012(b) 52, 53

42 U.S.C. §1988 2

FED. R. APP. P. 4(a)(3) 7

FED. R. CIV. P. 52(a).... 23, 24

Local Rule 28.2.1 ii

TEX. CONST. art. IV, §22 2

TEX. OCC. CODE §2304.001 17

HOUSE BILL 1131, now codified at
TEX. OCC. CODE §2307.001, *et seq*.... 6, 17, 51

TEX. OCC. CODE §2307.001.... 17, 18, 35, 37, 40, 51

TEX. OCC. CODE §2307.002.... 18, 33, 34, 51

TEX. OCC. CODE §2307.003.... 18, 35, 37, 51

TEX. OCC. CODE §2307.004.... 18, 35, 37, 51

TEX. OCC. CODE §2307.005.... 18, 51

TEX. OCC. CODE §2307.006 .... 18, 25, 27, 28, 31, 35, 37, 51

TEX. OCC. CODE §2307.007 .... 18, 34

TEX. OCC. CODE §2307.008 .... 18, 31, 51

TEX. OCC. CODE §2307.009 .... 6, 19, 51

Other Authorities

Julian Cyril Zebot, Note, *Awakening a Sleeping Dog: An Examination of the Confusion in Ascertaining a Purposeful Discrimination Against Interstate Commerce*, 86 Minn. L. Rev. 1063 (2002) 41

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Northern District of Texas, Dallas Division

APPELLEES' PRINCIPAL AND RESPONSE BRIEF
OF GREG ABBOTT AND CAROLE KEETON STRAYHORN

TO THE HONORABLE COURT OF APPEALS FOR THE FIFTH CIRCUIT:

The State Defendants (Greg Abbott and Carole Keeton Strayhorn, in their official capacities) ask the Court to reverse the judgment in part and affirm it in part. It should affirm that States have authority to regulate an insurer's operation of an autobody-repair shop. But it should reverse the district court's erroneous judgment that Texas's Code of Conduct for insurers was facially invalid.

JURISDICTIONAL STATEMENT

Allstate's Jurisdictional Statement omits a concern that was identified and litigated below—whether Allstate's claims fail for lack of standing.[2] Although the State Defendants are defending a largely favorable judgment and do not seek dismissal of this action, they provide this discussion to assist the Court in evaluating its own jurisdiction.

Allstate sued two state officials, not the State itself. In state court, Allstate sued Texas's Attorney General and its Comptroller to declare invalid a statute that neither official enforces. 1.R.47-77 (state-court petition). After removal, Allstate amended its complaint to seek attorney's-fee damages from those two officials under 42 U.S.C. §1988. 3.R.648-80 (amended complaint); *see also* 3.R.676.

The officials moved for Rule 12(b)(1) dismissal on standing grounds, noting that the Texas statute creates a private cause of action; neither official is charged with its enforcement.[3] 4.R.876-91. Under Fifth Circuit precedent, there is a strong argument that Allstate's claims against these officials therefore failed for lack of Article III standing. *Okpalobi v. Foster*, 244 F.3d 405, 426-27 (5th Cir. 2001) (en

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[2] *See* 4.R.876-91 (motion to dismiss under Federal Rule of Civil Procedure 12(b)(1)); 5.R.1064-88 (Allstate's response); 5.R.1187-1202 (reply); 6.R.1276-77 (order).

Record references are designated "(volume#).R.(page#)." The volume of Appellants' Record Exhibits is referenced "R.E. tab (tab#)." The volume of the State Defendants' Record Exhibits is referenced "State Defs. R.E. tab (tab#)." The trial transcript is referenced "(volume#).Tr.(page#)." And trial exhibits are referenced "PX(exhibit#)" or "DX(exhibit#)."

[3] The Texas Attorney General is the attorney for the State and state agencies; only in defined classes of cases does the Attorney General sue on his own behalf. *See* TEX. CONST. art. IV, §22.

banc) (finding a deficiency in both the causation and redressability elements of Article III standing; noting a distinction between "the *statute's* immediate coercive effect on the plaintiffs [and] any coercive effect that might be applied by the *defendants*—that is, the Governor and the Attorney General").

There is, however, an added layer of complexity to the standing question—the presence of the Intervenors. Although Allstate never sought relief against them, *see* 3.R.649 (Allstate's amended complaint continued to name only Abbott and Strayhorn as defendants), the Intervenors sought to intervene as defendants, *see* 1.R.96-104. It is unclear whether Allstate would have had standing to sue the Intevenors preemptively (particularly for *facial* relief against the whole statute), but Allstate instead made the strategic choice to move to strike the Intervenors rather than to pursue claims against them. *Cf.* 3.R.558-583 (Allstate's motion).

Allstate's discussion of immunity, *see* Allstate Br. 1, does not answer these concerns about Article III standing. *See Okpalobi*, 244 F.3d at 424-25 (noting the independence of the two grounds for dismissal). Although the State Defendants dispute Allstate's characterization of sovereign immunity from suit under Texas law, Fifth Circuit precedent renders those differences immaterial after the State Defendants removed the action to federal court. *See Meyers v. Texas*, 454 F.3d 503, 504 (5th Cir. 2006) (op. on reh'g).

ISSUES PRESENTED

Principal Issues:

A Texas statute (H.B. 1131) prohibits any auto insurer from acquiring or expanding an ownership interest in any autobody-repair shop. It also provides a set of conditions under which any auto insurer that does own such an interest may continue to do so. Among those conditions are that the two operations must be conducted at arm's length, as defined in the statute, and that the insurer cannot make certain kinds of representations defined by the statute that might imply that the operations are intertwined.

1. Before the statute's effective date, Allstate brought a facial challenge asserting a commercial-speech violation. Allstate contends that a certain script it wishes to read its customers is technically truthful. Could an allegation of a single allegedly unconstitutional application render a statute invalid on its face?

2. The commercial-speech doctrine does not apply to speech that is inherently misleading or that is incidental to prohibited conduct. In light of Texas law's ban on operational integration between an insurer and an autobody shop, does the doctrine apply to speech that suggests a deeper connection between Allstate and Sterling?

3. Commercial speech is given less constitutional protection than are other types of speech. Do the four subsections of the statute that the district court held were facially invalid satisfy the test for commercial speech?

Response Issues:

The dormant Commerce Clause is a background rule that applies only in the absence of congressional action. When it applies, it limits the ability of States to discriminate based on the interstate nature of a transaction.

4. Was the district court correct that the statute did not have a "discriminatory purpose" within the doctrine of the dormant Commerce Clause? [Response to Allstate Issues 1 & 3]

5. The statute is facially neutral; it applies evenhandedly to insurers and autobody shops regardless of domicile. Allstate contends that because it happens to be an interstate corporation, the statute necessarily has an impermissible "discriminatory effect" on interstate commerce. Is Allstate correct that States cannot regulate a business model merely because the first company to exploit that model is an interstate firm? [Response to Allstate Issues 2 & 3]

6. The district court concluded that the benefits of the statute as considered by the Legislature outweighed the hypothetical burdens on interstate commerce. Was the district court correct in its balancing? [Response to Allstate Issues 4 & 5]

7. Through the McCarran-Ferguson Act, Congress placed primary responsibility for regulating insurance with the States. The Act exempts state insurance regulations from the background rule of the dormant Commerce Clause. Is Texas's regulatory scheme insulated by those portions of the McCarran-Ferguson Act? [Response to Allstate Issues 1 through 5]

STATEMENT OF THE CASE

In its 2003 regular session, the Texas Legislature enacted a statute (H.B. 1131) regulating the operation of autobody-repair shops by insurers.[4] TEX. OCC. CODE §2307.001, *et seq.* [The text of this statute is provided in the Addendum.] It creates a private cause of action by a "person . . . aggrieved by a violation of this chapter by an insurer" "to compel the insurer" to comply and to pay a civil penalty. TEX. OCC. CODE §2307.009(a) & -(c).

Before the statute's effective date, Allstate filed suit in Texas state court against the State Defendants—Greg Abbott (the Texas Attorney General) and Carole Keeton Strayhorn (the Texas Comptroller of Public Accounts). 1.R.47-77. Allstate sought a declaration of the statute's facial invalidity. 1.R.71, ¶80; 1.R.74, ¶92; 1.R.101, ¶101; 1.R.76. Two other parties, Automotive Service Association and Consumer Choice in Autobody Repair, intervened in the state-court action. 1.R.96-104.

The State Defendants removed to federal court. 1.R.34-37. Allstate moved for preliminary relief against certain subparts of the statute alleged to affect its commercial speech. 1.R.116-53. The district court granted preliminary relief. 2.R.389-406 (Dec. 11, 2003 order).

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[4] The statute was originally codified at Chapter 2306 of the Texas Occupations Code. In 2005, the statute was moved to Chapter 2307 of the same code. [R.E. tab 5].

The State Defendants moved under Rule 12(b)(1) to dismiss for lack of standing, arguing that—because neither of them is tasked with enforcing the statute or had attempted to do so—Allstate's injury was neither caused nor redressable by them. 4.R.876-891. The district court denied the motion. 6.R.1276-77.

At trial, the State Defendants and Intervenors submitted a joint motion for judgment as a matter of law arguing that the McCarran-Ferguson Act removed this insurance regulation from the reach of the dormant Commerce Clause. 10.R.2140-59; *see also* 4.Tr.192 (motion); 6.Tr.155-57 (renewing motion).

On March 9, 2006, the trial court rendered a final judgment declaring that "H.B. 1131 . . . is constitutional, except for sections 2306.006(3), (4), (6), and (9), which violate the First Amendment to the United States Constitution, and are therefore unconstitutional and invalid." 10.R.2490 [R.E. tab 3]. The trial court also entered findings of fact and conclusions of law. 10.R.2411-2489 [R.E. tab 4]. And it denied the State Defendants' and Intervenors' motion for judgment relating to the McCarran-Ferguson Act as moot in light of the failure of Allstate's dormant-Commerce-Clause claim. 10.R.2409-10 [State Defs. R.E. tab A].

On April 6, 2006, Allstate timely filed a notice of appeal. 10.R.2491-93 [R.E. tab 2]; *see* FED. R. APP. P. 4(a)(1). On April 10, 2006, the Intervenors timely filed a notice of appeal, as did the State Defendants on April 12, 2006. 10.R.2494-99 [State Defs. R.E. tab B]; *see also* FED. R. APP. P. 4(a)(3).

Statement of Facts

The State Defendants are dissatisfied with Allstate's presentation of the record. Rather than catalog those disagreements, they offer a counter-statement.[5]

A. The Insurance and Autobody-Repair Industries, and Allstate's PRO Program

This case involves an automobile insurer (Allstate) that has acquired a chain of repair shops (Sterling). FOF50.

When a person needs automotive repairs under an insurance policy, quite often "the insurance company is the first point of contact for a customer after a collision." FOF8. Claimants can accept a cash settlement offer (reflecting a measure of the reasonable cost of repair) or the chance to go to a repair shop that Allstate has approved. FOF17. If the policyholder chooses the latter course, Allstate becomes the direct payor for the repair services. FOF17. An Allstate executive explained, "They look to us to give them some kind of reference, to give them someone who can put the car back into the pre-existing condition." 1.Tr.100 (Rubenson). Thus, an insurer can "exert substantial influence and control over where its customer will take a wrecked car for repairs." FOF8.

At the same time, the insurers must negotiate with repair shops. The district court identified an "inherent conflict of interest" between the insurance company's desire to profit its shareholders (by keeping costs of repair low) and its duties to its

[5] The Intervenors' brief details the factual errors in Allstate's presentation.

insureds (to provide appropriate and safe repairs). FOF9. This tension has surfaced in the push by insurers to have cars repaired with non-OEM (non-"original equipment manufacturer") parts—parts that are not acquired from the manufacturer of the part being replaced—such as salvaged parts, recycled parts, or used parts. FOF10. These non-OEM parts are often of lower quality, but they generally save the insurer money. FOF10.

There are roughly 4600 autobody-repair shops in Texas. 4.Tr.183. Allstate has chosen some of these shops to participate in its PRO program—signifying that the shop has met a certain level of quality sufficient for Allstate to guarantee the repairs made by the shop. FOF36-38. When a claimant would call Allstate seeking advice for which autobody-repair shop to use, Allstate would recommend PRO shops near the claimant, resulting in a higher volume of repair work for the recommended shops. FOF39-40.

B. Allstate's Purchase of Sterling

In the late 1990s, Allstate was approached by investment bankers who suggested that Allstate look at acquiring one of the chains of "consolidators" that were springing up in the autobody-repair industry. 1.Tr.121-22 (Rubenson). "So the idea came initially from consultants and investment bankers. They said this is something [Allstate] can look at." 1.Tr.121-22 (Rubenson).

Eventually, Allstate did explore that acquisition option. When Allstate canvassed the field of large consolidators looking for acquisition targets, it identified Sterling as one of at least eight possibilities. FOF49 (Allstate considered firms including ABRA, AutoNation, the Boyd Group, Caliber, CTA, True 2 Form, and Sterling). Sterling boasted a "'team' approach to autobody repairs, under which multiple technicians would work on a single vehicle." FOF51. That model—the "'Sterling model' for collision repair"—had been "implemented long before Allstate purchased Sterling." FOF52. (As the district court found, many of the benefits that Sterling now touts also existed when Sterling was independent of Allstate. FOF52).

Sterling's rapid growth came through its own acquisition of existing "'Mom and Pop' body shops." FOF53. After having difficulty integrating these shops into a cohesive whole, Sterling then "migrated toward building new shops." FOF55. The older shops were known as "brownfields" and the newly built shops "greenfields." FOF55. The new greenfield shops were expensive to construct and equip, and they ultimately required building a new book of business. FOF57.

In 2001, Allstate acquired Sterling, in part to drive down its costs by taking advantage of economies of scale. FOF50 & FOF59. Sterling would benefit by having access to capital "a supply of customers." FOF58.

C. Soon After the Acquisition, Allstate Is Forced To Change Its Strategy To Send More of Its Claimants to Sterling To Keep Volume at a Sufficient Level.

"By acquiring Sterling, Allstate intended to take advantage of the economies of scale that were available in the Sterling shops." FOF59. But "[w]hen Allstate acquired Sterling, Sterling lost its source of referrals from other auto insurers who dropped Sterling from their preferred provider programs." FOF125. Those insurers hold 85% of the Texas market, while Allstate holds only 15%. FOF1 & FOF126. As soon as the integration with Allstate was announced—those other insurers dropped Sterling from their programs. 1.Tr.205-06. A senior Allstate executive testified that this reaction was a "surprise"—he had expected Sterling to continue to receive those referrals for some time. 1.Tr.205-09.

1. Allstate used a new "script" that gave Sterling preferential treatment over other autobody shops that Allstate also approved through its PRO program.

Soon after, Allstate began using a script "to first offer the services of the Sterling shops to its policyholders, without offering its PRO shops directly to the customer as it had previously." FOF67. Under this new practice, Allstate will "refer policyholders to PRO shops only when asked." FOF68.

This new script, in an aside, mentioned that policyholders had a choice, but then quickly offered Sterling's services without providing other options:

> Mr./Mrs. ________, of course you are always free to choose any repair shop and are under no obligation or requirement to use a

> shop we recommend, however, I would like to make you aware of the benefits of Sterling Autobody Centers, which are affiliated with the Allstate Corporation.
>
> Sterling Autobody Centers are highly respected and provide exceptional customer service. Sterling provides a lifetime guarantee as long as you own your vehicle on both parts and labor. In addition, they will handle all the paper work, keep you updated throughout the repair process, guarantee a completion date, and, even, professionally clean your vehicle inside and out. They can also assist with rental arrangements on site and will pay for additional rental expenses if the guaranteed delivery date is missed."

FOF62; *see also* PX362 (the script itself).[6] The document continues with an attempt to immediately close the sale: "May I recommend a Sterling shop near your home or work?" PX362 [State Defs. R.E. tab C].

The district court found that the script was not, as it understood the test, "false or misleading." FOF71. The district court explained, "From the script, it is clear to Allstate's customers that they are free to use any autobody repair shop they choose. It is also clear from the script that Allstate is advertising Sterling's services because Allstate is affiliated with Sterling."[7] FOF71.

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[6] The district court found that both Sterling and PRO shops "provide a lifetime guarantee on parts and labor for so long as the policyholder owns his or her car." FOF64.

[7] Although it is likely not material, there was some conflicting testimony about the precise nature of the affiliation between Allstate and Sterling. The script actually specifies that Sterling is affiliated with "Allstate Corporation"—a different entity than the insurance company with which the customer deals. *See* Allstate Br. ii (indicating that Allstate Corporation is the parent company). One senior Allstate witness testified that Sterling was "technically a nonaffiliated company" but that Allstate operates it as if it were a part of Allstate. 1.Tr.164.

2. Throughout this time, Sterling's quality remains below that of other PRO shops, yet Allstate continues to funnel its policyholders to Sterling.

Despite Allstate's goals of improving quality, a 2002 survey following up on repair satisfaction "showed that overall, consumers were less satisfied with Sterling than non-Sterling repairs." FOF75. An August 2002 internal review "found (among other things), that the repair quality at Sterling was below PRO standards in 60% of its stores." FOF94. For example, Sterling's stores in Houston "were given failing marks." FOF94. Yet, "[d]espite these findings, Allstate continued to refer its customers to Sterling." FOF95.

As of May 2003 (while the Texas Legislature was enacting the challenged statute), Allstate "had 'hard evidence' of quality issues related to Sterling." FOF75. "Despite its awareness of these customer satisfaction and quality problems, Allstate continued to refer its policyholders to Sterling." FOF75.

Indeed, although Allstate had information about the varying quality level of service provided by Sterling shops—including variations between greenfield and brownfield stores—Allstate "continued to refer customers to Sterling without regard to the quality and performance of the particular shop recommended." FOF76. "Allstate placed its own financial interests in Sterling above those of its policyholders who often turned to Allstate for guidance and recommendations about where to take their vehicles for repair following an accident." FOF85.

3. Rather than continue to offer its policyholders a choice among PRO shops, Allstate began to sharply curtail the number of PRO shops in order to give its insureds a stronger incentive to choose Sterling.

Another strategy that Allstate employed was reducing the number of other preferred shops available to its claimants. "Sterling's CEO Jon McNeill emphasized that Allstate needed to 'right-size' the number of PRO shops located within 10 miles of Sterling shops in order to increase business for Sterling." FOF84. Thus, "Allstate removed some independent repair shops from its PRO network. For example, in September 2001, an Allstate representative stated that Allstate had 'dialed down some fairly large PRO players that surround the North Houston stores as a first attack on volume.' Other PRO shops were also eliminated from the PRO program because of their location close to a Sterling shop." FOF81.

This trimming of the ranks of PRO stores was aimed more at increasing volume to Sterling than at improving the overall level of quality: "When Allstate reduced the size of its PRO network, Allstate did not remove any Sterling stores from that network, even when those shops experienced quality problems." FOF85.

4. Allstate also used confidential information gathered from other autobody shops through its insurance operations to tweak Sterling's practices.

Allstate also used its position as an insurer to send information to Sterling that it did not share with its other preferred autobody-repair shops. FOF80. This was "confidential information obtained from PRO shops" that helped Sterling "in

adjusting its operations based upon information Allstate knew about Sterling's competitors." FOF79-80.

5. The new alignment between the interests of Allstate and Sterling removed an advocate for the claimants and led to lower quality.

The district court also found as fact that "vertical integration of an insurance company into the autobody repair industry creates an inherent conflict of interest." FOF86. Based on the trial record, the court found, "Evidence and experience have shown that aligning those incentives" between insurance companies and repair shops to favor lower-cost repairs "places the repair shop in the unfortunate position of having to decide whether to be an advocate for the accident victim (its customer) or an arm of the insurance company keeping the costs of repair down." FOF86.

The district court discussed, in particular, a claimant whom Allstate referred to a Sterling location in Houston that "had received failing marks for repair quality in an internal audit Allstate conducted in August 2002." FOF89. When he noticed that "not all the repairs were complete," he asked the Sterling shop manager why, and was told that "Sterling had done all the repairs authorized by Allstate and that it was not up to her what repairs should be done." FOF91.

D. The Allstate-Sterling Merger Has Failed To Achieve Its Promised Efficiency Gains.

The district court found that "Allstate's acquisition of Sterling has produced mixed results to date, and has had problems achieving its goal of reducing costs in autobody repairs." FOF128. Allstate blames two factors in addition to the Texas statute for Sterling's nationwide difficulties: (1) "the immediate cessation of Sterling business from any other insurer after the date of the Allstate purchase"; and (2) "lower than anticipated volume from Allstate customers." FOF128.

At trial, Allstate's expert characterized the model as "an 'experiment' that should be allowed to go forward." FOF129. The district court rejected that expert's opinion, which was largely confined to "'possible' or 'potential' economies to be realized by the two companies." FOF130. "Regardless of Professor Harrington's vision of the potential benefits of the Allstate/Sterling integration, the court finds that on the current factual record, Allstate has not yet realized the efficiencies he identifies." FOF130. The district court also noted that the expert's opinion was at odds with evidence that "the cost of repairs at Sterling tended to be higher than similar shops" and evidence of substandard repair quality in 60% of Sterling's shops. FOF131.

The district court chose instead to credit the expert testimony of Dr. Donald House. FOF132. "Dr. House has explained that there is no evidence to show that the vertical integration of insurance companies into the collision repair industry

creates economies of scale. Dr. House believes, and the court agrees, that Allstate's ownership of Sterling gives Sterling economic incentives to under-repair vehicles, so that the costs paid by Allstate for repairs are reduced." FOF132.

E. The Texas Legislature Enacts a Statute To Regulate This Vertical Integration Between Insurers and Autobody-Repair Shops

In its 2003 Regular Session, the Texas Legislature enacted a statute regulating how insurers can own or operate a repair facility[8]—House Bill 1131, now codified in Chapter 2307 of the Texas Occupations Code. This statute is reprinted in the Addendum.

The Legislature first considered a bill that would have required any insurer that already owned an interest in a repair shop to divest itself of those assets. PX3; *see also* PX2 (printout of the Legislature's record of proceedings for the bill). After the Lieutenant Governor expressed some opposition to that aspect of the bill, a compromise was reached that included a less severe restriction on those insurers who already owned a repair shop. They would be allowed to retain their ownership interest so long as they complied with a Code of Conduct designed to prevent conflicts of interest and anticompetitive effects. *See* TEX. OCC. CODE §2307.001, *et seq*. In enacting this statute, the Legislature held hearings, *see* DX3,

[8] The statute defines "repair facility" as being "a person that engages in the business of repairing or replacing the nonmechanical exterior or interior body parts of a damaged motor vehicle." TEX. OCC. CODE §2304.001; *see also id.* §2307.001(5) ("'Repair facility' has the meaning assigned by Section 2304.001.").

DX4, PX7, PX11; had available staff-prepared bill analyses, *see* DX243, PX5, PX6; conducted its normal floor debates, *see* DX2, PX4; and permitted participation in the legislative process by, among others, Allstate and Sterling, FOF106, FOF108.

As enacted, the statute does two things. First, it prohibits an insurer from owning any interest in a repair facility "[e]xcept as provided by this section." *See* TEX. OCC. CODE §2307.002(a). Second, it establishes a set of rules to govern any insurer that already owns an interest in a repair facility—those grandfathered in under the statute. *See* TEX. OCC. CODE §§2307.002(d), -.003, -.004, -.005, -.006., -.007, -0.008. Accordingly, the statute's grandfathering provision does not really remove an insurer from the statute's reach; continued ownership of a repair facility is legal "only if the insurer and its tied facility are otherwise in compliance with this chapter."[9] *Id.* §2307.002(d).

Insurers who wish to continue to operate a repair facility must do so at arm's length. *Id.* §2307.007. Other provisions of the statute aim to implement that standard of conduct, such as the requirements in §2307.006, which provides a laundry list of prohibited conduct—including the four provisions struck down by the district court. 10.R.2490 [R.E. tab 3]. For enforcement, the statute creates a private cause of action for "injunctive or other appropriate relief to compel the

[9] The statute defines "tied repair facility" as "a repair facility in which an insurer owns an interest." *Id.* §2307.001(7).

insurer to comply," *id.* §2307.009(a), which "may" result in a civil penalty, *id.* §2307.009(b) & (c).

SUMMARY OF THE ARGUMENT

The district court upheld a Texas statute that: (1) prohibits insurers from buying or opening autobody-repair shops and (2) regulates how any insurer who already owns an autobody-repair shop can conduct business, requiring the two business units—insurance and autobody repair—to operate at arm's length.

But it struck down the parts of the same statute that require insurers to conduct themselves at arm's length from their own repair shops in dealing with the public—whether they can engage in joint marketing, share trademarks, and give their own repair shops preferential access to the insurers' claimants. The district court held that those provisions were facially unconstitutional under the commercial-speech doctrine. But allowing an insurer to make those representations while Texas law prohibits the actual operational integration between the two industries is inherently misleading and thus loses commercial-speech protection. *See* Part II.B, *infra*. These regulations are also an incident of the other conduct regulations: Preventing an insurer from giving preferential treatment to its own autobody-repair shop is part and parcel of requiring them to operate at arm's length. This part of the district court's judgment should be reversed. *See* Part II.C, *infra*.

The remainder of the district court's judgment—which rejected Allstate's theory under the dormant Commerce Clause—should be affirmed. The Texas statute attacks a troublesome new business practice, not any *interstate* aspect of that practice. The statute applies evenhandedly to local and interstate insurers, as well as to local and interstate autobody-repair chains. It is facially neutral and, as the legislative record confirms, aimed at the problems created by vertical integration in the sensitive area of insurance.

Rather than tailor its legal theory to fit this record, Allstate has taken the opposite approach—reframing the record to fit its legal theory. Allstate's method is to imagine that each participant in the legislative process was secretly fixated on interstate concerns, rather than concerns about vertical integration.[10] Even Allstate's issue presented tries to interject that concern, altering the district court's language and adding emphasis to what the district court did *not* say:

> (1) **Discriminatory Purpose:** Did the district court err when it concluded that "H.B. 1131's purpose . . . to protect one business model over another by favoring [***overwhelmingly local***] independent autobody shops over those [***exclusively*** out-of-state competitors] owned by insurers" is not a discriminatory purpose under the Dormant Commerce Clause?

[10] An integration between two firms that would otherwise deal with each other at arm's length as buyer and seller of goods or services is a "vertical" integration.

Allstate Br. 2 (all emphasis and alterations in Allstate's brief). Throughout the brief, Allstate employs this sort of gloss so often that it explains in a footnote, "Unless otherwise indicated, all emphases are added . . . ." Allstate Br. 3 n.1.

Nor does Allstate's legal theory hold together. Allstate believes that—as an Illinois company—if it happens to be the first adopter of a particular business model, each State in which it does business is powerless to regulate that model. Allstate suggests that, since it is first to use the model, regulating the model is synonymous with regulating interstate commerce. *See* Allstate Br. 14. So presumes much of Allstate's brief. But that fundamentally mistakes a corporation's status as an interstate *firm* for a statute's effect on interstate *commerce*—departing radically from the Supreme Court's modern jurisprudence. *See* Part III, *infra*. Nor can Allstate's theory be squared with the McCarran-Ferguson Act, which insulates insurance regulation from the dormant Commerce Clause. *See* Part IV, *infra*.

ARGUMENT

I. STANDARDS OF REVIEW

Allstate's suggestion that all issues "concerning a statute's constitutionality" are subject to *de novo* review, Allstate Br. 23, misses some nuances. That standard does apply to an alleged violation of free speech, which presents a mixed question of fact and law that is reviewed *de novo*. *LLEH, Inc. v. Wichita County, Tex.*, 289

F.3d 358, 364-65 (5th Cir. 2002); *Hays County Guardian v. Supple*, 969 F.2d 111, 116 (5th Cir. 1992). And it applies to whether commercial speech is "misleading," which is a legal characterization. *See Peel v. Att'y Registration & Discip. Comm'n*, 496 U.S. 91, 108 (1990) (plurality opinion).

But the standard of review applicable to the dormant Commerce Clause is more complex. Allstate broadly suggests findings of "nondiscrimination" are always subject to *de novo* review, relying on *Parson v. Kaiser Aluminum & Chem. Corp.*, 575 F.2d 1374, 1382 (5th Cir. 1978).[11] *See* Allstate Br. 23. That case, however, has been disapproved by the Supreme Court. *Pullman-Standard v. Swint*, 456 U.S. 273, 285-87 & n.15 (1982). It has instead treated "the empirical components" of scrutiny under the dormant Commerce Clause as factual findings subject to clear-error review. *Maine v. Taylor*, 477 U.S. 131, 144-45 (1986).

Factual findings may be set aside if they rest on an erroneous view of the law. *Pullman-Standard*, 456 U.S. at 287. But if the district court applies the right legal standards, the Court will not set aside a finding unless, based upon the entire record, it is "left with the definite and firm conviction that a mistake has been committed." *Anderson v. City of Bessemer City*, 470 U.S. 564, 573 (1985) (quoting *United States v. United States Gypsum Co.*, 333 U.S. 364, 395 (1948)).

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[11] Allstate's description of the test employed in *Parson* was also incomplete, omitting the "subsidiary" findings about discrimination to which even *Parson* would apply clear-error review. *See Parson*, 575 F.2d at 1382-83.

"If the district court's account of the evidence is plausible in light of the record viewed in its entirety," the Court will affirm—even if convinced that had it "been sitting as the trier of fact, [it] would have weighed the evidence differently." *Anderson*, 470 U.S. at 573-74. That level of deference acknowledges "the opportunity of the trial court to judge of the credibility of the witnesses." FED. R. CIV. P. 52(a). And the deference persists "even when the district court's findings do not rest on credibility determinations, but are based instead on physical or documentary evidence or inferences from other facts." *Anderson*, 470 U.S. at 574.

The standard of review for whether a statute has a "discriminatory purpose" under the Dormant Commerce Clause thus may turn on the Court's view of the underlying substantive legal standard. Allstate says that "statutory purpose is—like contract interpretation—a pure question of law," Allstate Br. 23, analogizing to a case that "review[ed] issues of statutory interpretation, including the legislative record, *de novo*," *id.* (describing *U.S. v. Orellana*, 405 F.3d 360 (5th Cir. 2005)). To the extent the Court is weighing the legislative record, as it would in a statutory-interpretation case, a *de novo* standard indeed seems appropriate.

But Allstate's attack on legislative "purpose" veers from the legislative record to encompass evidence far more pedestrian:

- "[t]alking points prepared by [one representative's] office"—refuting hypothetical objections that might be lodged against the bill—which Allstate contends "implicitly acknowledged" something about the bill, Allstate Br. 9 (citing PX25);

- an email from Allstate's Texas lobbyist to another Allstate employee describing a meeting with one legislator, Allstate Br. 10 (citing PX57);
- a memorandum from a trade group addressed "Dear Shop Owner," Allstate Br. 9-10 (citing PX58); and
- an email sent by a dealers' group to a dealership praising one legislator's role in passage of the bill, Allstate Br. 10 (citing PX53).

To the extent that the Court indulges Allstate's request that it weigh this type of speculative, circumstantial evidence of what a handful of individual legislators may have thought—rather than the legislative record itself—to discern the Texas Legislature's purpose, the Court should afford the district court's factual findings (made after testimony about many of these issues) the deference of clear-error review. *Cf.* FED. R. CIV. P. 52(a) ("due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses").

II. THE DISTRICT COURT ERRONEOUSLY STRUCK DOWN THE SPEECH COMPONENT OF THE CODE OF CONDUCT.

The district court properly upheld Texas's statute regulating how an insurer that owns an autobody-repair shop must conduct itself. 10.R.2490 [R.E. tab 3]. That statute sets out a Code of Conduct that the insurer must follow, effectively enforcing the statute's overall requirement that insurers deal with an autobody shop at arm's length to protect against conflicts of interest. TEX. OCC. CODE §2307.006(1)-(13). But the district court held, erroneously, that four subparts of that Code of Conduct were facially unconstitutional restrictions on commercial speech. *See* 10.R.2490 [R.E. tab 3] (striking down subparts (3), (4), (6), and (9) of §2307.006).

Three defects in that aspect of the judgment demand reversal, even before reaching the relatively lenient balancing tests for commercial speech. First, the district court turned on its head the test for facial invalidity. Instead of requiring Allstate to prove that the Texas statute has *no* valid applications, the district court erroneously relied on just one purportedly invalid application. *See* Part II.A, *infra*. Second, because Texas law requires the insurer and its tied shop to operate at arm's length, the speech regulated by the statute—including the Allstate "script" examined by the district court—is inherently misleading. *See* Part II.B, *infra*. And third, these restrictions are incidental to the statute's conduct regulations. As

Texas law requires Allstate and Sterling to deal at arm's length, it requires the same even-handedness in certain areas of marketing and sales. *See* Part II.C, *infra.*

Beyond those threshold reasons to reverse, the district court also erred in its application of the balancing tests for commercial speech. After all, the Texas statute allows Allstate complete freedom to trumpet the benefits of Allstate, and it allows Sterling complete freedom to trumpet the benefits of Sterling. It is only when Allstate seeks to violate the restriction on arm's-length dealing by treating Sterling on different terms than it does other autobody-repair shops that the Texas statute is violated. Those restrictions are perfectly suitable for this commercial-speech context.

A. The District Court Applied the Wrong Legal Standard for a Facial Challenge.

The district court's judgment declares four parts of the statute to "violate the First Amendment . . . and [to be] therefore unconstitutional and invalid."[12] 10.R2490 [R.E. tab 3]. But the district court applied the wrong legal standard. A judgment of facial invalidity must rest on the conclusion that the statute is unconstitutional in every application. A statute "may be facially unconstitutional in either of two respects: 'either . . . it is unconstitutional in every conceivable application, or . . . it seeks to prohibit such a broad range of protected conduct that

[12] Allstate's litigation strategy sought a "facial" invalidation of the law in a suit against these two State Defendants before any private litigant would have a chance to bring a private cause of action to enforce the statute.

it is constitutionally 'overbroad.''" *Brazos Valley Coalition for Life, Inc. v. City of Bryan*, 421 F.3d 314, 322 (5th Cir. 2005) (quoting *Members of City Council v. Taxpayers for Vincent*, 466 U.S. 789, 796 (1984)). And "the overbreadth doctrine does not apply to commercial speech." *Village of Hoffman Estates v. Flipside, Hoffman Estates, Inc.*, 455 U.S. 489, 497 (1982) (citing *Central Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n*, 447 U.S. 557, 566 n.8 (1980)); *see also Umphlet v. Connick*, 815 F.2d 1061, 1066 (5th Cir. 1987) ("[T]he only type of speech arguably infringed by the statute is commercial speech, to which the doctrine of overbreadth does not apply.").

The Texas statute is not "unconstitutional in every conceivable application."[13] *Brazos Valley Coalition for Life*, 421 F.3d at 322. Nor did Allstate attempt to make such a showing. Instead, Allstate presented isolated datapoints, such as a script that Allstate contends was not technically false.[14] PX362 [State Defs. R.E. tab C]; *see also* FOF62. But even if that one script had been protected commercial speech beyond the regulatory authority of the State (and Parts II.B

[13] For example, subpart (4) bars an insurer from providing a tied facility with an "advantage" or "access to its policyholders" on uneven terms, TEX. OCC. CODE §2307.006(4), provisions that are not targeted at speech and involve substantial non-speech conduct.
[14] The only other datapoint about which the district court made a factual finding was the Allstate website, which is also inadequate to support a judgment of facial invalidity.

through II.D explain why it is not), Allstate's showing could, at most, have justified as-applied relief—relief that Allstate chose for tactical reasons to forgo.[15]

Moreover, Allstate's script does not even implicate some of the subparts that the district court struck down as facially invalid—the subpart prohibiting "a joint marketing program," TEX. OCC. CODE §2307.006(3), and the subpart requiring an insurer to be evenhanded if it allows "a tied repair facility to use the insurer's name, trademark, tradename, brand, or logo," *id.* §2307.006(6). At the very least, striking down those provisions as facially invalid went too far.

Much turns on whether a judgment is facial or as-applied. An as-applied challenge lets courts focus on whether particular speech is misleading and how it intersects with the State's regulatory interests, resulting in a narrow judgment that leaves open whether the statute might later apply to other, perhaps more egregious, facts. By contrast, a judgment of facial invalidity strikes down the statute for all purposes; it can no longer be enforced even against unquestionably misleading communication. As a result of the district court's improper facial judgment, the challenged subparts of the Texas statute cannot be applied to any speech at all—not just the particular script that Allstate touts as "truthful." Allstate did not carry its heavy burden to justify that result.

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[15] Allstate's tactics may have been motivated by doubts over whether it had standing to pursue an as-applied challenge against the State Defendants, neither of whom actually enforces this statute. *See* pp. 2-3, *supra* (Jurisdictional Statement).

B. Because Texas Law Prohibits Allstate and Sterling from Operating Other Than at Arm's Length, the Regulated Speech Is "Misleading" Under the Commercial-Speech Doctrine.

A key difference between commercial speech and other types of speech is how "misleading" it must be to lose constitutional protection. In commercial speech, the government can curtail speech that has an inherent tendency to mislead even if that speech might, after careful parsing, be technically true. *Young v. Am. Mini Theatres, Inc.*, 427 U.S. 50, 68 (1976) ("[R]egulatory commissions may prohibit businessmen from making statements which, though literally true, are potentially deceptive."); *see also Peel*, 496 U.S. at 102 (recognizing that a "statement, even if true, could be misleading").

This distinction is reflected in the *Central Hudson* test itself, which carves out false or misleading speech from the protection of the doctrine. *Central Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n*, 447 U.S. 557, 563 (1980). The Court explained, "The government may ban forms of communication more likely to deceive the public than to inform it . . . ." *Id.* The State can, in the Court's words, ensure "that the stream of commercial information flow cleanly as well as freely."[16] *Va. State Bd. of Pharmacy v. Va. Citizens Consumer Council*, 425 U.S. 748, 771-72 (1976).

[16] The Supreme Court has explained that commercial speech (which is motivated by profit) is likely to be more "robust" than other forms of speech and, accordingly, there is less concern about it being indirectly chilled. *Va. State Bd. of Pharmacy*, 425 U.S. at 771 n.24. For that

The district court's finding that the script submitted by Allstate was not "false or misleading" is, accordingly, based on a misguided view of the law. *Cf.* COL61; FOF71. The district court explained its conclusion as being based on whether Allstate's statement, taken in a vacuum, was literally true:

> The court finds that Allstate's script is not false or misleading. From the script, it is clear to Allstate's customers that they are free to use any autobody repair shop they choose. It is also clear from the script that Allstate is advertising Sterling's services because Allstate is affiliated with Sterling.

FOF71. But those elements are not what the statute regulates. Of course Allstate can tell its insureds that they are free to choose whatever shop they wish—Allstate is perfectly free to make that statement regardless of this statute. Nor is it a violation of the statute for Allstate to, in the course of mentioning Sterling, signal to the insured that it may have a conflict of interest.

Allstate's script is misleading in three ways. First, it suggests a link between Allstate and Sterling that would be barred by Texas law. The statute as a whole bars many interactions between insurer and its tied body shop. If Allstate and Sterling really are in compliance with those requirements, then marketing that focuses on the deeper connection between Allstate and Sterling may mislead the consumer into believing that using Sterling would give them advantages—such as

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reason, it is "less necessary to tolerate inaccurate statements for fear of silencing the speaker." *Id.*

with pricing or other considerations—that are barred by Texas law.[17] *Cf.* TEX. OCC. CODE §§2307.006(1), -.006(5), .008.

Second, by giving Sterling primacy to the exclusion of all others with which Allstate has a favored-facility agreement, *cf. id.* §2307.004, the script tends to limit the listener's options.[18] The script ends, after all—not with an offer to list the other options—but with a request that the insured simply agree to use Sterling. PX362 ("May I recommend a Sterling shop near your home or work?").

Third, other elements of the script are actively misleading. The description of Sterling's "benefits" wrongly implies that the *other* members of Allstate's favored-facility program lack the same benefits. While the script touts Sterling's "lifetime guarantee" as its first selling point (and a bullet point on the script says "Most shops only guarantee their work for a limited time"), PX362, the district court found as fact that every other member of Allstate's program offered the same lifetime guarantee, FOF64. Worse, the script suggests that Sterling shops will offer a superior—or at least equivalent—quality of repair. Meanwhile, Allstate had information that 60% of its Sterling shops fell below those standards. FOF94.

[17] This is one concern of subsections 2307.006(3) and 2307.006(6), which limit joint marketing and the shared use of trademarks, precisely the types of communication that might lead a consumer to believe—incorrectly, under the Texas statute—that a shared corporate umbrella will affect insurance pricing, claims processing, or repair services.

[18] Presenting claimants with that additional information is one concern of subsections 2307.006(4) and 2307.006(9), which require an insurer to present information about its tied repair shop in the full context of the *other* options available to the claimant. Without that context, an insurer can exploit its significant influence with claimants to serve its own financial self-interests at the expense of policyholders. *Cf.* FOF8.

The district court found as fact that a significant number of Sterling shops, scattered throughout the country, had failed quality inspections and yet Allstate made no effort to tailor its recommendation accordingly. FOF94-95, FOF131. And the district court found as fact that, while Allstate believed that the Sterling experience was very different for customers who went to newly built shops (greenfields) rather than older shops (brownfields), Allstate "continued to refer customers to Sterling without regard to the quality and performance of the particular shop recommended."[19] FOF76.

The district court understood those facts. But because it applied the wrong legal test for when commercial speech is "misleading," it held the statute to be facially invalid. That aspect of the judgment should be reversed.

C. These Restrictions Merely Require Allstate and Sterling To Operate at Arm's Length.

It is well-settled that unlawful conduct cannot be shielded from regulation merely by packaging that conduct in words:

> Numerous examples could be cited of communications that are regulated without offending the First Amendment, such as the exchange of information about securities, corporate proxy statements, the exchange of price and production information among competitors, and employers' threats of retaliation for the labor activities of

[19] These indiscriminate recommendations are reminiscent of the hypothetical discussed by the plurality in *Peel*—"if the statement had been issued by an organization that had made no inquiry into petitioner's fitness, or by one that issued certificates indiscriminately for a price, the statement, even if true, could be misleading." 496 U.S. at 102 (plurality opinion); *see also id.* at 112-15 (Marshall, J., concurring in judgment) (applying an even looser standard for identifying misleading commercial speech).

> employees. Each of these examples illustrates that the State does not lose its power to regulate commercial activity deemed harmful to the public whenever speech is a component of that activity.

Ohralik v. Ohio State Bar Ass'n, 436 U.S. 447, 456 (1978) (citations omitted).

The district court was wrongly fixated on whether the words in Allstate's script were technically truthful rather than whether those words were part of a prohibited course of conduct. *Cf.* COL61, COL64. Words spoken to consummate a bribe are perhaps true, but that is no defense. Nor does the First Amendment shield the speech activity involved in contracting to restrict trade in violation of the antitrust laws—however "true" the promises exchanged by the parties.

The challenged parts of the Texas statute relate to a prohibited course of conduct—an insurer operating an autobody-repair shop at other than arm's length. Under the guidance of *Ohralik* and this Court's decision in *Ford v. Texas Department of Transportation*, 264 F.3d 493 (5th Cir. 2001), the district court should have held that the First Amendment did not shield this conduct, despite it being "carried out by means of language." *Ohralik*, 436 U.S. at 456.

The district court's error was in how it considered the question of whether Allstate's speech concerned legal or illegal conduct. The district court concluded that it concerned legal conduct because "Allstate's ownership" of Sterling "is expressly made lawful under" Texas Occupations Code §2307.002(b). COL70.

But asking about the legality of "ownership" is a red herring—that is not the feature of the Texas statute at stake here. The statute requires the two businesses, while under shared ownership, to operate at arm's length. It requires, among other things, that "an agreement between an insurer and its tied repair facility must be negotiated and executed as an arm's length transaction." TEX. OCC. CODE §2307.007; *see also id.* §2307.001(1) (defining "arm's length transaction"). And the four challenged provisions are about enforcing that standard of conduct on insurers.[20]

Fitting its purpose, the statute requires only even-handedness, not silence, about Sterling. Both subparts arguably implicated by Allstate's script would permit Allstate to discuss Sterling—so long as it, on even terms, also informed callers of their other Allstate-approved options. The provisions state, "An insurer may not: . . .

> (4) provide its tied repair facilities a recommendation, referral, description, advantage, or access to its policyholders or other beneficiaries under its insurance policies that is not provided on identical terms to other repair facilities with which the insurer has entered into a favored facility agreement; . . .
>
> (9) authorize or allow a person representing the insurer, whether an employee or an independent contractor, to recommend to a policyholder or other beneficiary under the insurance policy that the policyholder or other beneficiary obtain repairs at a tied repair facility, except to the same extent that the person

[20] Indeed, the grandfather clause that permits Allstate to retain its ownership interest in Sterling is itself conditioned on compliance with the other provisions of the statute. *Id.* §2307.002(d).

> recommends other repair facilities with whom the insurer has entered into a favored facility agreement . . . .

TEX. OCC. CODE §2307.006(4) & -(9); *see also id.* §§2307.001(3), -.003, -.004 (discussing "favored facility agreements").[21] For Allstate to give Sterling a position of special prominence defies the aspects of the statute designed to ensure the integrity of the statute's requirement that insurers deal with repair shops at arm's length. By the same token, allowing Sterling to benefit from "joint marketing," *id.* §2307.006(3), or a special dispensation for using the "insurer's name, trademark, tradename brand or logo in a manner different from that allowed for any other favored facility," *id.* §2307.006(6), would also break down the arm's-length relationship.

The case should also be controlled by *Ford*. In *Ford*, the Court upheld a Texas law that prohibited Ford from advertising cars on its website in a manner that circumvented Texas law's prohibition on it retailing cars to consumers. 264 F.3d at 506. The Court explained: "Section 5.02C(c) prohibits manufacturers from retailing motor vehicles to consumers. An accompanying result of this prohibition is that Ford is not allowed to advertise the sale of motor vehicles to

[21] A "favored facility agreement" is "an agreement between an insurer and repair facility under which the insurer agrees to recommend, directly or indirectly, to its policyholders or other beneficiaries under the insurer's policies, that the policyholder or other beneficiary obtain repairs at the repair facility . . . ." TEX. OCC. CODE §2307.001(3). If an insurer owns a tied repair facility, the insurer is allowed to have only one set of terms that it uses for all such agreements, *id.* §2307.004(a), and it is presumed that its tied facility is subject to that agreement, *id.* §2307.003, placing the tied facility on an equal plane with other, non-tied repair facilities.

consumers." *Id.* And it quoted *Pittsburgh Press Co*. for the proposition that any First Amendment concern "is altogether absent when the commercial activity itself is illegal and the restriction on advertising is incidental to a valid limitation on economic activity." *Id.* (quoting *Pittsburgh Press Co. v. Pittsburgh Comm'n on Human Relations*, 413 U.S. 376, 389 (1973)).

Under the challenged statute, it is illegal for Allstate to operate Sterling in a manner other than at arm's length, yet it wants to advertise to consumers that there is a connection between the two companies that should influence their choice of autobody-repair shops. Just as Ford could not use the speech nature of "advertising" to circumvent a valid restriction on the substance of its business activities, Allstate should not be able to cloak its relationship with Sterling in a script it gives its call centers in order to circumvent Texas's valid regulations of the insurance industry.

D. In the Alternative, the Texas Statute Satisfies *Central Hudson*.

To avoid needless duplication, the State Defendants join the Intervenors' discussion of how the statute satisfies the general First Amendment balancing tests for regulations commercial speech.

E. If Anything, the Texas Statute Is Analogous to the Disclosure Requirements Upheld in *Zauderer*.

The requirement that Allstate speak on even-handed terms about all members of its favored-facilities program is similar to the requirement upheld in

Zauderer v. Office of Disciplinary Counsel, 471 U.S. 626 (1985). In *Zauderer*, the Supreme Court noted the distinction between "disclosure requirements and outright prohibitions on speech." *Id.* at 650. Ohio required its attorneys to provide additional information to prospective clients in regard to fees—what the Court characterized as "somewhat more information than they might otherwise have been inclined to present." *Id.* The Court noted that, in the context of commercial speech, the State was perfectly permitted to require that a person "include in his advertising purely factual and uncontroversial information about the terms under which his services will be available." *Id.* at 651.

The Texas statute works much the same way. It provides a substantive limitation on "the terms under which" the insurer can conduct a favored facilities program that offers an array of recommended choices to its insureds. TEX. OCC. CODE §2307.001(3), -.003, -.004(a). It requires that the insurer include its tied body shop within that program, *id.* §2307.003, and it prohibits the insurer from including only its own tied body shop within that program, *id.* §2307.006(11). The challenged parts of the Texas statute require the insurer to make a full disclosure to the insured of all of their options under the program.

Thus, under *Zauderer*, even if this speech is not inherently misleading, *see* Part II.B, *supra*, and even if it is not considered incidental to prohibited conduct, *see* Part II.C, *supra*, the State still has the ability to require this sort of full

disclosure so long as the “disclosure requirements are reasonably related to the State’s interest in preventing deception of consumers.” *Zauderer*, 471 U.S. at 651. And, based on the reasons explained in Parts II.B–II.D, *supra*, these regulations would also meet the more lenient *Zauderer* test.

III. THE DISTRICT COURT CORRECTLY REJECTED ALLSTATE'S CLAIM UNDER THE DORMANT COMMERCE CLAUSE.

This claim is largely, perhaps entirely, controlled by the Court's 2001 decision in *Ford Motor Co. v. Texas Department of Transportation*, 264 F.3d 494 (5th Cir. 2001). In that case, the Court confronted the question whether Texas could bar an automobile manufacturer from vertically integrating into selling cars directly to consumers. *Id.* at 497-99. The Court concluded that: (1) the regulation did not have a discriminatory purpose—it was aimed at an impermissible business model regardless of domicile, *id.* at 500-01; (2) it did not have a discriminatory effect, even though Texas does not happen to have any local automobile manufacturers, *id.* at 501-02; and (3) it satisfied the *Pike* balancing test because the benefits of the statute (those benefits that a reasonable member of the Legislature could believe would flow from the statute) were not clearly outweighed by any detrimental effects on interstate commerce, *id.* at 503-04. The same result should hold here.

A. The Texas Legislature Did Not Have a Discriminatory Purpose; the Law Was To Attack a Vertical Business Model Irrespective of Domicile.

When determining the intent of the Legislature, courts should first look to the language of the statute and then to the legislative history. *Blum v. Stenson*, 465 U.S. 886, 896 (1984); *Union Bankers Ins. Co. v. Shelton*, 889 S.W.2d 278, 280 (Tex. 1994). The statute's text is facially neutral. There is no serious contention

that the Texas statute is facially discriminatory. Its terms apply equally to both local and interstate insurers. TEX. OCC. CODE §2307.001, *et seq*. They apply equally to local and interstate autobody-repair shops. The statute would apply just as fully to any Texas-based insurer that wished to mimic Allstate by buying an autobody-repair shop.

And the legislative history confirms that the Legislature was concerned with the business model, not with affecting the balance of interstate commerce. The Legislature was concerned with the problems created by such a vertical integration in the insurance industry, including protecting consumers from a conflict of interest and preventing anti-competitive practices. *E.g.*, PX5, PX6, DX243 (bill analyses created in the Texas Legislature); *see also* COL27-31.

Allstate belittles this legislative record by liberal use of epithets such as "pretextual" and "perfunctory." *E.g.*, Allstate Br. 2, 10. But the legislative record speaks for itself. Allstate's charge of "pretext" is particularly hard to square with its lobbying posture—its internal studies verified the deep public concern over the conflict-of-interest and quality issues implicated by insurer ownership, and even its own contemporaneous lobbying documents (and related testimony) confirm its awareness that the Texas Legislature was weighing those concerns. *E.g.*, DX8, at AL0063977 ("Allstate-Sterling oversight model does not provide a basis in fact

and in practice to counter" objections); DX12; DX345; *see also* DX6 (document suggesting that insurer-ownership was proving "a difficult practice to defend").

Allstate also tries to shift the focus from the statute's purpose to the purported motives of a handful of legislators whom Allstate derides as having "protectionist" goals. Allstate Br. 10. Setting aside the question whether one legislator's state of mind can unravel an entire statute,[22] the substance of Allstate's complaint blurs together two materially different things: (1) a purpose to regulate a particular business model that happens to be held by an interstate company and (2) a purpose to alter the balance of interstate commerce. This Court has already made clear that it is only the latter that matters—"Ford has failed to show that, either facially or in practical effect, [the statute] discriminates according to the extent of a business entity's contacts with the State. [The statute] does not discriminate based

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[22] It is far from clear that Allstate's attacks on just a few legislators—which are premised on inferences drawn from highly circumstantial evidence far removed from the legislative record itself—could ever condemn the statute as a whole. Allstate's constitutional theory seems to be that one bad apple spoils the bunch—that an allegedly impermissible motive by a single legislator, or even a lobbyist supporting a bill, could condemn the whole statute. That would depart from the modern view of legislative purpose.

In *McCreary County v. ACLU*, the Supreme Court recently defended the propriety of looking at legislative purpose in the Establishment Clause context, emphasizing that the inquiry is about the purpose of the body based on the legislative record. 125 S.Ct. 2722, 2724 (2005). After including the dormant Commerce Clause among those areas in which legislative purpose was "relevant," the Court emphasized that such inquiries "make practical sense, as in Establishment Clause analysis, where an understanding of official objective emerges from readily discoverable fact, without any judicial psychoanalysis of a drafter's heart of hearts." *Id.* Allstate's request that each legislator be subjected to "judicial psychoanalysis," *id.*, should be declined. *See generally* Julian Cyril Zebot, Note, *Awakening a Sleeping Dog: An Examination of the Confusion in Ascertaining a Purposeful Discrimination Against Interstate Commerce*, 86 Minn. L. Rev. 1063 (2002).

on Ford's contacts with the State, but rather on the basis of Ford's status as an automobile manufacturer." *Ford*, 264 F.3d at 502. And Allstate has not established that the Texas Legislature intended to draw distinctions based on "the extent of a business entity's contacts with the State."[23]

Instead, Allstate complains that it was the only firm affected by the statute and that, accordingly, the only firms affected were interstate firms. But there are Texas insurers that are affected by the statute in that they cannot later decide to emulate Allstate's business model by vertically integrating with an autobody-repair shop. The situation is like *Ford*, in which the Court rejected Ford's argument that few Texas-based firms would be affected implied a discriminatory purpose. 264 F.3d at 502. In *Ford*, the Court noted that *Exxon* foreclosed that argument. *Id.* (citing *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117, 125 (1978)). The same result should hold here.

[23] Allstate's argument is also at odds with the district court's findings of fact, which express some view as to the personal motives of at least a few individual legislators. Thus, even if that sort of subjective intent were legally relevant, Allstate would have failed to show clear error. *See* FOF99-104. The court found that Representative Kino Flores "was concerned that tied repair shops created a conflict of interest that would hurt consumers by eliminating their voice and their advocate (the independent repair facility) in the auto repair process." FOF99. It acknowledged that proof had been offered that Representative Nixon and Representative Puente also suggested their concern that a conflict of interest would allow the insurer to "make an extra buck off you" or "earn a premium twice." FOF102-103. And it noted that Senator John Carona "explained that his chief motivation in supporting [the bill] was to eliminate the obvious conflict of interest that arises when an insurance company also owns the repair facility." FOF104.

B. The Statute Does Not Have a Discriminatory Effect.

What does it mean for a statute to have a discriminatory effect under the dormant Commerce Clause? This Court has explained:

> Absent a facially discriminatory purpose, a State statute or regulation is discriminatory when it provides for differential treatment of similarly situated entities based upon their contacts with the State or has the effect of providing a competitive advantage to in-state interests vis-à-vis similarly situated out-of-state interests.

Ford, 264 F.3d at 501.

The district court correctly determined that the statute does not have a discriminatory effect. COL34-35. The distinctions drawn in the statute are based on whether an insurer is vertically integrated with an autobody-repair shop—not on any interstate characteristic of the businesses. It confers no competitive advantage to any similarly situated local businesses—it instead prohibits the creation of new similarly situated businesses, whether local or interstate.

In *Ford*, the Court applied that "similarly situated" language to conclude that a vertically integrated manufacturer-dealer was not similarly situated to a mere dealer. *Id.* at 502. The Court adhered to that rule in *International Truck*, which also explained the link between *Ford* and *Exxon*:

> *Ford*'s understanding of discrimination rests squarely on *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117 [] (1978), in which the Court evaluated a Maryland law that prohibited producers and refiners of petroleum products from operating retail service stations. The Court rejected Exxon's claim that, because Maryland had no in-state petroleum producers and refiners, the law discriminated against out-

> of-state interests. *Id.* at 125[]. That the law affected only out-of-state interests did not tend to prove impermissible discrimination. *Id.* at 125-26[].

Int'l Truck v. Bray, 372 F.3d 717, 725 n.9 (5th Cir. 2004); *see also id.* at 726 (applying this rule to find no discrimination). Indeed, both *Ford* and *International Truck* address Allstate's main contention—that somehow this rule cannot be squared with cases such as *Hunt v. Washington State Apple Advertising Commission*, 432 U.S. 333 (1977), and *Lewis v. BT Investment Managers, Inc.*, 447 U.S. 27 (1980); and *Oregon Waste Systems, Inc. v. Department of Environmental Quality*, 511 U.S. 93 (1994)—and reject that objection, concluding that the rule applied in *Ford* is perfectly consistent with Supreme Court guidance. *See Int'l Truck*, 372 F.3d at 725 (distinguishing *Hunt*, *Lewis*, and *Oregon Waste*); *Ford*, 264 F.3d at 500 (distinguishing *Oregon Waste*); *id.* at 501 (distinguishing *Hunt* and *Lewis*). This Court has already considered and rejected that aspect of Allstate's argument.

And although Allstate tries to repaint this case in highly charged language of "protectionism," *e.g.*, Allstate Br. 10, the characteristic feature of the market for collision-repair services is whether the firms are independent of an insurer—not where the company is domiciled. Sterling—an interstate company even before it was bought by Allstate—was an example of that last group, as are a number of other interstate "consolidators" and chains of automobile dealerships. FOF49.

Other interstate firms (such as Maaco) are also moving into the autobody-repair market. 2.Tr.84. And chains of automobile dealers also run body shops that compete with Sterling. COL46; 5.Tr.132 & 136-38. Thus, "collision repair work that may have been done by Sterling will go to either locally-owned autobody repair shops or interstate collision repair chains (including interstate auto dealerships that operate collision repair facilities)." FOF97.

Allstate contends that—if it shut down Sterling or withdrew Sterling from Texas—the work that it currently funnels to Sterling would have to go to some other, possibly local, autobody-repair shop. Allstate Br. 14-15. This is a strange way to frame the question. The Texas statute merely freezes in place Sterling's penetration in the Texas market—it does not require Allstate to divest so long as it complies with the Code of Conduct. And, in Allstate's hypothetical, it is Allstate that would be in control of which shops it permits to join its PRO program and thus receive the bulk of its referrals.

Moreover, Allstate's argument asks this Court to reweigh expert testimony to reach a result contrary to the district court's findings of fact. The district court made its credibility determinations about the experts clear, *see* FOF129-131, choosing to credit Dr. House's conclusion that Allstate had failed to establish what the effect on interstate commerce would be. On this record, and with this expert testimony, Allstate failed to satisfy its burden.

C. The Statute Passes the *Pike* Balancing Test.

Because the Texas statute does not have a discriminatory purpose or effect within the meaning of the dormant Commerce Clause, *see* Parts III.A & III.B, *supra*, it is reviewed under the lenient *Pike* balancing test. *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970). To reduce duplication, the State Defendants join the discussion of the *Pike* balancing test in the Intervenors' brief.

IV. IN ANY EVENT, THE MCCARRAN-FERGUSON ACT DEFEATS ALLSTATE'S DORMANT-COMMERCE-CLAUSE CLAIM.

Having ruled against Allstate on the merits of its dormant-Commerce-Clause theory, the district court denied "as moot" the State Defendants' and Intervenors' motion for judgment on the ground that Allstate's claim was precluded by the McCarran-Ferguson Act. *See* 10.R.2409-10 [State Defs. R.E. tab A]. The McCarran-Ferguson Act presents this Court with an alternate ground to affirm that aspect of the judgment.[24]

A. Through the McCarran-Ferguson Act, Congress Has Carved State Insurance Regulation from the Dormant Commerce Clause.

The doctrine known as the dormant Commerce Clause is an inference about congressional inaction. Allstate's soaring rhetoric about the economic virtues of *laissez-faire*, *e.g.*, Allstate Br. 3, ignores that—as a constitutional matter—the doctrine concerns the federal structure, not economic theory.[25] The doctrine aims to ensure that Congress has the opportunity to decide for itself whether to regulate a certain field. Once Congress decides, the dormant Commerce Clause falls aside. *Prudential Ins. Co. v. Benjamin*, 328 U.S. 408, 422-23 (1946) (explaining that the

[24] Although the order denied the motion "as moot" rather than on its merits, the Conclusions of Law nonetheless discussed the merits and expressed an erroneous view of the reach of the Act. *See* COL3-17. Regardless, this Court is free to affirm the district court's judgment on this alternative ground.

[25] Indeed, the federal power being preserved—Congress's Commerce-Clause power—also concerns whether lawmaking authority over a particular question (such as gun-free zones near schools) has been given to the federal government or instead remains with the States. *U.S. v. Lopez*, 514 U.S. 549, 552-53 (1995).

contrary rule "would invert the constitutional [Commerce Clause] grant into a limitation upon the very power it confers").

With regard to insurance, Congress has chosen local regulation free of the constraints that might otherwise be imposed by the dormant Commerce Clause. The McCarran-Ferguson Act gives States the primary role in the regulation of insurance. 15 U.S.C. §1011, *et seq*. As the Supreme Court explained one year after the statute's enactment, the law "remov[ed] obstructions which might be thought to flow from [Congress's] own power, whether dormant or exercised, except as otherwise expressly provided in the Act itself or in future legislation." *Prudential Ins. Co.*, 328 U.S. at 429-30. The Act is still held up as a model of how Congress can exempt a broad area of state regulation from the dormant Commerce Clause. *Granholm v. Heald*, 544 U.S. 460, 483 (2005) (noting the holding of *Western & Southern Life Insurance Co. v. State Board of Equalization*, 451 U.S. 648, 652-53 (1981), that "the McCarran-Ferguson Act . . . removed all dormant Commerce Clause scrutiny of state insurance laws").

Section 1011 of the Act unambiguously carves state insurance laws from the reach of the dormant Commerce Clause:

> Congress hereby declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States.

15 U.S.C. §1011; *see also id.* §1012(a) ("The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business."). Indeed, the Supreme Court has called that the Act's "*primary* purpose." *Group Life & Health Ins. Co. v. Royal Drug*, 440 U.S. 205, 218 n.18 (1979) (emphasis in original).

B. The Texas Statute Fits Within Congress's Grant of Primary Authority to States.

The Supreme Court—albeit in cases that only indirectly involve this provision—has used expansive language to define the reach of the part of the Act giving primary authority to States. In *Granholm*, the Court repeated the characterization of the Act as "remov[ing] all dormant Commerce Clause scrutiny of state insurance laws." 544 U.S. at 483. In *Royal Drug*, the Court described the Act as "preserv[ing] state regulation of the activities of insurance companies" from challenge under the dormant Commerce Clause. 440 U.S. at 218 n.18.

The difficulty, from an intermediate court's perspective, is that the Supreme Court has not given more precise guidance. It has instead focused the bulk of its attention on what is known as the "antitrust exception" in the McCarran-Ferguson Act, which exempts insurers from federal antitrust statutes (although not from state regulation).[26] The district court's Conclusions of Law suggest a mechanical

[26] Calling this an "exemption" from antitrust laws is a simplification. The Act is written to subject insurance companies to the antitrust laws "except as to conduct that is the business of

application of those cases—particularly the test of *Royal Drug* and *Pireno*—as though it did not matter which part of the Act was being considered. *See* COL5.

It does. The Supreme Court, in *Royal Drug*, was crystal clear that the grant of authority to States is broader than the antitrust exemption:

> The McCarran-Ferguson Act operates to assure that the States are free to regulate insurance companies without fear of Commerce Clause attack. The question in the present case, however, is one under the quite different secondary purpose of the McCarran-Ferguson Act—to give insurance companies only a limited exemption from the antitrust laws. . . . In short, the McCarran-Ferguson Act freed the States to continue to regulate and tax the business of insurance companies, in spite of the Commerce Clause. It did not, however, exempt the business of insurance companies from the antitrust laws. It exempted only "the business of insurance."

440 U.S. at 218 n.18 (citing *S.E.C. v. Nat'l Secs., Inc.*, 393 U.S. 453 (1969)). The Court distinguished the "quite different secondary purpose" of having an antitrust exemption, calling it "only a limited exemption." *Id.* And it rejected the view that the phrase "the business of insurance" acts to limit state authority in the same manner that it limits the scope of that antitrust exemption. To the contrary, *Royal Drug* indicates the Act "freed the States to continue to regulate and tax the business of insurance companies." *Id.*

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insurance, regulated by state law, and not a boycott." *Royal Drug*, 440 U.S. at 220. Thus, "[section 1012(b)], and the Act as a whole, embody a legislative rejection of the concept that the insurance industry is outside the scope of the antitrust laws—a concept that had prevailed before the *South-Eastern Underwriters* decision." *Id.*

The Texas statute plainly regulates what *Royal Drug* termed "the business of insurance companies"—it is, indeed, focused entirely on regulating whether and how insurers can integrate their operations with autobody-repair shops. TEX. OCC. CODE §2307.001, *et seq*. Essentially every operative provision of the statute speaks in terms of regulating insurers.[27] A number of those provisions directly regulate how insurers can deal with claimants.[28] So, too, the private cause of action that the statute creates allows a "person . . . aggrieved by a violation of this chapter by an insurer" to bring suit "to compel the insurer" to comply.[29] This is not a situation in which a State tries to bring some general-purpose statute within the McCarran-Ferguson Act. The Texas statute is so plainly about insurance that this should not be a close case.

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[27] TEX. OCC. CODE §2307.002(a) ("an insurer may not"); *id.* §2307.002(b) ("An insurer . . . may"); §2307.002(c) ("An insurer may"); §2307.002(d) ("applicable to an insurer"); §2307.003 ("An insurer is presumed"); §2307.004(a) ("an insurer . . . may"); §2307.004(b) ("the terms under which the insurer enters . . . must"); §2307.004(c) ("an insurer may not"); §2307.004(d) ("An insurer may"); §2307.005(a) ("An insurer . . .shall"); §2307.006 ("An insurer may not"); §2307.008(a) ("an insurer may").

[28] *Id.* §2307.006(1) ("An insurer may not . . .condition the provision of a product, service, insurance policy renewal, pricing, or other benefit on the purchase of any good or service from its tied repair facilities"); *id.* §2307.006(4) ("An insurer may not . . . provide its tied repair facilities a recommendation, referral, description, or access to its policyholders or other beneficiaries under its insurance policies that is not provided on identical terms to other repair facilities with which the insurer has entered into a favored facility agreement"); *id.* §2307.006(8) ("An insurer may not . . . directly or indirectly require a policyholder of the insurer . . . to obtain a damage estimate on a vehicle covered by the insurance policy at a tied repair facility"); *id.* §2307.006(9) ("An insurer may not . . . authorize . . . a person representing the insurer . . . to recommend to a policyholder"); §2307.006(10) ("An insurer may not . . . require a policyholder . . . to use a claims center located on the premises of a tried repair facility").

[29] *Id.* §2307.009(a).

C. A Broad Reading Also Fits How the Supreme Court Has Construed the "Reverse-Preemption" Provision of the Act.

Although not directly applicable here, the Court may take guidance from the broad construction that the Supreme Court has applied to a related part of the Act that provides a sort of "reverse-preemption" by state law of certain federal laws to the extent that they conflict with state insurance regulation.

That section begins:

> No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance . . . .

15 U.S.C. §1012(b). The Act thus gives a special status to "any law enacted by any State for the purpose of regulating the business of insurance." *Id.* Such laws are given prominence over conflicting demands of general, non-insurance-related federal statutes. *Id.*

The Supreme Court has made clear that this phrase "for the purpose of regulating the business of insurance" gives States more leeway than is provided to insurers themselves under the phrase "business of insurance" in the antitrust exemption:

> Both *Royal Drug* and *Pireno*, moreover, involved the scope of the antitrust immunity located in the *second* clause of §2(b). We deal here with the *first* clause, which is not so narrowly circumscribed. The language of §2(b) is unambiguous: The first clause commits laws 'enacted . . . for the purpose of regulating the business of insurance' to

> the States, while the second clause exempts only 'the business of insurance' itself from the antitrust laws. To equate laws 'enacted . . . for the purpose of regulating the business of insurance' with the 'business of insurance' itself, as petitioner urges us to do, would be to read words out of the statute.

United States Dep't of the Treasury v. Fabe, 508 U.S. 491, 504 (1993).

This makes perfect sense. Congress's primary purpose in the Act, after all, was to explicitly *approve* regulation of insurance by the States—a reaction to the Supreme Court's holding that insurance was commerce. *Nat'l Secs.*, 393 U.S. at 458; *see also United States v. South-Eastern Underwriters Ass'n*, 322 U.S. 533, 553 (1944). Indeed, Congress went farther. The Act "did not simply overrule *South-Eastern Underwriters* and restore the status quo. To the contrary, it transformed the legal landscape by overturning the normal rules of preemption. Ordinarily, a federal law supersedes any inconsistent state law. The first clause of [§1012(b)] reverses this . . . ." *Fabe*, 508 U.S. at 507. Given Congress's primary purpose of providing States a free hand in regulating insurance, the reach of the first clause of §1012(b) has been construed broadly. The same purposes drove Congress to enact §1011 of the Act, and the same result should hold.[30]

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[30] This would of course not mean that States are beyond federal regulation. They remain subject to, among other provisions, the Equal Protection Clause. *Metro. Life Ins. Co. v. Ward*, 470 U.S. 869, 880 (1985) ("Although the McCarran-Ferguson Act exempts the insurance industry from Commerce Clause restrictions, it does not purport to limit in any way the applicability of the Equal Protection Clause."). And Congress would retain power to enact laws specifically directed at regulating the insurance industry—a possibility contemplated by the McCarran-Ferguson Act itself. *See* 15 U.S.C. §1012(b) (protection of state law does not apply if federal law "specifically relates to the business of insurance").

CONCLUSION

The State Defendants respectfully request that the Court: (1) reverse the part of the district court's judgment declaring four subsections within the Texas Occupations Code to be facially unconstitutional and (2) affirm the remainder of the judgment.

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