

IN THE UNITED STATES DISTRICT COURT  
FOR THE NORTHERN DISTRICT OF TEXAS  
DALLAS DIVISION

ALLSTATE INSURANCE COMPANY and ( CIVIL ACTION NUMBER  
STERLING COLLISION CENTERS, INC., ( (   
Plaintiffs, ( (   
VERSUS ( (   
GREG ABBOTT, in his official ( (   
capacity as Attorney General of ( (   
Texas; and ( (   
CAROLE KEETON STRAYHORN, in her ( (   
official capacity as Texas ( 3:03-CV-2187-K  
Comptroller of Public Accounts ( (   
Defendants, ( (   
AUTOMOTIVE SERVICE ASSOCIATION, ( (   
a Not-for-Profit ( (   
Association; and ( (   
CONSUMER CHOICE IN AUTOBODY ( (   
REPAIR, a Not-for-Profit ( (   
Association, ( (   
Intervenors ( October 19, 2004

VOLUME 6  
TRANSCRIPT OF TRIAL  
BEFORE THE HONORABLE ED KINKEADE,  
UNITED STATES DISTRICT JUDGE

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PAMELA J. WILSON, C.S.R., U.S. DISTRICT COURT

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PROCEEDINGS:

THE SECURITY OFFICER: All rise.  
United States District Court in and for the Northern  
District of Texas at Dallas is now in session, the Honorable  
United States District Judge Ed Kinkeade presiding.

God save these United States and this Honorable Court.  
Please be seated.

THE COURT: It's good to see everybody back.  
Glad to know y'all are still kicking.

Where I had us is that we had one more witness, and  
that was an expert, let me look and see if I had your name,  
and then we were going to make argument.

Let's see Larry Stafford I think was our last witness.

MR. POWELL: Yes, Your Honor. We have Dr. Donald  
R. House, who will be our last witness.

THE COURT: Okay.

MR. POWELL: On the defendant and intervenor side.

THE COURT: Okay.

MR. POWELL: Your Honor, may I approach?

THE COURT: You may.

MR. POWELL: I have a notebook of papers.

THE COURT: That's good.

How are you doing?

MR. POWELL: I'm fine, sir. Thank you.

THE COURT: Okay.

1 MR. POWELL: We would call Dr. Donald R. House who  
2 is here in the courtroom, Your Honor.

3 THE COURT: Right up here, please, sir.  
4 Good morning.

5 Is there some water down there for you?  
6 Make sure that we've got you --

7 THE WITNESS: I believe there is.

8 THE COURT: Okay. Good.  
9 Let me swear you in.

10 (Witness sworn.)

11 THE COURT: All right. The chair swivels but does  
12 not move back and forth, so it's a little bit  
13 uncomfortable. I'm sorry about that. I can't fix that.

14 But make sure that the microphone -- sort of talk right  
15 across the top of it. If you hear your voice a little bit  
16 then you're okay.

17 THE WITNESS: Okay. I think I hear it.

18 THE COURT: Okay. Thank you.

19 MR. POWELL: May I proceed, Your Honor?

20 THE COURT: Yes, sir.

21 MR. SMITH: Excuse me. Sorry -- sorry, Your  
22 Honor.

23 Do you need this right now?

24 MR. POWELL: I don't know who put it up. That's  
25 not mine.

1 THE COURT: I think that was the last trial.

2 MR. SMITH: Well, it may get used in this trial.

3 THE COURT: Okay.

4 Don't throw your back out.

5 MR. POWELL: Your Honor, I want you to take notice  
6 of Mr. Smith's boots today.

7 THE COURT: Oh. Let me tell you, lawyers will do  
8 anything --

9 MR. SMITH: No.

10 THE COURT: -- to curry favor with the court.

11 MR. SMITH: I went to the State Fair and I  
12 couldn't resist.

13 THE COURT: Okay. That's good.

14 I won't let that influence me.

15 MR. POWELL: The full story of that is that I told  
16 him I would wear mine last time we were here and I did and  
17 he didn't.

18 MR. SMITH: I didn't have them then.

19 THE COURT: Let tell you, he's going to have  
20 blisters like you know what.

21 MR. POWELL: Could we have him move a few more  
22 things around?

23 THE COURT: We'll watch him limp this afternoon.

24 DONALD R. HOUSE,  
25 having been duly sworn testified as follows:

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1 (DIRECT EXAMINATION)

2 BY MR. POWELL:

3 Q. Would you tell the court your name and business

4 address, sir.

5 A. Donald Reed House, R-E-E-D. And I work at RRC

6 Incorporated at 3833 Texas Avenue, Bryan, Texas.

7 Q. And what academic degrees do you hold, sir?

8 A. I have a bachelor's degree in economics and a Ph.D. in

9 economics, both from Texas A & M University.

10 Q. Tell us a bit about RRC, Inc.?

11 A. RRC is a research consulting firm that was established

12 back in 1977, where we service a variety of clients

13 throughout the United States.

14 We have a litigation division, which is about half of

15 our business, where we do litigation consulting and research

16 and testimony.

17 And we have a survey division where we do mailed and

18 telephone survey research.

19 And then a business research division where we do

20 business consulting.

21 Q. Are you an officer of RRC?

22 A. I am.

23 Q. What office do you hold, sir?

24 A. I'm serving as the president of that company. We have

25 approximately 12 employees.

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1 Q. Let me show you, Dr. House, Plaintiff's Exhibit 175,

2 which should be in the book we provided to you as the first

3 tab.

4 Plaintiff's Exhibit 165 is already admitted into

5 evidence. And let me ask you if that is a report that you

6 prepared based on the work that you did in this case?

7 A. It is.

8 Q. Would you please turn the appendix B of that report,

9 which is Plaintiff's 165, and I would like for you to look

10 at the resume there. And I'm not going to spend a lot of

11 time on this, but I would ask you, does Exhibit B to

12 Plaintiff's 165 fairly represent your work experience, the

13 articles that you have authored, and your educational

14 background?

15 A. Yes, it does.

16 Q. Just briefly, have you taught economics both at Texas A

17 & M University and at Auburn University?

18 A. Yes, I have.

19 Q. Did you serve as a senior economist in the Bureau of

20 Economic Research of the American Dental Association in

21 Chicago for several years?

22 A. Yes, I did.

23 Q. Do you presently serve as an economic consultant to the

24 American Dental Association?

25 A. Yes, I do.

4 (Pages 6 to 7)

Page 8

1 Q. Have you served as an economic consultant to both the  
2 American and the Texas Medical Associations?

3 A. I have.

4 Q. Do you think there are parallels between your work as  
5 an economist studying the medical professions and the issues  
6 that you have considered in this case?

7 A. Yes, I do.

8 Q. Can you briefly, and we'll get to these in more detail  
9 as we go through, but briefly state what you think the  
10 parallels are.

11 A. Well, I think we're addressing the issues of a conflict  
12 of interest, where we have a conflict between an owner and a  
13 subsidiary, and in the medical field, including dentistry,  
14 we have prohibitions, legal prohibitions in the State of  
15 Texas, where a nondentist cannot own a dental practice.

16 And the legislature viewed that, the ownership has a  
17 conflict of interest where a nondentist could be practicing  
18 dentistry. We have the same thing against medical  
19 practices, only physicians can own medical practices. They  
20 recognize that conflict of interest. And the concerns we  
21 have with HMOs is another example, where within an HMO there  
22 is a profit incentive to reduce cost, and in so doing there  
23 are accusations from time to time that nonprofessionals,  
24 healthcare professionals, are making the choices of access  
25 to specialists and what care is to be rendered for

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1 different -- different diagnoses.

2 So you have conflicts of interest compared to the  
3 conventional model where the consumer is relying upon the  
4 professional for -- for expertise and advice, and that  
5 particular professional doesn't have the conflicting  
6 incentive to reduce costs such that profits are gained as a  
7 business entity, where there is insurance, and that you're  
8 trying to reduce claims expenses.

9 So those conflicts arise in the -- in the healthcare  
10 fields, just as they arise here as well.

11 Q. Have you provided economic consulting services to  
12 several departments and agencies of the United States  
13 Government as reflected in Plaintiff's Exhibit 165?

14 A. I have.

15 Q. Within the past day or two have you reviewed  
16 Plaintiff's Exhibit 165?

17 A. I have.

18 Q. Is there a correction that you need to make to  
19 Plaintiff's Exhibit 165?

20 A. Yes. If you turn to the table on page 12, table 1, the  
21 formatting is incorrect, where it shows as an example the  
22 complaint history among the largest insurance companies,  
23 Allstate Insurance Company having 56 complaints, 10.8  
24 percent, that is really .108 percent.

25 Q. So the decimal point is out of place?

5 (Pages 8 to 9)

Page 10

1 A. The decimal point is out of place due to a formatting  
2 error. It should be moved to the left two places.  
3 Q. Okay. And would you ask that that correction be made  
4 in your report?  
5 A. I do.  
6 Q. With that correction, does your report at Plaintiff's  
7 Exhibit 165 provide a summary of opinions that you have  
8 developed as a result of your work in this case?  
9 A. It does.  
10 Q. Did you attend two days of the trial of this case,  
11 Dr. House?  
12 A. Yes, I did.  
13 Q. And I believe those days were Wednesday and Thursday of  
14 the full week of trial that we had?  
15 A. That's correct.  
16 Q. Were you present here in the courtroom to hear all of  
17 the testimony of Allstate's witness, Professor Scott  
18 Harrington, who is the professor of finance and insurance at  
19 the Wharton School?  
20 A. Yes.  
21 Q. Are you read also some of the court reporter's  
22 transcripts of the days for which you were not here?  
23 A. Yes, I have.  
24 Q. For example, have you read the court reporter's  
25 transcript of testimony that Allstate's witness, George

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1 Ruebenson gave on the first day of trial?  
2 A. Yes.  
3 Q. The CEO of Sterling?  
4 A. Yes.  
5 Q. Have you also watched the video deposition of Mr. Jeff  
6 Brask, B-R-A-S-K, an employee of Allstate?  
7 A. I have.  
8 Q. And that's the -- you watched the deposition transcript  
9 that the defendants and intervenors have offered into  
10 evidence?  
11 A. I have.  
12 Q. Have you also read the transcript of the testimony  
13 given by defendant's witnesses Mr. Allen Walne, Mr. Victor  
14 Vandergriff and Mr. Larry Stafford on the last day before  
15 today that the court heard testimony in this case?  
16 A. I have.  
17 Q. Let me let you look at appendix A to your report,  
18 Plaintiff's Exhibit 165, and ask you if that is a summary of  
19 the materials that you considered before you prepared your  
20 report in this case.  
21 A. Yes, it is.  
22 Q. Have you also considered some exhibits that have been  
23 admitted into evidence by the court during the trial that  
24 are not on your list?  
25 A. I have.

6 (Pages 10 to 11)

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1 Q. Were you asked to form an opinion, as an economist,  
 2 whether there are or are not detrimental effects discernible  
 3 to an economist from the ownership and operation of auto  
 4 collision repair shops by automobile liability insurance  
 5 companies?  
 6 A. I have been asked that company, yes.  
 7 Q. And have you formed an opinion on that subject?  
 8 A. Yes, I have.  
 9 Q. Were you also asked to consider as an economist whether  
 10 HB 1131 does or does not tend to burden or impede interstate  
 11 commerce as it would be discernible to an economist?  
 12 A. Yes, I have.  
 13 Q. Have you formed an opinion on that subject?  
 14 A. I have.  
 15 Q. Were you also asked to review and evaluate the report  
 16 and testimony of Professor Harrington who did testify here  
 17 on behalf of Allstate?  
 18 A. Yes.  
 19 Q. I would like to start, and I think we've -- we've --  
 20 we've organized this -- I would like to start with your  
 21 evaluation of the opinions of Dr. Harrington and the  
 22 opinions that he provided to the court during his testimony  
 23 here.  
 24 And is it correct that we'll get to your other opinions  
 25 as we go through your evaluation of Dr. Harrington's report?

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1 A. I believe so. I believe going through Dr. Harrington's  
 2 opinions will bring out all the other opinions that I think  
 3 are important.  
 4 Q. Have you prepared a demonstrative aid that describes  
 5 the four opinions that you believe Dr. Harrington gave to  
 6 the court as you listened to his testimony?  
 7 A. Yes, I have.  
 8 MR. POWELL: Could we have that demonstrative up.  
 9 Your Honor, we have not numbered these and we're just  
 10 offering them as demonstratives. They're in the book --  
 11 THE COURT: Okay.  
 12 MR. POWELL: I don't know what the court's  
 13 pleasure is. We could put a demonstrative sticker number on  
 14 them, if that would be helpful to the court.  
 15 THE COURT: Just let me know how I find them in  
 16 the book.  
 17 MR. POWELL: They should be right in the very  
 18 front of the book, Your Honor.  
 19 THE COURT: Okay. There they are.  
 20 MR. POWELL: And then the exhibits that we're  
 21 going to refer to are in the book, Your Honor.  
 22 THE COURT: They're marked by number?  
 23 MR. POWELL: Yes. When they marked the book they  
 24 put the entire exhibit in. We're going to talk about  
 25 specific pages of it but it is a handy reference for the

7 (Pages 12 to 13)

Page 14

1 court to have the context of the page we're talking about  
2 there.

3 THE COURT: Okay.

4 BY MR. POWELL:

5 Q. Dr. House, the exhibit that's on the screen in front of  
6 the court, does that summarize your view or your  
7 understanding of Dr. Harrington's opinions?

8 A. Yes. This comes from one of Dr. Harrington's  
9 demonstratives.

10 Q. Okay. So the first opinion, just so we'll have it in  
11 the record, the first opinion that you are going to comment  
12 on was that HB 1131 disproportionately impacts out-of-state  
13 service providers by shifting business from out-of-state  
14 collision repair service firms to local body shops.

15 The second one is that HB 1131 substantially injures  
16 the market by denying Allstate and Sterling meaningful  
17 access to the collision repair service market.

18 The third opinion of Dr. Harrington was that insurer  
19 ownership poses no threat of unfair competition.

20 And the fourth opinion was that there are no  
21 substantial risks that consumers will be harmed by  
22 insurer-ownership.

23 Do you have an evaluation of each one of  
24 Dr. Harrington's opinions to give to the court this morning?

25 A. I do.

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1 Q. Let's go to Dr. Harrington's first opinion. His first  
2 opinion was that HB 1131 disproportionately impacts  
3 out-of-state service providers by shifting business from  
4 out-of-state collision repair service firms to local body  
5 shops.

6 Before we start this, let's -- let's talk about the  
7 concept of interstate commerce, which I think is what we're  
8 all dealing with here.

9 What did you understand Dr. Harrington's definition or  
10 concept of interstate commerce to be as you heard his  
11 testimony?

12 A. Well, Dr. Harrington seems to base his opinion of  
13 interstate commerce on the issue of a census of firms, that  
14 is looking at existing firms and counting heads, coloring  
15 them whether they are interstate firms or intrastate firms.  
16 And that seems to be the basis and foundation of his opinion  
17 on interstate commerce. He was confused from time to time  
18 on how you would color some firms, whether the ownership was  
19 out-of-state but the firm was in-state, whether that's an  
20 interstate firm or not.

21 But the basis of his assessment of interstate commerce  
22 is that, taking a census and looking at firms and whether  
23 they are interstate firms or intrastate firms.

24 That's not the way an economist looks at interstate  
25 commerce.

8 (Pages 14 to 15)

Page 16

1 Q. I was going to ask you that.

2 Is that the way an economist would look at the concept  
3 of interstate commerce; and if not, how would an economist  
4 do that?

5 A. No. An economist looks at interstate commerce as the  
6 flow of goods and services across state boundaries, and the  
7 issue that is to be addressed on interstate commerce and  
8 various interstate commerce is does particular statutes and  
9 practices impede the flow of products across state  
10 boundaries. That is --

11 Q. Products or services?

12 A. Or services.

13 And that's the issue, that is, we look at the free flow  
14 of products and services, and that's what we want in a  
15 competitive marketplace, we have the free flow of products  
16 and services. And when you have state boundaries if you  
17 want a competitive marketplace in the United States you want  
18 the free flow of goods and services across state lines, and  
19 interstate commerce is looking at whether the flow of those  
20 products and services are impeded in any way.

21 Q. Do you agree with Dr. Harrington's first opinion that  
22 HB 1131 disproportionately impacts out-of-state service  
23 providers by shifting business from out-of-state -- firms he  
24 has colored as out-of-state to the firms he has colored as  
25 in-state?

Page 17

1 A. No, I do not agree with that opinion.

2 Q. Let me ask you to consider this in two ways.

3 First, let's assume that HB 1131 remains in place, do  
4 you think that his opinion is correct?

5 A. No, I do not believe his opinions are correct.

6 Q. What's wrong with his opinion?

7 A. His opinion is really based upon what happens if HB  
8 1131 went away.

9 Currently HB 1131 protects the Sterling/Allstate model  
10 from entry that is it allows Allstate/Sterling to perfect  
11 that model but no one else can in the state of Texas. So to  
12 the extent that that model is an efficient one, and I think  
13 that is subject to some real debate, Allstate and Sterling  
14 stand in the predominant position or the dominant position  
15 of being the only firm in Texas that can adopt that kind of  
16 model, if in fact it's efficient it will be able to -- to  
17 accrue what we call supercompetitive profits, that is, it  
18 has protections, their entry into that model in the State of  
19 Texas, and it stands in a preferred position, if that model  
20 is the most efficient model --

21 Q. In other words, under HB 1131 State Farm could not come  
22 in now and duplicate what Allstate has done in the Dallas  
23 market, for example?

24 A. As I understand the statute, that is correct. It is  
25 protected. It has a legal barrier to entry to that model.

9 (Pages 16 to 17)

Page 18

1 Q. Now, your A point up here says, "If the  
2 Allstate/Sterling model is economically efficient,  
3 Harrington presents what is called partial equilibrium  
4 analysis.

5 Now, that's a term that you probably should explain to  
6 us.

7 A. Well, we're trained as economists to look at  
8 equilibrium, and equilibrium means what happens when all  
9 market forces work themselves out.

10 Partial equilibrium analysis is looking at a part and  
11 not allowing all market forces to work themselves out.

12 Dr. Harrington is looking at a partial equilibrium analysis.

13 Q. And describe what is the partial equilibrium analysis  
14 you say he's looking at.

15 A. Well, he's looking at the elimination of HB 1131 as if  
16 the protection that Allstate/Sterling currently have from  
17 entry into that model remains. That is, he is looking at  
18 what happens if HB 1131 went away, and if that was an  
19 efficient model, then he's looking at what happens if you  
20 place that -- what happens to the marketplace in terms of  
21 counting heads, how many interstate providers are there, if  
22 Allstate/Sterling were allowed to expand. That is a  
23 partial equilibrium analysis because it does not take into  
24 account what the other firms that would find that to be an  
25 efficient model too would do as well.

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1 That is, you're going to have -- if it's an efficient  
2 model, and that's subject to debate, you would have other  
3 firms, such as State Farm, such as USAA, such as the county  
4 mutuals finding that it's profitable to adopt that model to  
5 vertically integrate, meaning that they also would acquire  
6 ownership in collision repair shops and there would be more  
7 of those models in place. If that's true, we don't know how  
8 to color all of the participants in the marketplace under  
9 that particular scenario.

10 General equilibrium analysis, the correct way to look  
11 at it, is taking into account the market sources of other  
12 firms copying that model. That would include the county  
13 mutuals that predominantly were only in Texas.

14 So if the county mutuals are expanding as well and  
15 vertically integrating, you have a lot of repair shops that  
16 would then turn into intrastate firms instead of existing  
17 interstate firms, and we don't know the result. We don't  
18 know what general equilibrium analysis will end up with when  
19 we take into account the actions of all other firms.

20 Dr. Harrington is looking only at the impact of  
21 Allstate/Sterling. He is ignoring the impact of all others  
22 that would enter and adopt the same model.

23 Q. Do you think that in Dr. Harrington's papers, in his  
24 report or in his testimony, did you find any data analysis  
25 or any sort of a rigorous study that he made to come to the

10 (Pages 18 to 19)

Page 20

1 conclusion that he's expressed his first opinion?

2 A. No. I did not see what we would call an economic  
3 study. I did not see the examination of data that would  
4 demonstrate, for instance, the efficiencies of the model.

5 No such study was provided by Dr. Harrington.

6 Q. Do you --

7 A. No such study of the State of Texas and the composition  
8 firms in the State of Texas was conducted by Dr. Harrington.

9 Q. So you -- so I guess the A under your first comment  
10 about Dr. Harrington's first opinion is that one can't hold  
11 all variables constant except one and come to a conclusion?

12 A. That is correct. If you look at the next slide.

13 MR. POWELL: Move to the next slide, please.

14 THE WITNESS: Point some of this out.

15 If you look at the composition of automobile insurance  
16 in the State of Texas, and you look at those carriers in the  
17 State of Texas that have business outside of the State of  
18 Texas, and those that -- that render services only in the  
19 State of Texas, and the Department of Insurance breaks that  
20 data out for you, so you can capture that, just about  
21 exactly 50 percent of the premiums reported in Texas in 2003  
22 were reported either by noncounty mutuals, whose business is  
23 exclusively in Texas, that is, those firms which are not  
24 county mutuals but work only in the State of Texas, or by  
25 the county mutuals. The county mutuals are by law allowed

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1 to write policies only in the State of Texas.

2 So 50 percent of your premiums are from firms --  
3 insurance carriers that work only in the State of Texas. If  
4 they adopt that model you would not expect them to establish  
5 repair shops outside the State of Texas, because if the  
6 efficiencies are there, through vertical integration that  
7 is, insurance companies owning repair shops, there would not  
8 be any efficiencies of them owning repair shops in another  
9 state where they do not sell insurance.

10 So when you take that into account, you ask yourself  
11 what is going to be the end of the -- of the chapter here,  
12 when you have -- take into account the actions of  
13 competitors adopting, quote, this efficient model, you don't  
14 know what's going to happen to the head count of the firms  
15 and how you would color them interstate providers or  
16 intrastate providers. You do not have a foundation. It  
17 could equally reasonably be that you would have more firms  
18 that are engaged in interstate commerce, in the sense of  
19 being firms that have local -- have shops outside the State  
20 of Texas as well as in, versus those that are only in the  
21 State of Texas, you do not know.

22 BY MR. POWELL:

23 Q. You're using -- in that testimony you're using, I take  
24 it, Dr. Harrington's concept or definition of interstate  
25 commerce as opposed to yours?

11 (Pages 20 to 21)

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Page 22

1 A. Yes. I'm taking his -- by coloring heads I'm using his  
2 consideration of interstate commerce by counting the numbers  
3 of firms that deal only in Texas versus those that deal in  
4 Texas and other areas.

5 If you go to page -- Exhibit 260, for instance --

6 Q. Okay. We're going to move -- that's Exhibit 260. And  
7 what page do you --

8 A. Page 57.

9 Q. Okay. What -- what does this page do you think have to  
10 do with what you've just stated?

11 A. All right. If you -- unlike Dr. Harrington, who did  
12 not take into account the actions of competitors, if in fact  
13 this is a competitive model, if you look in the top  
14 left-hand corner --

15 Q. Page -- Exhibit 260 is the Allstate claims strategy  
16 steering committee update dated October 2nd, 2000. And  
17 we're on page 67.

18 A. You can see in the left-hand corner it says Allstate  
19 fears risk of being left out if repair network strategy not  
20 pursued. Other top-tier carriers could beat Allstate to the  
21 market, lock up key partners and shops, capture competitive  
22 advantage via better severity and LAE economics."

23 In other words, Allstate itself recognized that if this  
24 was an efficient model there would be competitors that would  
25 adopt the same model. Dr. Harrington does not take that

Page 23

1 into account.

2 MR. POWELL: For the record I think I misspoke,  
3 it's Plaintiff's Exhibit 260, not Defendant's Exhibit 260.

4 BY MR. POWELL:

5 Q. Okay, sir. What -- what is your ultimate conclusion  
6 about using Dr. Harrington's head counting methodology about  
7 whether one can know, whether an economist can tell the  
8 court whether the elimination of HB 1131 would in fact cause  
9 more interstate commerce than we would have otherwise?

10 A. If the Sterling Allstate model is an efficient model  
11 and has a competitive advantage in the marketplace, others  
12 would adopt that model and would acquire repair shops, many  
13 of whom sell insurance only in the State of Texas, would  
14 acquire only those shops within the State of Texas.

15 And the net effect, using Dr. Harrington's definition  
16 of interstate commerce, is unknown. You do not know whether  
17 you would have more firms that would be, quote, interstate  
18 firms in the State of Texas or fewer firms that are, quote,  
19 interstate firms in the State of Texas. You do not know.

20 Q. Do you think that Dr. Harrington's coloring and head  
21 counting methodology is a sound methodology to even view  
22 this problem?

23 A. If your issue -- if your concern is interstate  
24 commerce, no. It doesn't matter how you color the heads.  
25 What matters is do you impede the flow of goods and services

12 (Pages 22 to 23)

Page 24

1 across state boundaries.

2 Q. Do you see any of that in this case?

3 A. No, I do not.

4 Q. Why not?

5 A. This particular industry is one in which your services  
6 provided are largely local, such as barbershop, such as  
7 dental practices, such as other local service  
8 establishments. There is a lot -- there is not much flow of  
9 goods and services across state lines in those industries.

10 So whether HB 1131 is in existence or not, you would  
11 not expect it to affect in any material way the volume or  
12 flow of goods and services across state lines.

13 Now, if you're talking about -- if you're isolating  
14 your question to a shop in Texarkana and asking yourselves  
15 is it going to change the number of people that cross that  
16 state boundary, I don't know. But that's not really  
17 material. What is material is the volume of flow of  
18 services across state lines. And in a service industry,  
19 such as this, you don't have much of that. So the state  
20 statute is not really posed to affect the flow of goods and  
21 services across state lines in any material way.

22 THE COURT: What about the parts?

23 THE WITNESS: The parts are going to be purchased  
24 in the most efficient places anyhow. That is, if you have  
25 vendors, nationwide vendors that are finding that they're

Page 25

1 efficient in either producing or selling parts or

2 distributing parts, they're still there.

3 So whether you're an interstate firm or an intrastate

4 firm, you're still going to search for the lowest price

5 goods and services -- goods or products or parts from those

6 vendors, and those vendors aren't moving. So you would not

7 expect that pattern of flow of product to change materially

8 at all.

9 You're still going to go to the most efficient

10 distributors and producer of those, and those aren't

11 changing.

12 THE COURT: They won't have greater buying power

13 because they could buy -- they will be -- assuming that

14 their model works, and I'm not assuming that, but if their

15 model did work, wouldn't they be able to negotiate

16 nationwide buys of certain parts in a more efficient --

17 THE WITNESS: That's possible, but many of those

18 distributors are in the State of Texas.

19 THE COURT: Okay.

20 THE WITNESS: So you don't know whether it's going

21 to increase or decrease the flow across state boundaries.

22 You just don't know.

23 THE COURT: Okay.

24 THE WITNESS: That research hasn't been done.

25 BY MR. POWELL:

13 (Pages 24 to 25)

PAMELA J. WILSON, C.S.R., U.S. DISTRICT COURT

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1 Q. Did you see anything in Dr. Harrington's work that  
2 would answer that question, is there a study of the flow of,  
3 for example, paint, or new fenders, or used fenders or  
4 anything like that across state lines where he is able to  
5 tell the court one way or the other?

6 A. No. No such study was done.

7 Q. Now, all of the testimony you've given so far is based  
8 on the assumption that the Sterling model is a -- an model,  
9 in other words, it's a -- it's better mousetrap, it is --  
10 you know, it's a better of doing things. Is that correct,  
11 sir?

12 A. That is based upon that assumption. If that assumption  
13 is wrong, that it is -- it is not a better mousetrap, and  
14 there's a lot of evidence that would suggest that it is not,  
15 the elimination of HB 1131 would have no impact on the  
16 marketplace at all. Even by counting heads.

17 THE COURT: Is that because -- maybe you've said  
18 it; maybe I missed it. Is that because you would compare it  
19 to the theory of HMOs, that it has just not really been  
20 efficient and hasn't worked, whether it was legal or not  
21 legal?

22 THE WITNESS: That's correct. But remember, the  
23 HMO model has had a lot of support, legislatively, where you  
24 have had state legislators that have tried to get recipients  
25 of Medicaid to adopt the HMOs as their providers because

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1 they're cheaper. Medicare has pushed the HMOs. So you have  
2 had a lot more HMOs in the marketplace even though there are  
3 those conflicts, you have had legislative support there.  
4 Whereas in this there is no real engine that would try to  
5 push this model at all.

6 So if it is inefficient you will see Allstate/Sterling  
7 abandon it in time and no one else picking it up.

8 BY MR. POWELL:

9 Q. Now, let's -- in your testimony following  
10 Dr. Harrington's testimony thus far has been with the  
11 assumption that HB 1131 would go away, that the court would  
12 strike it or that the legislature would repeal it or in some  
13 way or another it would go away.

14 Let's talk about just briefly the same situation that  
15 we've just talked about, if HB 1131 did not go away and it  
16 remained there. And let's assume that HB -- that the  
17 Sterling model, big stores, assembly line process, clean  
18 stores, clean, well lighted, the things Sterling says about  
19 itself, let's assume that's a better mousetrap, what would  
20 you expect to find, in a full equilibrium analysis?

21 A. Well, in the State of Texas Sterling Allstate would be  
22 in the envious position of having barriers to entry to that  
23 model, so they would profit greatly in the State of Texas  
24 among the 15 establishments that they have. You would also  
25 see that model established throughout the United States,

14 (Pages 26 to 27)

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1 that is, most of the -- and I'll get to the specifics later,  
 2 but most of Allstate's business is outside the State of  
 3 Texas. Most of Sterling's outlets are outside the State of  
 4 Texas. And you would see those particular establishments'  
 5 profit and expand, if in fact this is the most efficient  
 6 model.

7 THE COURT: Well, I know they're going to ask this  
 8 question, so help me with it.

9 They claim that this is a straitjacket and that it's a  
 10 restraint of what they can say, the model with 1131 doesn't  
 11 allow them to market their collision repair business the way  
 12 they want to, that they would only be able to say certain  
 13 things according to what -- 1131, so it constrained them.  
 14 Help me with that from the economic perspective.

15 THE WITNESS: Number one, one of their concerns is  
 16 getting referrals, that is, of the people that have Allstate  
 17 insurance in a -- in a particular metropolitan area and make  
 18 claims, what percent of those claims are serviced in  
 19 Allstate stores, and those percentages are relatively low in  
 20 the State of Texas. But if you look at their reports  
 21 they're also low in their other areas as well where there is  
 22 no constraint by HB 1131.

23 THE COURT: Okay.

24 THE WITNESS: So the key is looking at Baltimore,  
 25 Cleveland, looking at Orlando, looking at these others where

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1 they have substantial presence with Sterling stores, there  
 2 is no HB 1131, and if you look at their financial reports of  
 3 Sterling as a whole, the minority of which is in the State  
 4 of Texas and subject to HB 1131, they're not reporting good  
 5 things at all. So the market test in these other areas,  
 6 without that legislative constraint, should allow them to  
 7 accrue the profits that they claim exist in this particular  
 8 model. And I have seen no evidence that this is succeeding  
 9 elsewhere.

10 THE COURT: Okay.

11 BY MR. POWELL:

12 Q. Dr. House, one of the arguments -- one of the  
 13 statements that I think Professor Harrington made was that  
 14 the auto collision repair industry, if it is going to expand  
 15 into these big new stores with the equipment that they have  
 16 described and the uniforms and the cleanliness and all that  
 17 sort of thing that they have described that Sterling has,  
 18 has to have capital from the insurance industry. And I  
 19 would ask you to comment on that, from the perspective of an  
 20 economist. Is that a correct assessment of the way the  
 21 capitals work?

22 A. No, not at all. Insurance companies are not the  
 23 purveyors of the major sources of capital in the United  
 24 States. The capital market in the United States is about as  
 25 close to a perfect market as you can have.

15 (Pages 28 to 29)

Page 30

1 Q. What do you mean by that?

2 A. It means that there is available capital that will flow  
3 to profitable enterprises. And if you have a mousetrap that  
4 is better than anyone else's, and if that mousetrap is a  
5 profitable mousetrap, you would be inundated with  
6 investment. Capital markets are always searching for the  
7 best expected return at the lowest risk. And when they find  
8 that, you have the flow of funds going into those projects.

9 So if you have a model, such as a -- a model of repair  
10 shops that are clean, that are bright, and you have -- the  
11 larger of the chains, the more profitable, you ask yourself  
12 is there available investment capital to enable a proprietor  
13 that has that more efficient model to get the capital to  
14 build them. Yes, it's there. Yes, it's there.

15 How did McDonald's expand?

16 How did Wal-Mart expand?

17 All of those things expand because they're shown to be  
18 profitable and the investment community is looking for that.  
19 They're looking for higher expected returns for a given  
20 level of risk. And when you can show that you attract  
21 capital. It is not dependent on an insurance company to  
22 provide you that capital. The markets provide it. The  
23 capital markets.

24 Q. Let's go to the slide that's titled net result and  
25 finish up on your first -- on your comments on Professor

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1 Harrington's first opinion. And would you just describe  
2 your ultimate conclusions about Professor Harrington's first  
3 opinion?

4 A. If in fact the Sterling Allstate model is more  
5 efficient than any other model, you would have other firms,  
6 insurance companies, vertically integrating, or acquiring  
7 their own repair shops, either by greenfield or brownfield,  
8 and that the net effect on the number or the proportion of  
9 business served by interstate firms, however you color them,  
10 or intrastate firms, is unknown. You don't know what the  
11 end result is, and there hasn't been any study that would  
12 demonstrate that.

13 The only thing that Dr. Harrington has addressed is  
14 what would happen to the business of Allstate/Sterling if  
15 1131 went away and it was a more efficient model. It does  
16 not address entry, which is to exist if it is an efficient  
17 model.

18 Q. If it is an efficient, not inefficient, but an  
19 efficient --

20 A. An efficient model.

21 Q. Okay. Let's move to Dr. Harrington's second opinion,  
22 which is that HB 1131 substantially injures the market by  
23 denying Allstate and Sterling meaningful access to the  
24 collision repair service market in this case.

25 Do you have an assessment of that opinion for the

16 (Pages 30 to 31)

Page 32

1 court, sir?

2 A. Yes, I do.

3 Q. And what is that assessment? Is it shown on the next  
4 visual?

5 A. Yes, it is. Again, we have to go to two different  
6 scenarios. One scenario is assuming that the Sterling  
7 Allstate model is the efficient model. And then we have to  
8 say, okay, what happens if it is not. And we will get -- we  
9 will get -- I'm sorry. I'm sorry. Let me restate that.

10 That's not exactly right.

11 We have to look at the Allstate model, if the Sterling  
12 Allstate model is more economically -- is more economically  
13 more efficient than existing models and HB 1131 would  
14 effectively limit or eliminate these advantages in the  
15 marketplace, is the market injured as a result of that.

16 Then a second part is insurance owned repair shops  
17 would cause no harm to competition. And that gets to his  
18 third opinion, and I would delay that. If we go to the  
19 next --

20 Q. All right, sir.

21 A. Yes.

22 Q. The next question we posed in the next slide to answer  
23 the questions you just addressed is, is the Sterling  
24 Allstate model, based on all the evidence that you have seen  
25 and the testimony that you have heard, is it economically

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1 more efficient than the other existing models?

2 A. The evidence that I have seen to date would say no,  
3 that I have not seen any evidence, other than  
4 Dr. Harrington's pronouncements that there are enormous  
5 economic efficiencies potentially. I have not seen any  
6 evidence to demonstrate that it is the more efficient model  
7 in the marketplace.

8 Q. When you say his pronouncements, did you see any  
9 rigorous study, academic study, something that one would try  
10 to publish or something like that on the subject matter of  
11 whether there are enormous potential benefits in any of his  
12 work?

13 A. No. Dr. Harrington did not conduct a study at all.

14 Q. Now, you say in your study that the Sterling Allstate  
15 model is not economically more efficient than the other  
16 existing models, and I take it therefore it would have no  
17 impact on the marketplace.

18 A. That's correct.

19 Q. And why do you say that the Sterling Allstate model is  
20 not more efficient than the other models?

21 A. Well, the evidence suggests strongly that it is not.

22 If you look, for instance, for first point, once  
23 Allstate purchased Sterling, Sterling Allstate shops lost on  
24 average 85 percent of its available market, volume  
25 substantially decreased. Now, let me explain what that

17 (Pages 32 to 33)

Page 34

1 means.

2 Allstate in the State of Texas only has 15 percent  
3 market share. Sterling before the acquisition had its  
4 available market, 100 percent of collision repair services.

5 Once that acquisition took place, other than insurance  
6 carriers dropped the Sterling shops from their preferred  
7 network of -- of repair shops. That eliminated 85 percent  
8 of the market available to Sterling.

9 So here you have a model that before Sterling had  
10 access to a hundred percent of the available market, or the  
11 available market was one hundred percent of the market, and  
12 then with acquisition you drop that down to 15 percent. And  
13 you have a model that is driven by volume. So immediately  
14 you -- you drop your available market down to 15 percent.

15 Then you ask yourself among the 15 percent that are  
16 covered by Allstate, how much of that can you get into the  
17 Sterling shops. They have to have a model in which a high  
18 proportion of the Allstate customers go to Sterling shops.  
19 The evidence suggests that they have failed in getting a  
20 high proportion, that they had sought relatively high  
21 percentages, up to 80 percent going to Sterling shops, and  
22 the evidence suggests that it's really around 23 percent.

23 Q. What evidence have you seen in the evidence that has  
24 been admitted in the court that leads you to these  
25 conclusions?

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1 A. If we go to Plaintiff's Exhibit 260, page 99 --

2 Q. Plaintiff's Exhibit 260 once again is the Allstate  
3 claim strategy on October 2nd, 2000, the steering committee  
4 update.

5 What do you see on page 99, sir?

6 A. Well, that's not it. That's not it yet. 260, page  
7 99.

8 BY MR. POWELL:

9 Q. We need to go one more. Yeah.

10 There you go.

11 A. Yeah, there it is.

12 If you look at that you can see what the -- the total  
13 volume that they're -- that they're seeking. And they're  
14 looking at the different ways in which they might enhance  
15 that and get that percentage of respondents very likely to  
16 use facility up to 80 percent. And then they have a  
17 projected actual of 60 percent. That is, what they would  
18 like to have under a perfect world it appears is 80 percent  
19 of the Allstate customers would go to Sterling shops,  
20 whereas, the projected was 60 percent.

21 Now, if we go to the actual record, which is  
22 Defendant's Exhibit 306, page 4, here we have their 2003  
23 evidence, 2002 and 2003 evidence of what the record shows.

24 And this is particularly interesting, because if you go  
25 to the 2003, where the average is only 23 percent, you can

18 (Pages 34 to 35)

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1 look at the cities here, the communities in which they're  
2 reporting, you can see the lowest is Baltimore, at 13  
3 percent. Only 13 percent of the Allstate covered collision  
4 repair services are going to Sterling shops in Baltimore.

5 Dallas is higher.

6 Herndon, Salt Lake City, Orlando, Chicago, western  
7 Pennsylvania, eastern Pennsylvania, Houston, all of those  
8 are under the average.

9 And the highest is only 37 percent, which is in  
10 Jacksonville, Jacksonville, Florida.

11 So if you're looking at what they had hoped to achieve,  
12 the target of 60 percent, the ideal of 80 percent, in 2003  
13 it's only 23 percent, and that's down from 2002, which was  
14 26 percent.

15 If you go to the statement of volume, which is under  
16 Defendant's Exhibit 149, page 16, and this is a 2003 report,  
17 you can see the volume is key, and you can see the decreases  
18 in volume, January through June.

19 You have an increase in reduction in the volume going  
20 to Sterling stores. And this is nationwide. This is not in  
21 Texas, alone.

22 So if you're asking yourself is this model working, the  
23 suggestion strongly is, given that they have 62 facilities  
24 throughout the United States, only 15 of which are in Texas,  
25 you would expect this model to be achieving the economies

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1 that you would -- you would expect, given the fact that  
2 there are no HB 1131s in these other states. And that's  
3 just not the case.

4 Q. This report that you just referred to, Defendant's  
5 Exhibit 149, is the Sterling executive committee update for  
6 the second quarter of 2003, which is before HB 1131 even  
7 went into effect, is it not, sir?

8 A. That is correct.

9 Q. All right. What other conclusions or what other  
10 statements do you base your opinion on that the Sterling  
11 model has not proved to be efficient, not only in Texas but  
12 elsewhere?

13 A. Well, when we -- when we economists look at vertical  
14 integration, we look at such things as diseconomies of scale  
15 and diseconomies of scope.

16 Diseconomies of scope are trying to find economies  
17 where there are different industries being put together.

18 An economy of scope would be a grocery store bringing  
19 in a pharmacy. There were economies of scope there. The  
20 grocery store traditionally was not a dispensing of drugs  
21 facility. In the old days the drugstore was independent and  
22 you had your grocery store. Nowadays, you find there are  
23 economies of scope of bringing these two industries together  
24 in the same place. Now you see many grocery stores having  
25 pharmacies. And those are -- there are some efficiencies

19 (Pages 36 to 37)

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1 there.

2 When you see issues of vertical integration you ask  
3 yourself where are the economies from.

4 And if you look at the point number 3 it says,  
5 "Although Allstate recognized the importance of repair shop  
6 with business expertise, it has lost much of that  
7 expertise."

8 I want to point you to Plaintiff's Exhibit 260, page  
9 48.

10 260, 48, if you look over at the right-hand corner,  
11 Allstate is acknowledging early on that -- on the right-hand  
12 corner up at the top: Management of large modern shop  
13 network, a challenge; Allstate has limited expertise  
14 actually running shops; there's a steep learning curve.  
15 There is an acknowledgement that Allstate itself recognized  
16 the importance of having the expertise and running collision  
17 repair shops.

18 But in fact as I understand it the top level people  
19 that were at Sterling, three of the four, are now gone and  
20 that Sterling is being run by insurance people that have  
21 long years of experience in running an insurance business,  
22 and I'm sure they're very good at that, but now they're  
23 running a collision repair shop. So where they recognize  
24 the importance of having that expertise on board, if you  
25 look at what has happened since the acquisition, three out

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1 of four of the top people at Sterling have left.

2 So you ask yourselves are they best positioned to  
3 address the issues of economies of scope and efficiently run  
4 two very different industries efficiently.

5 Q. Did you see something in the University of Southern  
6 California report that's at Exhibit 34, Defendant's Exhibit  
7 34, that sort of confirmed your thinking about this subject?

8 A. Yes. If we could have that up.

9 Q. This is Defendant's Exhibit 34. This one is not  
10 numbered but it's Bates number AI0059313.

11 A. Yes. You can see in the third bullet point, in looking  
12 at the building of a team between Sterling and Allstate --

13 Q. At the top.

14 THE COURT: Now, what is this document?

15 MR. POWELL: This is the -- Your Honor, this is  
16 Defendant's Exhibit 34, which was the report done by the  
17 University of Southern California consultants that Allstate  
18 hired to come in to see what was going wrong.

19 If Your Honor might recall -- could I have the ELMO for  
20 just a minute?

21 It was on -- yeah. It's this document here.

22 THE COURT: Okay.

23 MR. POWELL: The University -- Center for  
24 Effective Organizations at the University of Southern  
25 California, if Your Honor will probably recall the

20 (Pages 38 to 39)

Page 40

1 testimony.

2 THE COURT: I do.

3 MR. POWELL: They interviewed all the people.

4 And go back to then the --

5 THE COURT: What is that exhibit number?

6 MR. POWELL: That is Defendant's Exhibit 34.

7 THE COURT: Thanks.

8 BY MR. POWELL:

9 Q. And in this report, Dr. House, did you see something  
10 that the University of Southern California said about what  
11 the two companies were saying about each other?

12 A. Yes. They both are concerned early on, and certainly  
13 during this examination, the bullet point both disparage  
14 others experiences not knowing body shops, MBAs and  
15 marketers versus insurance guys. These are some of those  
16 same concerns that you see in HMOs where you have the MBAs,  
17 quote, practicing medicine, that is, dictating what services  
18 can be rendered to a person that has a policy with a  
19 particular diagnosis. There are claims that the physicians  
20 who have the expertise are not calling the shots. Here you  
21 have the insurance guys calling the shots.

22 MR. POWELL: Let's go back, Mr. Prigett, (sic)  
23 let's go back to the listing of your -- the facts under your  
24 conclusion no, which starts with is the Sterling Allstate  
25 model economically more efficient than all other existing

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1 models.

2 BY MR. POWELL:

3 Q. If we can, I want to ask you a question about the  
4 second point under that.

5 Your second point says, "Volume can be recovered if  
6 Allstate becomes very effective in channeling customers to  
7 its own shops." And then you said, "To date, it has not  
8 been successful at this." Does that present dangers that  
9 you think the legislature might reasonably have been  
10 concerned with?

11 A. I think the concern, of course, is the conflict of  
12 interest. That is, when you have the conflict of interest  
13 you ask ourselves what will a player in the marketplace do  
14 to try to achieve the profits and are those actions, actions  
15 that serve the public well, are they in conflict with the  
16 interest of the consumer. And those are legitimate  
17 questions and questions that you have whenever you have such  
18 things as conflicts of interest presented by ownership or  
19 vertical integration of this type, whether it be in this  
20 particular industry or the healthcare industry. So those  
21 are concerns.

22 There are some flags, I would say, that are available  
23 to us to indicate that perhaps there are some incentives  
24 that would push Allstate to positions that they ordinarily  
25 would not be in, trying to improve the profitability of the

21 (Pages 40 to 41)

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1 Sterling line that may not be in -- in the interest of the  
2 consumer and may be of concern to legislators.

3 THE COURT: Let me make sure I understand where  
4 you're going. And if I'm shorthanding it too much you tell  
5 me.

6 There are not economic efficiencies in this, so you're  
7 pushed to do some things that you might not do otherwise  
8 that would be unethical and to force the number up around  
9 the 80 percent; is that what you're telling me?

10 THE WITNESS: Right. That is correct.

11 THE COURT: Okay. And that's why you're telling  
12 me that the legislature can't leave this venture to its own  
13 devices and let it just go run itself in the ground, is  
14 because they're going to do unethical things to make it  
15 work?

16 THE WITNESS: Those actions that are very  
17 difficult to police, that are internal to the company, that  
18 would improve the bottom line, but not in the interest of  
19 the consumer.

20 Same thing exists in principal, the prohibition on the  
21 ownership of dental practices by nondentists some of which  
22 is driven by something other than economics.

23 THE WITNESS: It's driven by the interest of  
24 improving profitability, but it's going to be a different  
25 set of decisions that are made than what you would have if

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1 the person with the expertise is making the decisions on  
2 behalf of the consumer, such as a dentist, a physician, a  
3 hospital, or in this case a technician at a -- at an owned  
4 repair shop.

5 When you have the insurance company making the  
6 decisions, or in this case a corporate enterprise owning a  
7 dental practice that is trying to minimize the cost to  
8 service an insurance policy, those decisions may be  
9 different decisions that are made, and that would be of  
10 concern to legislators, are they serving the public. And  
11 those are difficult to police.

12 If you look at Defendant's Exhibit 205, page 67, as an  
13 example, here are some flags.

14 MR. POWELL: Can we pull up 205?

15 THE COURT: Well, wait a minute. If that's so,  
16 then why in these other markets are they still doing so  
17 poorly?

18 THE WITNESS: That's a good question. It's a good  
19 question. That is, if they are making some steps beyond  
20 what the legislature would want, why is it still failing?  
21 That's a very good question.

22 And an economist would say it's not a good model, even  
23 in spite of trying to channel more of their customers to  
24 their Sterling shops, given the fact that the Sterling shop  
25 may not be offering the consumer anything better than that

22 (Pages 42 to 43)

Page 44

1 they could find elsewhere, why are they still failing to do  
2 that?

3 It's a good question.

4 BY MR. POWELL:

5 Q. You were going to point out -- and perhaps we get to  
6 more of this later on in your testimony, but you were going  
7 to point out something in Defendant's Exhibit 205 as a -- as  
8 a red flag?

9 A. Yes. On 205, if you look at the findings and  
10 implications and recommendations, in looking at the agency  
11 interviews, again, the agent is one of -- they have  
12 identified as a key point in trying to channel more  
13 customers to the Sterling shops.

14 If you look on the right-hand side, the middle bar in  
15 the middle point, says strong clear message from Allstate  
16 required to communicate amended agency standards. In other  
17 words, they want to have a bigger influence upon the  
18 Allstate agents.

19 If you drop down to the next bar, the first line,  
20 Allstate to provide monthly/quarterly quality rankings  
21 comparing Allstate-approved repair options. That is they  
22 want to provide information.

23 But then if you look at the bottom of the left-hand  
24 column it says certain information required for agents to  
25 recommend Sterling cannot be shared with Sterling, for

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1 example, comparative quality ratings. So here are some  
2 flags recognizing the impact of such information but  
3 recognizing that there may be some prohibitions against  
4 that.

5 Q. If you go on to the next page you looked I think at the  
6 option two they recommend on this particular report?

7 A. Correct. Here is another flag. Recommend only  
8 Sterling. Recommend only Sterling. And it indicates -- if  
9 you look down here at the third group, they're recognizing  
10 that it is a potentially risky legal position to take, but  
11 nevertheless it is an option that is -- that is being  
12 considered. That is, again, trying to get more of their  
13 customers channeled to Sterling shops, in whatever way they  
14 can, to be able to improve the profitability of the Sterling  
15 model.

16 Those are flags. Those are concerns that presumably  
17 the legislature had in mind to try to prohibit.

18 THE COURT: When it talks about alienating agents,  
19 it's talking about the people that sell the insurance?

20 THE WITNESS: The people that are selling that  
21 insurance and roof insurance and all other types of  
22 insurance. Those are the people that live in the  
23 communities and these are the people, the housewives, the  
24 friends they go to Lions Club with and so forth, and trying  
25 to get them in that option number two is to recommend only

23 (Pages 44 to 45)

Page 46

1 Sterling when the person that has the accident and calls the  
2 agent and says what do I do, the agent would then recommend  
3 only Sterling. Again, trying to channel more business to  
4 Sterling, which they have not been able to do successfully.

5 BY MR. POWELL:

6 Q. This is really not I guess economic analysis, the part  
7 about alienating agents, the agents may not want to do that?

8 A. They may not want to do that. They have a relationship  
9 with these people usually. They live in the community. And  
10 they may not want to alienate those people and say, no, I'm  
11 not going to recommend the shop that you always go to, I'm  
12 recommending you should go to the Sterling shop, which is  
13 the new facility in this neighborhood.

14 Q. Let's go back to your -- the slide that starts is the  
15 Sterling Allstate model economically more efficient than all  
16 existing models, and you answer no. Because there were a  
17 couple of points on there we hadn't covered yet that I do  
18 want you to opine about.

19 I think 4 you may have touched on. You're saying that  
20 the Sterling Allstate model is not more efficient and what  
21 role does item 4 have in your drawing of that conclusion?

22 A. Item number 4 basically says if it is an efficient  
23 model it will be adopted, that is efficient model in the  
24 sense of large scale repair shops, or large -- this is  
25 getting a little bit of feedback. Maybe I'm too close.

Page 47

1 Q. Could you push it away a little bit. I think it sounds  
2 a little garbled out here?

3 A. Is that better.

4 Q. That's better?

5 A. Okay. If the efficiencies are in large footprints, or  
6 in the sense of many footprint shops linked together under  
7 the same ownership, if those are where the efficiencies are,  
8 there is nothing in the marketplace that is a hindrance to  
9 establishing that model and in fact there are firms that  
10 have established that model.

11 There are firms that have many different -- or a large  
12 collection of repair shops in the market today that are  
13 large that are efficient. That model is there.

14 Now, to the extent that they are going to take over the  
15 marketplace, there are no barriers to that.

16 HB 1131 does not constrain the marketplace to say that  
17 there will be no more of those. All it takes is the  
18 investment of capital. And if it is a profitable  
19 enterprise, the investments will come, that will not be a  
20 barrier to expansion in this marketplace.

21 Q. And what's your item number 5?

22 A. Number 5 is a real important one, in answering the  
23 question about the efficiency of this particular model, that  
24 is the vertical integration.

25 No insurance company has demonstrated the economic

24 (Pages 46 to 47)

Page 48

1 efficiencies of insurer-owned repair shops in any state in  
2 which there are no local restrictions, including Allstate.

3 I'd like to first point out Plaintiff's Exhibit 205,  
4 page 8.

5 Q. All right, sir.

6 A. Where this is a report from May 2004.

7 Q. Just one second and we'll have it up here.

8 MR. POWELL: I can put it on the ELMO if that will  
9 be better. Let me put it on.

10 We're having a little technical difficulty with that  
11 one.

12 BY MR. POWELL:

13 Q. And if you look at the top, the first point that is  
14 being made is current performance of the network is not  
15 meeting expectations. Average EBITDA margins in 2003 were  
16 negative.

17 Just for the record, would you tell us what EBITDA is,  
18 please.

19 A. It's earnings before interest and taxes, and the DA,  
20 usually we're referring -- that is depreciation and  
21 amortization taken out as well, before depreciation and  
22 amortization.

23 Q. What is that a measure of?

24 A. It's a measure of profitability. It's very close to  
25 gross margins.

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1 Q. Would you push that thing away from you?

2 How is that?

3 A. Is that better?

4 Q. We're looking at Defendant's Exhibit 205, page 9, the  
5 Sterling transition status update materials, May 2004.

6 All right, sir. Do you have other exhibits that you  
7 reviewed that you think --

8 A. Yes.

9 Q. -- support this position?

10 A. Yes. Defendant's Exhibit 31, page 2.

11 Q. Defendant's Exhibit 31 is the Allstate/Sterling review  
12 of the executive committee meeting, May 28th, 2003. Page 2.

13 A. Right. If you look at the right-hand column of  
14 findings, in the second group, the results suggest average  
15 Sterling prices 15 to 25 percent higher than PRO.

16 So you ask yourselves about the efficiency of this  
17 particular model, which if in fact it is efficient in a  
18 competitive marketplace you would have lower prices than  
19 PRO, that is the consumer would get the gains of those  
20 efficiencies. This is reporting that the Sterling price is  
21 higher than the PRO shops. That is, there are no gains and  
22 efficiencies being passed on to the consumer.

23 Q. And is this nationwide?

24 A. This is nationwide. This is from their whole system of  
25 62 shops, only 15 of which are in the State of Texas.

25 (Pages 48 to 49)

Page 50

1 Now, if we go to -- that was DX 31.  
 2 Let's go to my slide.  
 3 Q. All right. Back to --  
 4 A. Which is the pie chart.  
 5 Q. Okay. Let's go to the pie charts.  
 6 A. There we go.  
 7 Q. There we go.  
 8 A. We went to the State Department of Insurance in Texas  
 9 to identify where Allstate is writing its premiums -- or  
 10 writing its policies. And in terms of direct premiums  
 11 written for the Allstate group of companies, in the year  
 12 2003 89.3 percent of the premiums written were outside the  
 13 State of Texas.  
 14 So that gives Allstate an incredible ability to test  
 15 their model, to prove their model outside the State of Texas  
 16 where HB 1131 does not have any impact at all.  
 17 If you go to the next slide, we can identify those  
 18 areas in which we would expect the efficiencies to be shown.  
 19 What I've done here is I've looked at the stores, the  
 20 Sterling stores, by metropolitan area. I've also looked at  
 21 the population of the metropolitan areas in which Sterling  
 22 has stores and Allstate has policies written.  
 23 If you look at the -- the corner in the top left-hand  
 24 corner, you see Texas, you see Dallas/Fort Worth, seven  
 25 stores. In the MSA, that is the population of that

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1 metropolitan area is 5.5 million people. You look at  
 2 Houston where there are five stores, you have 5.986 million  
 3 people.  
 4 Austin at the one store, 1.3 million people.  
 5 San Antonio two stores, 1.8 million people.  
 6 Now, those are the areas in which they are subject to  
 7 HB 1131.  
 8 Now let's look at the remainder of the Sterling  
 9 stores.  
 10 Key areas, look at Atlanta, Georgia metropolitan area  
 11 of 4.5 million people, in line with some of the stores you  
 12 saw in Texas, they have five stores. You would expect if  
 13 this is an efficient model HB 1131 has no impact in Atlanta,  
 14 Georgia you would expect to be able to show efficiencies,  
 15 profitability, and high volumes in those stores because  
 16 there are no restrictions there.  
 17 Dr. Harrington provided none of that.  
 18 If you go to Baltimore, Maryland, you have three  
 19 stores --  
 20 THE COURT: Can I stop you just for a sec?  
 21 THE WITNESS: Yes, sir.  
 22 THE COURT: Would you also be able to see the  
 23 result of your concern, maybe the state's concern of what  
 24 they would be doing to try to drive the -- the numbers  
 25 higher in an economically inefficient model?

26 (Pages 50 to 51)

PAMELA J. WILSON, C.S.R., U.S. DISTRICT COURT

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1 THE WITNESS: In terms of Allstate's activities?

2 THE COURT: Yes.

3 THE WITNESS: What Allstate is doing?

4 THE COURT: Yes.

5 THE WITNESS: We saw the red flags there on what  
6 Allstate is concerned about, that is trying to get the  
7 higher volumes.

8 THE COURT: Okay.

9 THE WITNESS: But the prohibition is not there.  
10 They can expand the stores, have as many stores as they  
11 want. Those are the real important ones from what we've  
12 hearing from Dr. Harrington. If you allow us to have the  
13 stores, if they are bright, shiny, clean, and we have many  
14 of them, they will fill up, we don't need to do things to  
15 drive the customer there, it will do it itself, it is an  
16 efficient model.

17 But we aren't seeing it.

18 Remember, Baltimore with three stores, with 2.6 million  
19 in the metropolitan area, that was one with the lowest  
20 percentage of Allstate collision repair services being done  
21 in Sterling shops, and there is no prohibition to make those  
22 stores clean, efficient, bright.

23 Look at Philadelphia as an example, they have six  
24 stores, 5.7 people in the metropolitan area.

25 Cleveland, five stores, 2. 2.1 million people.

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1 Chicago, five stores, 9.3 million people.

2 So in looking at the rest of the United States, you  
3 have Allstate coverage, you have Sterling stores, and you  
4 have urban concentration. And you ask yourselves why isn't  
5 the model working in those areas.

6 And when we look at the profitability of the Sterling  
7 Allstate profits of this venture, you're showing negative  
8 profits, declining volume, and that's not consistent with  
9 the efficient model.

10 And you can't point to HB 1131 as the culprit.

11 Q. All right, sir. Let's move to Professor Harrington's  
12 third opinion, which was that insurer-ownership poses no  
13 threat of unfair competition.

14 Have you considered whether that is accurate or not  
15 based upon what you've seen in the testimony and what you  
16 were given to review in this case?

17 A. Yes, I have considered that. I've considered it in two  
18 ways.

19 One, I've considered the question: Is there unfair  
20 competition from the standpoint of antitrust, that is, would  
21 we expect there to be -- or have I seen unfair competition  
22 that leads to higher prices being paid by consumers. And I  
23 can't make a conclusion there.

24 However, if we look at unfair practices by a firm, that  
25 is having an unfair advantage over its competitors, then the

27 (Pages 52 to 53)

Page 54

1 story is different.

2 If we look at my next exhibit, where we look at the  
3 statute itself --

4 Q. It would be the one that --

5 A. I think it's one more.

6 Q. One more. There we go?

7 A. The statute itself, in section 2306.006, the  
8 prohibition is what an insurer may not do. Point 2 is share  
9 information with a tied repair facilities that is not made  
10 available on identical terms and conditions to other repair  
11 facilities with which the insurer has entered into a favored  
12 facility agreement.

13 That is, that is what is prohibited by the statute.

14 Q. Did you see evidence that that is a very legitimate  
15 concern in this context?

16 A. Yes. It's a legitimate concern because of the vertical  
17 integration and the concerns that the legislature has in  
18 unfair competition.

19 Q. How does vertical integration affect that?

20 How can that be a factor?

21 A. It gives an insurance company access to market facts at  
22 the lower level of customers that other firms at that lower  
23 level does not have access to. In short, it gives Allstate  
24 access to information about repair services and shops for  
25 which it, Sterling, competes, that the non-Sterling shops

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1 don't have access to.

2 Q. Did you see specific evidence of that in some of the  
3 materials that you've seen that have been admitted into  
4 evidence in this case?

5 A. I have.

6 Q. And, for example, sir?

7 A. For example, if we look at Jeff Brask's deposition.

8 Q. Let's run -- we have just a short excerpt from that  
9 deposition we would like to have you look at, Dr. House.

10 "You are no longer primarily involved in Sterling  
11 analysis, is that what you just said?

12 "A. That's what I said.

13 "Q. What do you mean by primarily involved?

14 "A. I have one individual that still does a task that  
15 supports Sterling leadership.

16 "Q. Who is that one person?

17 "A. Eugene Xu.

18 "Q. What is the task that Mr. Xu is still doing?

19 "A. He runs numbers off a database to do competitive  
20 benchmark pricing.

21 "Q. What do you mean when you say 'he runs numbers'?"

22 "A. He gathers data.

23 "Q. For what purpose?

24 "A. To share them with Sterling leadership.

25 "Q. How often does he gather this data and share it with

28 (Pages 54 to 55)

Page 56

1 Sterling leadership?

2 "A. I believe he tries to update numbers on a monthly

3 basis.

4 "Q. What's the name of the database?

5 "A. We overall call the database -- we give it an overall

6 name of Paris.

7 "Q. That's the Paris database he's using?

8 "A. Um-hum.

9 "Q. And these analyses take the form of written documents

10 or written reports that he shares with Sterling leadership?

11 "A. I believe that today he shares one type of analysis

12 with Sterling leadership.

13 "Q. And describe for me that one analysis that he shares

14 with Sterling leadership today.

15 "A. The purpose of the analysis is to get an understanding

16 of Sterling's competitive pricing relative to benchmark.

17 "Q. Why does Allstate from a financial perspective want

18 Sterling to be competitively priced long term?

19 "A. We want them to compete with other body shops while

20 still providing financial returns to the company.

21 "Q. By 'the company' you mean Allstate, correct?

22 "A. Sterling and Allstate combined.

23 "Q. So, if Sterling is not competitively priced long term,

24 that will -- that will not result in good returns for

25 Allstate?

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1 "A. If Sterling is not competitively priced, there could be

2 an impact.

3 "Q. If Sterling is not competitively priced long term,

4 there would be a negative financial impact for Allstate?

5 "A. There could be an adverse impact if Sterling is not

6 competitively priced.

7 "Q. Earlier when you were testifying about Mr. Xu's

8 competitive pricing analysis that relates to Sterling, you

9 referred to the other body shops that Sterling's compared

10 to, correct?

11 "You can answer.

12 "A. The group in comparison to a group of body shops.

13 "Q. And those group of shops would include PRO shops,

14 correct?

15 "A. That is -- that is correct.

16 "Q. So, within that competitive pricing analysis that

17 Mr. Xu prepares, Sterling is being -- competitively compared

18 to PRO shops, correct?

19 "A. To a group of PRO shops.

20 "Q. So, supporting the Paris, you have information within

21 Allstate all the way down to the individual repair costs on

22 a specific repair, correct?

23 "A. I believe we have the total repair cost to individual

24 claims."

25 BY MR. POWELL:

29 (Pages 56 to 57)

PAMELA J. WILSON, C.S.R., U.S. DISTRICT COURT

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1 Q. All right. Dr. House, what does that piece of  
2 testimony from Mr. Jeff Brask, who is an Allstate employee  
3 and whose deposition in its entirety -- or the excerpts have  
4 been admitted into evidence, what does it tell you?

5 A. It says that Allstate through Mr. Xu is looking at  
6 claims files, analyzing claim files and giving Sterling the  
7 benefit of those analyses to help in their pricing, and no  
8 other repair shop has that access.

9 Q. Do you think that's conduct consistent with an unfair  
10 practice?

11 A. Yes, it is, and it can grow.

12 For instance, if -- if Allstate and Sterling do get to  
13 the point in which Sterling is servicing the customers of  
14 other insurance companies, then through Sterling and those  
15 contacts they will know the discounts that other insurance  
16 companies are getting from their competitors. That  
17 information then would go to Allstate, where Allstate now  
18 has the discounts that are being accepted by their  
19 competitors.

20 So you -- you don't have that yet, but you do have  
21 Sterling having access to the information gleaned from the  
22 claim files. And that is something that is not done in any  
23 other industry I have examined, such as hospitals, such as  
24 physicians, such as dentists.

25 Q. Is -- is the possibility of unfair trade practices in

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1 the -- in the lower market one of the recognized dangerous  
2 of vertical integration?

3 A. Yes. And in my understanding that's why that  
4 prohibition is there.

5 Q. The prohibition that you referred to?

6 A. Yes. Where you -- an insurance company should not make  
7 use of its claim files to benefit its firm competing at the  
8 repair shop level.

9 Q. Now, of course, that is for a grandfathered shop.  
10 That's in the prohibitions -- the code of conduct for a  
11 grandfathered shop.

12 A. Correct.

13 Q. If you -- if you -- if you do not have vertical  
14 integration between the insurance companies and the repair  
15 shops you don't have this problem, do you?

16 A. You don't have that problem at all.

17 And the other danger, of course, is with the  
18 elimination of HB 1131, even if Allstate were pristine and  
19 were not using the claim fills to share information with  
20 Sterling, even if that were true, you have to ask yourself  
21 what will all the other players do, what will all the county  
22 mutuals that are going to buy a local repair do.

23 So you have to ask yourself about Allstate, number one,  
24 but you also -- also ask your question about all the other  
25 insurance companies that are going to vertically integrate

30 (Pages 58 to 59)

Page 60

1 and collect information from their subsidiary using their  
2 claim files, how are they going to use information in  
3 violation of this prohibition as well.

4 Q. When you say "you have to," do you mean that that's a  
5 consideration that the legislature would have to take into  
6 account?

7 A. That would be a concern of the legislature, and without  
8 HB 1131 you don't have that prohibition.

9 THE COURT: All right. Let's take a 20 minute  
10 break. See you back at 20 till.

11 MR. POWELL: Thank you, Your Honor.

12 THE SECURITY OFFICER: All rise.

13 (Recess taken.)

14 (DIRECT EXAMINATION)

15 (Continued)

16 BY MR. POWELL:

17 Q. Dr. House, we were on the third opinion of  
18 Dr. Harrington that insurance-owned shops posed no threat of  
19 competition. We've talked about the data information. And  
20 I wanted to move to your next visual aid under that  
21 particular opinion which starts off with facts and you say  
22 Allstate has the incentive to terminate relationships with  
23 the preferred PRO shops providing greater market shares for  
24 its Sterling shops."

25 Can you explain why you think that is indicative or

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1 consistent with unfair competition?

2 A. It's consistent with unfair competition because what  
3 you're doing through the vertical integration or the  
4 insurance-owned repair shops is eliminating competition for  
5 your repair shops. So that is consistent with unfair  
6 competition by eliminating competition.

7 Q. And have you seen some particular pieces of evidence  
8 that have been admitted in this case that -- that cause you  
9 to believe that that is a legitimate concern?

10 A. Yes, I have. Defendant's Exhibit 331 is an example.

11 Q. Defendant's Exhibit 331, which is in evidence, is a  
12 e-mail from Jon McNeill. Can you remind the court who Jon  
13 McNeill is, sir?

14 A. Yes. He was the original CEO of Sterling before the  
15 acquisition.

16 Q. And this is an e-mail dated April 12th, 2002.

17 And what did you see in this e-mail that you thought  
18 gave some concern to you, sir?

19 A. It's a -- this is, of course, an e-mail from him after  
20 the acquisition.

21 If you go to point number 2 --

22 Q. Before he introduces the point he says, "Here's the  
23 checklist of items that seem to be critical into making the  
24 Allstate/Sterling relationship successful. Please review  
25 this with your Allstate and Sterling teams locally to see

31 (Pages 60 to 61)

Page 62

1 how you stack up. Responsibility for making this work is  
 2 owned jointly."  
 3 And then go to item 2.  
 4 A. Correct. And it says, "Rightsize PRO."  
 5 "The next chronological step is the right-sizing of PRO  
 6 within 10 miles of Sterling stores. This step is critical,  
 7 but also painful in local market. It can't be avoided  
 8 though as this step has the single most positive impact on  
 9 volume."  
 10 This is another example of trying to increase volume  
 11 in Sterling stores but a different tact. This is  
 12 eliminating competition.  
 13 Q. All right, sir. And then you have another exhibit  
 14 besides that. We're going to go over these rather quickly,  
 15 so we can finish.  
 16 A. Yes. If we go to Defendant's Exhibit 49. If you go  
 17 toward the bottom.  
 18 Q. This is an e-mail from Bill Haylon with Jeff Brask's  
 19 name on it who we've already met this morning?  
 20 A. Correct. And if we go down to the bottom.  
 21 Q. The e-mail at the top of the page or the e-mail at the  
 22 bottom of the page?  
 23 A. The e-mail at the bottom of the page.  
 24 Q. All right, sir.  
 25 A. And the next to the last paragraph. We now found some

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1 fairly large PRO players which surround the north Houston  
 2 stores as a first attack on volume.  
 3 Again, they're trying to eliminate competition with  
 4 Sterling stores by eliminating PRO shops in those market  
 5 areas.  
 6 Q. And do you see that as another pieces of evidence that  
 7 is consistent with unfair competition?  
 8 A. That is consistent with unfair competition.  
 9 Q. All right, sir. Let's move to Professor Harrington's  
 10 fourth opinion, which is that there are no substantial risks  
 11 that consumers will be harmed by insurer ownership. Do you  
 12 have an opinion as to whether that's an accurate assessment  
 13 or not?  
 14 A. I do. And I disagree with that opinion.  
 15 Q. Before we proceed on the page here, looking back at the  
 16 point of view of the legislature, is your opinion the  
 17 legislature was reasonable or not reasonable, in being  
 18 concerned, assuming the court finds that that's what  
 19 motivated them here, about the -- potential impact of this  
 20 vertical integration on the consumers?  
 21 A. Yes. I think it was a reasonable decision in managing  
 22 the risk of a conflict of interest, just as it did in  
 23 medicine and dentistry and other professions.  
 24 Q. All right, sir. Why do you think that Professor  
 25 Harrington's fourth opinion is an incorrect assessment of

32 (Pages 62 to 63)

Page 64

1 the facts?

2 A. Well, one of them -- problems in terms of the conflict  
3 of interest is that Allstate's profits are improved with  
4 reductions in claims expenses. If we go to the next slide.

5 And if we go to Plaintiff's Exhibit 260, page 112.

6 Q. For the record, this is back on the Allstate claims  
7 strategy document dated October 2nd, 2000. Page 112.

8 A. Page 112. That's page 12. We got another hundred  
9 pages.

10 Q. Page 112.

11 A. There we go.

12 Q. All right, sir. What do you see on this page that  
13 makes you concerned that this is not -- that there are  
14 potential dangers for consumers in this?

15 A. Well, here, this is showing that Allstate will improve  
16 its bottom line if it shifts to aftermarket and salvage  
17 parts and by shifting to those parts they get them at lower  
18 prices. And in this case they estimate there is 71 million  
19 dollars in savings to Allstate by shifting to aftermarket  
20 parts and salvage parts.

21 So we already have acknowledged here the profit  
22 incentive of shifting to parts that many consumers don't  
23 want.

24 If we go to Plaintiff's Exhibit 260, page 47.

25 Q. Plaintiff's Exhibit 260, page 47.

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1 A. Page 47, you see in the left-hand corner, and this is a  
2 slide, an Allstate slide that is trying to look at some  
3 parts cost reduction strategies. And in the left-hand  
4 corner you see "Allstate control of repair shops allows for  
5 easier implementation of aftermarket and salvage part  
6 initiatives."

7 So one of the benefits of the vertical integration to  
8 Allstate is they don't have to convince the technicians to  
9 use aftermarket and salvage parts, they can directly control  
10 them.

11 If we go on to Defendant's Exhibit 31, page 11. And  
12 this is a May 2003 document.

13 Q. All right, sir. And what page of that document?

14 A. This is page 11. We've got it there.

15 If you look at the scenarios that they have put forth,  
16 scenario one and scenario two --

17 Q. Okay. Let's just for the record, let's be somewhat  
18 descriptive.

19 We have Defendant's Exhibit 31 and we have the page 11,  
20 and the title at the top of this is changes to current labor  
21 staffing mix could also produce material gross margin  
22 benefits. All right, sir.

23 A. Correct. This is another way of trying to squeeze more  
24 profits out of the Sterling line. And what is proposed  
25 here, if you look at the staffing in metal and in paint, the

33 (Pages 64 to 65)

Page 66

1 left-hand corner, it shows you the hourly salaries. In  
2 paint, for instance, level 1 is \$7.34, all the way up to  
3 18.05 an hour for level 4.

4 For metal workers it starts at 7.20 an hour, and it  
5 goes all the way up to 17.87 an hour.

6 So you have different skill levels.

7 Remember, they have 62 shops.

8 If you look at scenario one, and particularly scenario  
9 two, and compare that with the current, there's a current  
10 column where they show count and percentage.

11 As an example, their count of the top level paint  
12 people, 37 in level 4 and 48 in level 3, the sum of those  
13 represent 61 percent of the people in that category -- in --  
14 for paint that are at the top two levels of pay.

15 If you go up to metal, you have 138 in level 3 and 55  
16 in level 4. That represents 67.5 percent of the staffing of  
17 metal workers.

18 Now let's go to scenario two, which is an attempt to  
19 reduce costs. If you notice that the sum in scenario two of  
20 the total number of metal workers is still 286, the total  
21 number of paint workers is still 139, so the number of  
22 people have not changed.

23 But if you look at the composition, it's different. If  
24 you look at the level 3 and level 4, in paint, it drops from  
25 61 percent to 48 percent. If you look at the metal workers,

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1 the top two levels, it drops from 67 percent to 48 percent.

2 So one of the ways in which they are going to improve  
3 profits under scenario two is to reduce the skill -- number  
4 of skilled -- highly skilled people in their -- in their  
5 stores.

6 So if they can in fact eliminate competition, if they  
7 can in fact divert customers to Sterling stores by  
8 eliminating any references to any others, and if they can  
9 use salvage and aftermarket parts to a large extent, and if  
10 they can reduce the skill levels of the technicians that are  
11 doing the work, they can improve profits.

12 Q. Did you see in any -- let's go back to the first one  
13 you talked about, the aftermarket and salvage parts.

14 Did you see any evidence that in fact Allstate has  
15 induced or pushed the use of aftermarket or salvage parts?

16 A. They have -- yes. If you look at some of the  
17 depositions -- some of the affidavits, and even trial  
18 testimony, they are consistent with the insistence of  
19 Allstate using more aftermarket and salvage parts.

20 For instance, if you look at the affidavit of Greg  
21 Griffith.

22 Q. This is Plaintiff's Exhibit 543. These were offered  
23 and admitted into evidence as plaintiff's exhibits. So  
24 let's look at Exhibit 543, which is the affidavit of Mr.  
25 Griffith.

34 (Pages 66 to 67)

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1 A. If you look at the second page.

2 Q. Could you push that mic back a little bit.

3 THE COURT: Actually, if you will just talk across  
4 the top of it.

5 THE WITNESS: Let me put it way down and maybe  
6 that will help.

7 THE COURT: Sorry. It wants to keep popping up.

8 BY MR. POWELL:

9 Q. The second page is the affidavit of Greg Griffith, what  
10 paragraph, page 2?

11 A. Look at paragraph 3.

12 Q. Mr. Griffith, in paragraph 2 says, "I am the body shop  
13 manager for Rusty Wallis body shop in Dallas."

14 What about paragraph three?

15 A. Paragraph three says "Rusty Wallis was a participant in  
16 Allstate's direct repair program, also known as the priority  
17 repair option, PRO, for at least six years. During my  
18 direct dealings with Allstate, it has been my experience  
19 that Allstate continually pressured Rusty Wallis to increase  
20 the use of aftermarket parts or to recycle damaged parts  
21 when, in some circumstances, it would have been more  
22 appropriate to use original equipment manufacturer, or OEM  
23 parts. In some instances, aftermarket parts are not  
24 appropriate because OEM parts provide a better product for  
25 the consumer in terms of fit, wear, finish, and safety. My

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1 experience with Allstate is that it continually pushed the  
2 use of aftermarket parts or recycled parts in order to drive  
3 down its own claim costs without regard to the ultimate end  
4 product for the consumer."

5 Q. All right, sir. And then you have -- you have a chart  
6 of other similar items of either testimony from the trial or  
7 affidavits that were admitted into evidence as plaintiff's  
8 exhibits that you have relied on.

9 A. Correct. There are at least four other affidavits  
10 consistent with this, and Mr. Stafford's trial testimony is  
11 consistent with this as well.

12 Q. All right. The affidavits were PX 546, 543, 550, 546,  
13 and then you listed the Stafford trial testimony, which you  
14 did read?

15 A. Correct. These are all consistent with the attempts of  
16 Allstate to control and to pressure the use of aftermarket  
17 and salvage parts, and these were eliminating, because once  
18 you have vertical integration you have direct control of  
19 that.

20 Q. Now, of course, you've been in the courtroom and you  
21 understand that Allstate says or Sterling says that they  
22 give the consumer a written election, a written choice to  
23 make as to whether to use aftermarket parts or OEM parts,  
24 and that's at Plaintiff's Exhibit 170.

25 Have you examined Plaintiff's Exhibit 170?

35 (Pages 68 to 69)

Page 70

1 A. I have.

2 Q. And what is your comment about the choice that's given  
3 to consumers?

4 A. Well, it's missing the third option.

5 If you look at the two options under item 7, the first  
6 option is "I authorize Sterling autobody to use aftermarket  
7 crash parts."

8 And if you look at the second option it says: I do not  
9 authorize Sterling autobody to use after crash parts in  
10 repairing my vehicle; I understand and acknowledge that  
11 recycled parts may be used in the repair of my vehicle.

12 So your only options here that are provided is the  
13 absence of aftermarket crash parts, but you are  
14 acknowledging the use of recycled parts, which are the parts  
15 that are in the junkyards that are -- have been there in --  
16 in junked automobiles, which we heard in testimony.

17 So the other option that you would want to see is I  
18 authorize only the use of OEM parts, but that option is not  
19 there.

20 Q. Dr. House, I believe I pass the witness at this point,

21 MR. POWELL: Your Honor, if --

22 THE COURT: Okay.

23 MR. KASS: Your Honor, may I have a minute to set  
24 up?

25 THE COURT: Yes, sir, Mr. Kass.

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1 BY MR. KASS:

2 Q. During the direct examination you said that this  
3 market, the collision repair services market has some  
4 parallels to the medical field, and you expressed some  
5 concerns about HMOs. Do you recall that testimony?

6 A. That's correct, I do.

7 Q. But you understand that HMOs are prevalent in the  
8 United States economy and that they provide an affordable  
9 way of providing medical coverage. Correct?

10 A. They are available in the marketplace. That's  
11 correct. Their market shares are not as high as was  
12 predicted.

13 Q. And you understand unlike here one of the things  
14 that's unique about HMOs is that they do not provide the  
15 insureds with a choice if they are to receive the full  
16 benefits under the insurance contract, true?

17 A. Not totally, no.

18 Many HMOs provide you a choice but you pay a premium  
19 for that choice.

20 Q. So if you want --

21 A. They do not have a panel to say that that's the only  
22 place you can go. Many HMOs give you the provision of  
23 choosing yours, but you pay a premium -- an extra charge for  
24 that.

25 Q. So if you want the lowest cost provision you have to

36 (Pages 70 to 71)

Page 72

1 use somebody within the network, right?

2 A. Typically the lower cost is within the network, and  
3 the -- the penalties you pay for out-of-network services are  
4 higher. That's correct.

5 Q. Now, Dr. House, you cannot say that HMOs even provide  
6 lower quality than nonvertically integrated healthcare  
7 services, can you?

8 A. It's a debatable point. I'm not one that is trained to  
9 be able to judge the quality of healthcare, but it is a  
10 debatable point. There are those that say, yes, indeed, you  
11 get lower quality, in two fashions.

12 One, you don't have as free an access to the  
13 specialties. And you have the gatekeepers that provide you  
14 primary care providers, but resistance to give you access to  
15 the specialists. If you believe that is lower quality care  
16 and if that's your definition, then I can say, yes, it does  
17 provide lower quality care.

18 Q. Okay. Let's put up on the screen page 153 from your  
19 deposition and I asked you the question:

20 "Q. Do you hold the opinion that HMOs provide  
21 lower quality than nonvertically integrated healthcare  
22 services?"

23 And your answer was:

24 "A. I do not have an opinion because I have not  
25 conducted my own study."

Page 73

1 A. No.

2 Q. Isn't that what you said?

3 A. That is. And it is consistent with the fact that an  
4 economist can't judge the quality of care. That's not our  
5 field of study. So if we're asked to judge the quality of  
6 care under an HMO, an economist can't do it.

7 But if you define it in terms of access to specialists,  
8 if that's your definition, I can opine to that. But that's  
9 the only convention of quality of care that I can opine to.

10 Q. Okay. My question, Dr. House, was didn't you give that  
11 answer in the deposition?

12 A. That is. And that is a correct statement. I cannot  
13 judge quality.

14 Q. Now, you understand that innovation in the marketplace  
15 can be a good thing?

16 A. In general, yes.

17 Q. Somebody has to go first, somebody has to be the  
18 trialblazer?

19 A. That's correct. That's called the pioneer.

20 Q. And within the Texas market you would understand that  
21 the experiment has been stopped by HB 1131 into insurer  
22 ownership, correct?

23 A. I do not believe that, no. In fact, in Texas you have  
24 the experiment now with legal protection from entry. You  
25 have Sterling and Allstate providing the services under that

37 (Pages 72 to 73)

Page 74

1 model, and no one else can duplicate it.

2 Q. And you understand that HB 1131 prevents companies from

3 trying to determine whether in Texas insurer-owned shops

4 would be a more efficient way of delivering automobile

5 coverage?

6 A. Not true. Allstate/Sterling can define whether that is

7 an efficient model in the State of Texas, with protection,

8 and everywhere else in the United States without protection.

9 Q. Let me put on the ELMO your -- this is your graphic,

10 your chart.

11 And you say, "There would be a host of insurance

12 company acquisitions of existing repair shops and the

13 establishment of new shops." Do you see that?

14 A. That's correct.

15 Q. And in Texas you talk about county mutuals.

16 A. Yes.

17 Q. Okay. Now, in Texas no shop -- no insurer can enter

18 into a -- can acquire a collision repair shop, if they even

19 wanted to. Right?

20 A. In the State of Texas they can't. Elsewhere they can.

21 Q. So the experiment was stopped within Texas?

22 A. Within Texas, but not elsewhere.

23 Q. And elsewhere you understand that legislation is

24 pending in other states. Right?

25 A. Well, I haven't -- I haven't considered what bills are

Page 75

1 pending, but I am aware that the law allows it.

2 Q. And you're aware that Mr. Rubenson testified because of

3 the pending legislation even Allstate's plans of furthering

4 their effort to vertically integrate has been placed on

5 hold. You're aware of that testimony?

6 A. Well, I'm aware of that testimony. I'm also aware that

7 Allstate has 62 shops under that configuration, that they

8 have already done it.

9 Q. Now, you talk about whether Allstate's Sterling model

10 is an efficient model, and you pointed to other 62 shops.

11 And let put's this on the screen.

12 A. Well, there's a total of 62.

13 Q. Total of 62 shops.

14 And these are the markets that you reference and the

15 numbers of shops in each of those markets.

16 A. Right.

17 Q. You don't know how many -- you would agree that many of

18 those shops are legacy shops that were acquired by Sterling

19 and not greenfield facilities built by Sterling after the

20 acquisition, right?

21 A. That may well be true.

22 Q. Now, you talked about one of the things that might

23 occur if Allstate's model was not successful would be the

24 channeling of customers. Correct?

25 A. Yes.

38 (Pages 74 to 75)

PAMELA J. WILSON, C.S.R., U.S. DISTRICT COURT

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Page 76

1 Q. And if I could put this on the ELMO, you talk about the  
 2 goal -- Allstate's goal was 80 percent?  
 3 A. Right.  
 4 Q. And they're achieving 20 percent. Do you see that?  
 5 A. 23 percent.  
 6 Q. 23 percent.  
 7 A. Yes, in 2003.  
 8 Q. And for the 80 percent figure you relied on PX 260,  
 9 page 99, which I would like to put up on the screen.  
 10 Now, this was a survey taken by Allstate prior to their  
 11 acquisition of Sterling. Right?  
 12 A. That -- that's correct.  
 13 Q. And all they did was they asked customers will you be  
 14 likely to use Sterling if we offered it or an insurer-owned  
 15 network if we offered it, and these were the responses that  
 16 people that had not even been in accidents were asked.  
 17 Right?  
 18 A. Correct.  
 19 Q. Okay. Now, if we turn to PX 360, which is the actual  
 20 data of what happens after somebody gets into an accident,  
 21 and we turn to page 1, you can see that the model, the  
 22 business model that Sterling was operating under, wasn't 80  
 23 percent of survey respondents but was 30 to 40 percent of  
 24 people within a 10 mile radius of people that actually got  
 25 into accidents. Right?

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1 A. Correct.  
 2 Q. And if we turn to page 4 of that exhibit, which is the  
 3 data, you can see that while it's not quite at 30 percent  
 4 yet, the numbers are 26 percent and 23 percent. Do you see  
 5 that?  
 6 A. Correct. I see that. That raises the question that if  
 7 in fact 23 percent is sufficient, why aren't they making  
 8 profits. Why aren't they expanding.  
 9 Q. And you understood that Mr. Rubenson said that they  
 10 would expand and they were planning on continuing their  
 11 investment in Sterling if HB 1131s were stopped?  
 12 You understand that?  
 13 A. I understand that. But why aren't they making profits  
 14 in their 62 shops now.  
 15 Q. Now, let me turn to your point that insurer ownership  
 16 has detrimental affects. That's your overall opinion?  
 17 A. Correct.  
 18 Q. I want to understand -- you make two points: One is  
 19 that there is some unfair competition?  
 20 A. Yes.  
 21 Q. And the other one is conflict of interest, right?  
 22 A. Yes.  
 23 Q. Okay. Let's take unfair competition first.  
 24 If we could put PDX 24 on the screen just a minute.  
 25 MR. KASS: Your Honor, the last exhibit I put on

39 (Pages 76 to 77)

PAMELA J. WILSON, C.S.R., U.S. DISTRICT COURT

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1 the screen was DX 306, not PX 306.

2 THE COURT: It was what?

3 MR. KASS: DX 306, not PX 306.

4 THE COURT: I got that. Thank you.

5 BY MR. KASS:

6 Q. Dr. House, on the screen is PX 34, and is this those

7 Allstate and Sterling's market share in the state of Texas?

8 Do you understand that?

9 A. Yes.

10 Q. You understand there are 3600 or so body shops in the

11 State of Texas, right?

12 A. That is what was reported by Dr. Harrington.

13 Q. And you understand that to be the case, right?

14 A. I don't have any evidence to -- to disagree with him on

15 that point.

16 Q. And if we put up PX 61, page 2, this is a letter sent

17 by the ASA to -- or it's reporting on the letters that went

18 out by the ASA. It's an article reporting on that. Page 2

19 it notes that the ASA sent letters to 4,650 body shops in

20 Texas. Do you see that?

21 A. Okay.

22 Q. Now, if we go back to PDX 24, your understanding is

23 that Sterling has just 15 of those 4650 body shops in Texas,

24 right?

25 A. That's correct.

Page 79

1 Q. And you understand that the collision repair services

2 market is highly competitive, right?

3 A. Generally speaking, yes, I would say in general it is

4 highly competitive.

5 Q. And you're not claiming that the auto insurance market

6 with Allstate's 16 percent share is not competitive, are you?

7 A. I believe that it is concentrated in the State of Texas.

8 Q. My question is you don't believe that it's not

9 competitive.

10 A. I believe there is competition among insurance carriers

11 in the State of Texas for automobile insurance. I will

12 agree with that statement.

13 Q. Now, whether we're talking about the insurance market

14 or the collision repair services market, you're not

15 expressing any opinion on the impact of insurer ownership on

16 competition. That was what was in your report. True?

17 A. I am not making a statement on the impact of

18 competition from an antitrust standpoint. I am making a

19 statement about the actions of Allstate being consistent

20 with unfair competition.

21 Q. So in terms of the impact on competition overall and

22 whether it is a competitive market as an economist would

23 define it, you're not making an opinion on the impact of

24 insurer ownership on competition. True?

25 A. I am not making a statement in the general market in

40 (Pages 78 to 79)

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1 Texas that Allstate has the wherewithal or the position to  
2 effect prices as we measure them statewide.

3 I am making the statement that in some localities,  
4 where Allstate has a relatively significant market share  
5 above the 16 percent, and are able to eliminate the PRO  
6 shops in those areas, it is eliminating competition and it  
7 does have a strong position in the marketplace.

8 But I am not making the statement statewide whether it  
9 is an antitrust issue.

10 Q. Well, let me focus then on the issue of the impact on  
11 body shops.

12 You understand that one of the concerns by the  
13 legislature was the desire to level the playing field and  
14 that's what Allen Walne, Victor Vandergriff, Larry Stafford  
15 all testified about. Right?

16 A. Yes.

17 Q. But you understand as an economist that in competition  
18 there are winners and losers, right?

19 A. Yes.

20 Q. And although the losers may believe it is unfair that  
21 they lost their exalted status on the PRO program, from an  
22 economic point of view vertical integration only constitutes  
23 unfair competition if it leads to higher prices. True?

24 A. In an antitrust perspective, yes.

25 But the actions can be consistent with unfair

Page 81

1 competition, but not be an antitrust violation.

2 Q. And you certainly did not conclude that insurer  
3 ownership would field higher prices, right?

4 A. I did not conclude it would field higher prices. That  
5 is correct.

6 Q. Okay. And you didn't do a study of the number of body  
7 shops that will go out of business as a result of insurer  
8 ownership. Right?

9 A. No. I did not -- and let me correct a statement --  
10 make sure we're clear on that previous answer.

11 I am not saying that the impact of vertical integration  
12 will lead to higher prices. When I say higher prices I'm  
13 talking about the market as a whole.

14 We are aware that Sterling has higher prices as a  
15 result of vertical integration, but that is not a  
16 description of market prices from an antitrust sense.

17 Q. So you are not making an opinion that overall prices  
18 for collision repair services in the State of Texas would go  
19 up in the absence of HB 1131, right?

20 A. No. I believe that Sterling is able to raise prices  
21 because of the protection it has under HB 3 -- HB 1131.

22 THE COURT: Did you take into account that if the  
23 PRO shops, or maybe the former PRO shops, got together with  
24 an advertising campaign, they could do something -- I don't,  
25 and I didn't have a good analogy right now, but the Pepsi

41 (Pages 80 to 81)

Page 82

1 challenge, or something like that, and say, you know, look,  
2 here we are, for those of you that have car wrecks, this is  
3 a bad idea because of A, B, C, and D, and you ought to come  
4 to us and you need to know you have a right to, and you  
5 ought to, say, hire some well-known football player or  
6 dignitary or whatever to make that pitch?

7 Did you take that into account?

8 THE WITNESS: Yes. And that's a very good  
9 question. When you look at PPOs, which are preferred  
10 provider organizations, where an insurance company have a  
11 network of physicians that their -- that their people can go  
12 to at discounts, they can go outside the network and pay an  
13 extra fee for going outside the network.

14 There have been organizations that have been formed  
15 called IPAs, which are independent -- or practice  
16 associations, with exactly that in mind. Those that are not  
17 in network are getting together and trying to promote  
18 themselves to get contracts with the insurance companies.  
19 And the FDC has raised questions about that whether  
20 providers can get together that are not in a network and  
21 have an impact on the market.

22 I have done a study of that on the dentistry side to  
23 see if IPAs have had any impact on prices or volume at all,  
24 and my conclusion is no they haven't. They can organize,  
25 but they haven't had an impact, at least in that market.

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1 THE COURT: But the difference here is that in  
2 that model you talked about there's a discount, here if they  
3 go to Herb's Body Shop or Craig's Collision Repair or any of  
4 these other body shops, they have to pay the same price.  
5 They're -- the consumer gets the same deal, unlike the PPO.

6 They can take their hundred percent coverage and take it  
7 somewhere else. That's what -- do you see what I'm saying?

8 THE WITNESS: Yeah.

9 THE COURT: So it seems like that the impact maybe  
10 of advertisement could overcome what Allstate is doing.

11 THE WITNESS: I see that. And it's difficult to  
12 get organizations together to pool their funds to do that  
13 advertising as a group, as a whole.

14 THE COURT: Okay.

15 THE WITNESS: There is the free ride problem. I  
16 don't have to advertise, the group will do it on my behalf  
17 so I get a free ride. So it's difficult to get those people  
18 organized to do that.

19 THE COURT: I see.

20 BY MR. KASS:

21 Q. Dr. House, let me put up on the ELMO, this is your  
22 slide, you say, "This reduces consumer choice and local  
23 competition."

24 Do you see that?

25 A. Correct.

42 (Pages 82 to 83)

Page 84

1 Q. And you're talking about Allstate's decision to taylor  
2 their PRO program to meet their needs. Right?

3 A. Right.

4 Q. Now, the fact of the matter is customers, unlike an  
5 HMO, have the choice to go to any shop they want. Right?

6 A. They do.

7 Q. And as we just discussed, you did not do any study to  
8 show that any body shops were going to go out of business,  
9 right?

10 A. That is correct. I did not do such a study. However,  
11 I am aware of the information available that suggests that  
12 channeling is an effort that would fill -- that would be the  
13 attempt to fill the shops of Sterling. And if Sterling is  
14 able to be the only preferred shop that is referred to their  
15 customers, it would have an impact of lowering competition  
16 that is met by the Sterling stores.

17 THE COURT: Let me stop you.

18 Isn't that what happens when I go in and buy a car --  
19 not me personally, but let's assume a consumer goes in and  
20 buys a car, and you're in there and the finance guy is  
21 working you on the finance deal and he says what about this  
22 insurance that you need to be buying if you drop dead will  
23 pay this off. I forgot what it's called. Credit life.

24 THE WITNESS: Right. Right.

25 THE COURT: Which is a bad deal.

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1 THE WITNESS: Right.

2 THE COURT: For everybody, except the person  
3 selling it to you.

4 Why isn't it like that?

5 I mean, you can just say the consumer just says either  
6 yes or no?

7 THE WITNESS: Well, I think the consumer generally  
8 that is going to buy a car, one, is not looking for life  
9 insurance; and two, is probably -- probably already carries  
10 life insurance, is probably aware of the options.

11 But here you have a person that has a crash, a rare  
12 event, and is going in and trying to determine where do I  
13 get my car fixed, and goes to the insurance agent, goes to  
14 Allstate to find out where do I go.

15 And if the insurance company only provides Sterling as  
16 the only place to go because the other PRO shops are not  
17 listed at all, it would presumably have an impact on the  
18 competition that Sterling faces.

19 THE COURT: But if you had an informed consumer,  
20 does that affect your answer at all?

21 THE WITNESS: If you had an informed consumer  
22 there would be a more competitive environment.

23 That's the real question, how informed will the  
24 consumer be, and will Allstate or other insurance companies  
25 that are vertically integrated properly inform that

43 (Pages 84 to 85)

Page 86

1 consumer.

2 The question may be -- or the answer may be that

3 Allstate may do it right.

4 But what about all the others?

5 What about all the other county mutuals that are going

6 to be doing the same thing, having their local shop in that

7 neighborhood, are they going to provide that information?

8 That's what the statute is trying to address as well.

9 THE COURT: Okay. Thank you.

10 Go ahead.

11 BY MR. KASS:

12 Q. If we could just put up PX 362 for a second. This is

13 Allstate's script.

14 THE COURT: Can you make that a little bigger?

15 There. Thank you.

16 BY MR. KASS:

17 Q. And if we could just blow up the first paragraph.

18 That's the one. That's Allstate's script. And what they

19 tell their customers is "you are always free to choose any

20 repair shop."

21 That's the first thing out of their mouth. Right?

22 A. That's what it says.

23 Q. You haven't compared the scripts that Sterling uses --

24 that Allstate uses when it recommends Sterling and the

25 script that it uses when it recommends PRO, right?

Page 87

1 A. I have not. It may be --

2 Q. For all you know it may be the same except they replace

3 the name out?

4 A. Allstate may be doing it right. We do have the

5 evidence that they consider suggesting only Sterling to

6 their agents. We do see those flags in the literature.

7 But it may be that they're doing it perfectly right.

8 But the question is will everybody do it right.

9 THE COURT: Well, we also know at this point

10 whatever they're doing, they're not doing it very

11 successfully.

12 THE WITNESS: That's right. That's correct. Good

13 point.

14 BY MR. KASS:

15 Q. Well, Dr. House, I want to focus again on unfair

16 competition. And the intervenors and body shops that

17 testified, they talked about information sharing and they

18 talked about redesigning the PRO program.

19 But as a matter of economics you are not concluding

20 that Allstate or Sterling, or in fact any insurer-owned

21 collision repair network, is engaged in any unfair

22 competition in any economic sense. Isn't that true?

23 A. No, that's not true.

24 If we examine the affidavits of the former PRO shops

25 that were terminated in the interest of getting a larger

44 (Pages 86 to 87)

Page 88

1 market share for Sterling, Sterling has the advantage of  
2 being linked to an insurance company that can channel  
3 customers.

4 Q. Well, let me --

5 A. And no other repair shop has that advantage. One could  
6 call that unfair, and I would call that unfair.

7 However, does it meet the requirements of an antitrust  
8 violation, where prices rise as a result of that? I can't  
9 answer that question.

10 But I can answer the question does it affect  
11 competition that is faced by Sterling stores because of the  
12 advantage that it has by being linked to Allstate. I would  
13 say yes.

14 Q. So an important point, whatever you just said, I take  
15 it, is that the impact on competition in the sense of are  
16 customers hurt, do they have higher prices as a result of  
17 insurer ownership, your answer would be no. Right?

18 A. My concern is, one, that the prices that we see  
19 reported in the Allstate documents is that, yes, they are  
20 paying higher prices if they go to Sterling. Sterling's  
21 prices are 15 percent to 25 percent higher than the PRO  
22 shops. That's a result of their study.

23 Also there is the danger of the use of aftermarket and  
24 crash parts being imposed upon the technicians where the  
25 technicians no longer have the independent choice on behalf

Page 89

1 of the consumer. There is that risk as well.

2 Q. Well, let's play a clip from your deposition. It's  
3 page 52, lines 13 through 15.

4 Maybe we could just put up the transcript.

5 THE COURT: This is why we went to law school. We  
6 couldn't do this.

7 MR. KASS: It's not -- well, we can read it:

8 (Videotape unintelligible)

9 "But from an economic point, I --

10 That is it -- it leads to higher prices."

11 MR. KASS: We might need to play that from the  
12 beginning.

13 (Videotape unintelligible)

14 "Losers believe that -- that opinion. Have an  
15 opinion -- unfair competition in an antitrust sense, that  
16 is, it leads to higher prices."

17 THE COURT: I read it.

18 MR. KASS: You read it.

19 THE WITNESS: I had trouble with the mic then,  
20 too, I guess.

21 BY MR. KASS:

22 Q. Now, you're an economist?

23 A. Yes.

24 Q. And as an economist you're aware of the fact that the  
25 term "exclusionary conduct" is a term of art. It has a

45 (Pages 88 to 89)

Page 90

1 meaning in the antitrust context and in the literature of  
2 industrial organizations?

3 A. Yes.

4 Q. And you did not review the literature and the facts of  
5 this case and come to the conclusion that insurer ownership  
6 in the collision repair market constitutes exclusionary  
7 conduct, did you?

8 A. Well, let me respond to the -- the tape, if I could,  
9 and the statements that were read out of context.

10 If you go up to page 51, the statement that I have made  
11 here establishes my -- the use -- use of unfair competition  
12 in what you have just played is this, "I assume when you say  
13 unfair competition you're using it in the sense of an  
14 antitrust application in economics, where you're examining  
15 the impact of prices and, again, I have not expressed an  
16 opinion of vertical integration's impact upon prices from an  
17 antitrust standpoint."

18 So preceding the question that you raised and any  
19 answer we had defined unfair competition as competition  
20 within the context of an antitrust violation.

21 Q. Well, you would agree that nothing about insurer  
22 ownership creates a barrier to entry and in that sense  
23 there's nothing exclusionary about insurer ownership, right?

24 A. From a market as a whole it is not exclusionary in the  
25 sense that its impact leads to overall higher prices.

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1 When you get to the local market area you have  
2 exclusionary conduct by eliminating PRO shops producing the  
3 competition that Sterling faces. But I cannot say the  
4 result of that is higher prices.

5 I do know that Sterling has higher prices, but I can't  
6 predict that those higher prices will be sustained.

7 Q. Well, I don't know -- I don't know if the video is  
8 working now, but I would like to play page 54, lines 22 to  
9 55, 9. And if it is not working, just the transcript would  
10 be fine.

11 (Videotape playing.)

12 "Q. Do you have an opinion that vertical  
13 integration in the collision repair market constitutes  
14 exclusionary conduct?"

15 "A. By exclusionary conduct do you mean  
16 exclusionary conduct in the sense of creating barriers to  
17 entry?"

18 "Q. Okay.

19 "A. If that is your opinion, no, I don't believe  
20 it creates barriers to entry in the collision repair  
21 business."

22 That's the opinion you provided?

23 A. Yes. From an antitrust perspective it does not; that  
24 is, we would not expect to see higher prices as a result of  
25 that conduct.

46 (Pages 90 to 91)

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1 However, we are concerned about local issues and the  
2 reduction of competition within the local store, but from an  
3 antitrust standpoint we can't raise it to the level of  
4 expecting higher prices.

5 Q. And you don't believe that insurer ownership --

6 THE COURT: Let me stop you right there just a  
7 sec.

8 But when they eliminate the PRO shops, don't PRO shops  
9 pick up more business from all the other insurers?

10 THE WITNESS: They get the advantage of that,  
11 yes. They get the business -- the other insured business  
12 that went to Sterling that would go to PRO shops, that's  
13 right. But the concern is what happens when you're in a  
14 local market area -- and this would be spotty, in a local  
15 area in which Allstate has a relatively large market share.

16 THE COURT: Okay.

17 THE WITNESS: Then there is not much other insured  
18 business for the PRO shops to enjoy.

19 THE COURT: I'm trying to remember what the  
20 testimony is right now, but in Texas there are market spots  
21 like that, like they have got Laredo cornered or something  
22 like that?

23 THE WITNESS: We don't know. We haven't seen that  
24 evidence. That evidence hasn't been presented by anyone,  
25 Dr. Harrington or anyone else.

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1 But we expect -- I know I've studied insurance coverage  
2 in dentistry and found that, yes, there are local spots  
3 where there are carrier concentrations quite different than  
4 what we see statewide as a whole.

5 So we know at least in dental insurance we do have  
6 pockets where a carrier will have a surprisingly large  
7 market share that is unique to that community. Given that,  
8 I would expect to find it. But I don't have the evidence.

9 THE COURT: Okay.

10 BY MR. KASS:

11 Q. So just to be clear, did you not do a study yourself  
12 to show that Allstate's market shares in any region in Texas  
13 approach monopolistic levels, for example?

14 A. No. I do not. I know the potential is there, but I do  
15 not have those facts.

16 Q. Now, the intervenor's findings use pejorative terms,  
17 like Allstate's power, but you have not concluded that  
18 insurer ownership of collision repair facilities would lead  
19 to the exercise of market power, have you?

20 A. No. I did not conclude that the vertical integration  
21 will lead to an antitrust issue that will -- that results in  
22 higher prices. I don't believe that's the issue we're  
23 facing.

24 I think the issue we're facing is conflict of  
25 interest.

47 (Pages 92 to 93)

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1 Q. You haven't even concluded that insurer ownership would  
2 substantially lessen competition, true?

3 A. As a market as a whole, no. Within local markets, yes,  
4 it could. And the affidavits we've seen is consistent with  
5 that.

6 Q. Well, in response to just the basic question of whether  
7 insurer ownership would make the Texas collision repair  
8 services market less competitive, your response would have  
9 to be that you have not drawn that opinion.

10 A. That's correct. As a market as a whole I would not.  
11 But in local markets it could, and that's the danger.

12 Q. I would like to turn now to the discriminatory effects  
13 economic analysis under Exxon. And if we could put up PDX  
14 701, which is a summary of Dr. Harrington's opinions which I  
15 think you retyped as your first slide in your set of  
16 exhibits.

17 Dr. Harrington testified that HB 1131  
18 disproportionately impacts out-of-state service providers.  
19 Do you see that?

20 A. Yes.

21 Q. And I take it you disagree with Dr. Harrington's  
22 opinion?

23 A. Yes. It was only a partial equilibrium analysis.

24 Q. But you would agree that Sterling is itself an  
25 interstate entity, true?

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1 A. That's a good question. If by that definition

2 Allstate/Sterling has shops in multiple states I would say  
3 yes.

4 I raise the question: So?

5 Q. I understand. We'll get to so. But at least you  
6 understand that Sterling is an interstate entity, right?

7 A. Yes, it has shops in multiple states, correct.

8 Q. And I understand that you now -- well, let me step back.

9 You haven't done any study to determine how many of the  
10 4650 body shops in Texas are local body shops. Right?

11 A. I have not done my own study to show the distribution  
12 of ownership among body shops in the State of Texas. That  
13 is correct.

14 Q. You didn't see any presented in the testimony in  
15 court. Right?

16 A. Dr. Harrington didn't do a study. I haven't seen  
17 anyone do a study of that.

18 Q. But it's your understanding that most collision repair  
19 shops operating in Texas are not interstate entities.

20 A. That's my understanding, but it's based upon  
21 Dr. Harrington's first statement in his study. I am  
22 assuming that Dr. Harrington is correct. I don't know that  
23 now.

24 In the course of the trial I have become aware of  
25 relatively large chains of body shops that exist here that I

48 (Pages 94 to 95)

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1 don't see in College Station as a casual observer, but you  
2 see it in the larger cities. So I'm not sure that that's  
3 true. I assume that Dr. Harrington was true in his  
4 statement, but I don't know that.

5 Q. Okay. So you don't know, but at least as of the time  
6 of your deposition your understanding as an economist  
7 retained by the intervenors, whose members are collision  
8 repair shops, was that most collision repair shops operating  
9 in Texas are not interstate entities. Right?

10 A. Based upon what Dr. Harrington has stated in his  
11 report, I believed him at the time.

12 Q. Let's put up PDX 704. I want to walk through the  
13 discriminatory effects analysis in a little more rigor.

14 This is from -- a quote from the Exxon case. And here  
15 it says that "A law may be discriminatory or may have a  
16 discriminatory effect if the affect of a state regulation is  
17 to cause local goods to constitute a larger share, and goods  
18 with an out-of-state source to constitute a smaller share,  
19 of the total sales in the market."

20 Do you see that?

21 A. Correct.

22 Q. Okay. Now, Dr. Harrington went through a four part  
23 test -- and if we put up PDX 708, he asked four questions.

24 And I understand that there is a -- that you have a  
25 question on the law of whether or not the services

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1 themselves have to cross state lines in the sense that they  
2 have to be provided outside of the State of Texas in order  
3 to implicate the dormant commerce clause, but let's just  
4 look at whether or not -- if the law is that it matters who  
5 is the provider and whether or not local providers --  
6 out-of-state providers can be denied access to the local  
7 market.

8 These four questions that Dr. Harrington asks you would  
9 agree are fair questions, if you wanted to determine the  
10 economic affect of HB 1131 under the Exxon test, right?

11 A. No. I would not agree with that. I think under the  
12 Exxon test the question is what happens to the flow of  
13 services and products in that case across state lines.

14 Q. But if you wanted to find out whether firms that -- if  
15 you wanted to find out whether out-of-state firms were  
16 denied access and thereby harmed, these are the four  
17 questions you would ask to determine whether or not the law  
18 had a discriminatory effect analysis, correct?

19 A. No, sir. Those are not the four questions I would  
20 ask. Does HB 1131 adversely impact local providers.

21 I would ask the question does it affect the firms that  
22 are importing goods from out-of-state. If it does, then  
23 it's going to affect the flow of interstate commerce across  
24 state boundaries. That would be the question I would ask.

25 Q. I understand we have a difference of what the legal

49 (Pages 96 to 97)

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1 standard is under Exxon, but take these four questions one  
2 by one.

3 As far as you know, there are no local body shops that  
4 have to change their business plans as a result of HB 1131?

5 A. I believe that we have testimony that some did, when  
6 some PRO shops were eliminated, with Allstate and Sterling  
7 having the advantage of being the only firm vertically  
8 integrated to compete, then, yes, we did have local shops  
9 being affected.

10 Q. All right. There are no local shops that were  
11 adversely affected in the sense that they had existing plans  
12 to vertically integrate that were then stopped by HB 1131.

13 A. No.

14 But that's not the right question.

15 The right question is with equilibrium. When you  
16 find -- if in fact this is an efficient model and you find  
17 State Farm is going to vertically integrate, so the USAA is  
18 going to vertically integrate, the local county mutuals are  
19 going to integrate, then you're going to see the plans of  
20 the local shops being locally integrated because that would  
21 be presumably the efficient model.

22 Q. I understand you may think I'm not asking the relevant  
23 question, Dr. House, but my question was you're not aware of  
24 any existing body shop that had -- that actually had the  
25 plan of vertically integrating and then that plan was

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1 thwarted because of HB 1131. True?

2 A. That is true. Because the market is not convinced that  
3 that is an efficient model, so such plans would not be made.

4 Q. Now, let's talk about in-state.

5 You mentioned again the county mutuals and other  
6 insurers and the intervenors have talked about USAA. And  
7 let's put up Plaintiff's 16. You can pull up the second  
8 bullet point. It says, "USAA insurance does not currently,  
9 nor does it have any plans in acquiring an interest in auto  
10 repair facilities." Right?

11 Do you see?

12 A. Correct.

13 Q. And USAA is an in-state insurer?

14 A. It is an in-state insurer. And I would say the same  
15 thing: If they don't believe that this is a model that is  
16 efficient, they wouldn't make the plans.

17 But if Allstate and Sterling prove that it is  
18 efficient, then their plans would change.

19 Q. But HB 1131 did not adversely affect USAA's current  
20 business plans? That's my question.

21 A. That's correct. They don't believe that this is going  
22 to work.

23 Q. Now, you're not aware of any other insurers that had  
24 actually made a decision to enter the collision repair  
25 business and whose plans were thwarted by HB 1131?

50 (Pages 98 to 99)

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1 A. No. I don't know of any other insurance company that  
2 plans to adopt this model on the basis of efficiencies.

3 Q. Okay. Now, if we can turn back to PDX 708 and turn now  
4 to the second question, which is whether HB 1131 reduces  
5 sales to interstate firms by denying them access to the  
6 local market. You would agree that HB 1131 will in fact  
7 reduce sales to Sterling.

8 A. That's a good question, and one we have to be very  
9 careful with.

10 Would you repeat that question?

11 Q. You would agree that HB 1131 will in fact reduce sales  
12 to Sterling?

13 A. Under what perspective?

14 If in fact this is an efficient model, with HB 1131  
15 and with Sterling having 15 plants, if this is an efficient  
16 model the sales to Sterling will increase in the presence of  
17 the existing HB 1131.

18 Q. My -- my question, Dr. House, is whether your  
19 understanding as an economist reviewing the entry is that  
20 the presence of HB 1131 will reduce the volume of sales that  
21 go to Sterling?

22 A. Under the present scenario, I don't believe it would.

23 But if you assume, and this was the context of your  
24 questions in deposition -- if you assume that Sterling is  
25 going to expand the number of locations in the State of

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1 Texas, and if you assume that every one of those are going  
2 to gain sales, and that the affect of HB 1131 is to  
3 eliminate those expansions, all of which would have sales,  
4 then I would say, yes, under those assumptions.

5 Q. And you understood that Allstate was in fact planning  
6 to expand in Texas?

7 A. I understand that they had plans to expand in Texas. I  
8 understand that they had plans to expand all over the United  
9 States under this model. And I also understand that they  
10 had not done so in Texas and all over the United States.

11 Q. And you understand that Allstate's business model was  
12 not to stop at the 38 stores or the 62 stores that Sterling  
13 has, but to really expand Sterling throughout the country  
14 and offer an interstate -- nationwide interstate network of  
15 collision repair shops that could serve and benefit  
16 Allstate's customers, that's your understanding?

17 A. Yes. And that's the question: Why haven't they.

18 Q. Now, the third question, Dr. House, is do the lost  
19 sales go predominantly to local in-state body shops. Do you  
20 see that?

21 A. Yes.

22 Q. And you have not done a study to determine where the  
23 lost sales would go.

24 A. No, I haven't. It's a -- it's not a -- a productive  
25 question, because the question here is what would happen to

51 (Pages 100 to 101)

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1 those sales that Allstate/Sterling would have had with these  
2 expansions that are assumed, with sales at every store that  
3 are assumed, had HB 1131 stopped that expansion.

4 But it does not address the question that if in fact  
5 they were expanding, and it was an efficient model, you  
6 would have other insurance carriers expanding as well.

7 Q. Not in Texas?

8 A. Not in Texas you -- yes. In the absence of HB 1131 you  
9 certainly would, if it's an efficient model.

10 Q. So if -- if Allstate is ultimately proven to be  
11 correct, then there would be more interstate insurers  
12 building interstate networks of collision repair chains?

13 A. Yes. And you would also have more mutual -- county  
14 mutual insurance companies buying intrastate firms, away  
15 from interstate firms that are not linked, to where you have  
16 more intrastate firms as well. So you don't know the answer  
17 to that question.

18 Q. And you analyze the economics that local small insurers  
19 have with respect to the building of an interstate or even  
20 an intrastate network of collision repair shops?

21 A. I looked at what competition will do. Competition --  
22 if in fact this is the efficient model, just as the grocery  
23 store with the pharmacy is an efficient model, if that's  
24 where it's going, and Allstate/Sterling proved that that's  
25 the case, you're going to have insurance companies as a

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1 result of the profits and efficiencies of that acquiring  
2 certain collision repair services, some of which are  
3 existing as interstate chains not owned by insurance  
4 companies but will be sold off to the county mutuals to take  
5 the advantage of that vertical integration because the  
6 unowned interstate chains will not be an efficient model.  
7 They will go away.

8 Q. You understand -- talking again about the lost sales,  
9 you understand that one thing HB 1131 does is it restricts  
10 Allstate from recommending Sterling, from investing in  
11 Sterling stores, from expanding. That's your understanding?

12 A. That's what has been stated. I'm not an attorney. I  
13 can't interpret it, but that's what I've heard stated.

14 Q. And you understand that one of the purposes and one of  
15 the reasons that the body shop coalition pushed for HB 1131  
16 was to prevent competition from Sterling.

17 A. Well, I don't know. I don't know that history well.

18 Q. Well, let's put up PDX 901. You weren't here for this  
19 testimony, but this is a chart made during Mr. Walne's  
20 testimony, cross-examination, and he testified that what he  
21 did was he had opened up a two million dollar facility in  
22 the summer of 2002 and then Sterling entered with a 16,000  
23 square foot facility later that summer and that's when he  
24 approached Senator Carona.

25 Now, you would agree -- well, did you see Mr. Walne's

52 (Pages 102 to 103)

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1 testimony where he admitted that HB 1131 mitigated a  
 2 projected decline in the sales of his five body shops?  
 3 A. Yes. I read that testimony. Again, he's one of those  
 4 where he was -- where he was a PRO shop and eliminated.  
 5 Q. And you would -- and he is a local body shop?  
 6 A. Yes.  
 7 Q. And, in fact, you would agree that most of the lost  
 8 sales suffered by Sterling as a result of the recommendation  
 9 provisions or the expansion provisions would go to local,  
 10 that is noninterstate entities?  
 11 A. I don't know that. No. I cannot make that statement.  
 12 Q. Well, let's put up a clip from your deposition, page  
 13 212, lines 12 to 14.  
 14 MR. KASS: If we can just have the transcript,  
 15 that will be fine as well.  
 16 Page 212, lines 12 through 14.  
 17 BY MR. KASS:  
 18 Q. And I asked you this question:  
 19 "Q. And so most would go to local, that is,  
 20 noninterstate entities." And I'm referring to the lost  
 21 sales.  
 22 And you say: "A. I would agree with that."  
 23 Do you see that?  
 24 A. I see that.  
 25 Q. And that's the question I asked you?

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1 A. Yes.  
 2 Q. And the answer you gave?  
 3 A. Yes.  
 4 Can we read on?  
 5 MR. POWELL: We would offer some more right at the  
 6 point by way of optional completeness.  
 7 Let's turn over to page 213, Dr. House. Line 1.  
 8 THE WITNESS: Here.  
 9 MR. POWELL: Would you read your answer there?  
 10 THE WITNESS: "Let me see if I understand the  
 11 question. And I apologize for being confused.  
 12 "Your question is: Does that statute, as it exists  
 13 today, with vertical integration, yield smaller sales at  
 14 Sterling than would have existed in the absence of that  
 15 statute with vertical integration?"  
 16 MR. POWELL: And then the question is by Mr. Kass:  
 17 "Q. That's not my question. It's close but it's  
 18 not quite that my question.  
 19 THE WITNESS: And I say:  
 20 "A. Let's try again.  
 21 MR. POWELL: "Q. HB 1131 has the effect of  
 22 shifting sales from interstate providers of collision repair  
 23 services to in-state providers of collision repair  
 24 services?"  
 25 And then what was your answer on line 16?

53 (Pages 104 to 105)

PAMELA J. WILSON, C.S.R., U.S. DISTRICT COURT

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1 THE WITNESS: "A. When you say interstate  
2 providers, are you talking about Sterling -- "

3 MR. POWELL: Question by Mr. Kass:  
4 "Q. I'm talking --"

5 THE WITNESS: And I say: "A. -- exclusively?"

6 MR. POWELL: By Mr. Kass:

7 "Q. I'm talking about the class of interstate  
8 providers, if you look at the number of sales that go to  
9 interstate providers --"

10 THE WITNESS: "A. Okay."

11 MR. POWELL: "Q. -- and you look at the number  
12 of sales that go to in-state providers."

13 THE WITNESS: "A. Yes.

14 MR. POWELL: "Q. That number going to interstate  
15 providers would be higher but for HB 1131 and the number  
16 going to in-state providers would be lower but for HB 1131."

17 What's your answer on line 10?

18 THE WITNESS: "A. I cannot agree with that.  
19 There are interstate providers that are not vertically  
20 integrated."

21 MR. POWELL: That concludes our offer, Your Honor.

22 THE COURT: Okay.

23 BY MR. KASS:

24 Q. If we go to page 216, sorry to keep this going, but  
25 page 214, lines 20 through 24:

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1 "Q. But as you say, interstate firms are  
2 relatively rare?

3 And the answer:

4 "A. Interstate firms are relatively rare."

5 Do you see that?

6 A. Yes.

7 Q. Again, that's an answer you gave?

8 A. Yes. And if you continue on I say "I don't know the  
9 distribution of where that business would go." That's line  
10 11 and 12.

11 And then I summarize on line 19, "I am not prepared to  
12 tell you where all of that business would go. I am prepared  
13 to say that that statute reduces sales to Sterling. I am  
14 willing to say that. But where that business goes, I am not  
15 willing to speculate."

16 Q. Okay. Well, we'll talk about where that -- the other  
17 interstate consolidators that are out there, but you did say  
18 that interstate consolidators that are not vertically  
19 integrated are relatively rare. That's what you said?

20 A. That what I said based upon my understanding and my  
21 reading of Dr. Harrington. Yes.

22 Q. Okay. Let's go to PDX 708 again.

23 THE COURT: No. Let's go to lunch.

24 We'll be back at 1:15.

25 See y'all then.

54 (Pages 106 to 107)

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1 Off the record.  
 2 (Discussion off the record.)  
 3 (Recess taken.)  
 4 (CROSS-EXAMINATION)  
 5 BY MR. KASS:  
 6 Q. During the direct examination the court asked you the  
 7 question: Well, why can't the local body shops get together  
 8 and advertise themselves. And you said there's a big free  
 9 ride problem and it was hard to get them to contribute. Do  
 10 you recall that testimony?  
 11 A. That's correct. They're competitors.  
 12 Q. Now, you were retained by the intervenors. Correct?  
 13 A. I was retained by whom?  
 14 Q. The intervenors, the ASA?  
 15 A. I suppose. I don't really know.  
 16 Q. Okay. And Mr. Walne is a member of the ASA, he's the  
 17 corporate representative here?  
 18 A. I suppose. I don't know that.  
 19 Q. Did you look at the amount of money that the  
 20 intervenors and Mr. Walne have spent as part of this  
 21 lobbying effort in the litigation here to retain Mr. Powell  
 22 and Mr. Yoxall to litigate the validity of HB 1131?  
 23 A. No, I do not know that.  
 24 Q. Now, do you really think that the -- Mr. Walne and the  
 25 collection of body shops that make up the ASA would have

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1 spent all this money, all these corporate resources, and  
 2 would have devoted their precious time sitting here all week  
 3 long if they didn't believe that HB 1131 would shift  
 4 business to them?  
 5 MR. POWELL: Objection. This calls for  
 6 speculation on the part of this witness about what somebody  
 7 else might believe.  
 8 THE COURT: Sustain.  
 9 BY MR. KASS:  
 10 Q. Now, turning to the fourth question, Dr. House, the  
 11 question of will the lost sales be promptly replaced by  
 12 rapid expansion by other interstate firms in Texas, did you  
 13 ask Mr. Yoxall and Mr. Powell to provide you with evidence  
 14 concerning these rare interstate consolidators' expansion  
 15 plans into Texas?  
 16 A. No, I did not. That's not how I would conduct my  
 17 research.  
 18 Q. Now, I'd like to turn now to the question of what  
 19 happens if --  
 20 THE COURT: Wait. Wait. I want to ask him a  
 21 question.  
 22 THE WITNESS: Sure.  
 23 THE COURT: With regard to that, whether there are  
 24 few or many other interstate providers, does that affect  
 25 your opinion in any way?

55 (Pages 108 to 109)

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1 You see what I'm saying?

2 If there's not other competitors at this time that  
3 are -- that are interstate competitors, one of the questions  
4 I had written to myself to ask, and so that's what I'm  
5 asking, does that matter?

6 THE WITNESS: Well, I think there are two  
7 perspectives.

8 One, if we are in fact looking at interstate commerce  
9 in terms of the flow and products of services across state  
10 lines, no.

11 If in fact we are counting heads and our concern is do  
12 we have an increase or decrease in the proportion of five  
13 years that have an interstate presence versus an intrastate  
14 presence, the answer to that question still will be if the  
15 model is efficient we're going to have vertical integration,  
16 much of which is going to be among insurance companies that  
17 are intrastate. And those insurance companies have no  
18 incentive to establish service -- collision repair service  
19 firms outside the state, and they're going to grow.

20 So in that sense, again, we come back to the conclusion  
21 that we don't know. We don't know what is going to happen  
22 when and if this is the efficient model and what the impact  
23 is going to be in terms of the proportion of providers that  
24 are interstate and the proportion of providers that are  
25 intrastate, in terms of the collision repair service

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1 market. So I can't say. We don't know.

2 But what exists today in terms of the representation of  
3 interstate providers versus intrastate providers is not  
4 going to be a good map -- reference map of what's going to  
5 be if this is an efficient model.

6 I hope I answer your question.

7 THE COURT: Well, what about car dealers? Aren't  
8 they interstate providers?

9 THE WITNESS: Car dealers are -- are -- many of  
10 which are interstate providers, but if this is an efficient  
11 model and you do find that you have gained tremendous  
12 efficiencies from the combination of the collision repair  
13 service firm and the insurance company, they will also drive  
14 out the dealerships in trying to compete in that marketplace  
15 because they can't control and divert business to themselves  
16 in the same way that an insurance company can, if in fact  
17 this is efficient.

18 So I would anticipate that if this model is the  
19 efficient model, the dealerships may well lose market share  
20 because they are not linked to insurance companies.

21 Now, it may be that they get linked to insurance  
22 companies, but I would -- I would tend to think that what's  
23 going to happen, if in fact this is the -- this is the  
24 efficient model, you're going to have insurance companies  
25 acquiring the -- the repair shops, some of which were

56 (Pages 110 to 111)

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1 originally interstate, some of which were not.

2 THE COURT: Well, here's my last question and I'll  
3 let you go.

4 Is an automobile dealership that has auto repair, is  
5 that vertical integration, horizontal integration, or  
6 neither?

7 THE WITNESS: That's an economies of scope. That  
8 is really neither in the sense of being an in-line, if you  
9 talk about a dealership and their principal business is  
10 selling cars, then the line of business of course is car  
11 manufacturing and then reselling.

12 Now, auto repair is an -- is an adjunct kind of  
13 business and it's related, but it is not vertical, because  
14 it is not an input into the sale of automobiles. It's a  
15 complementary service.

16 So it is a horizontal expansion in that sense that  
17 you're having economies of scope or you're combining related  
18 industries.

19 It's like the grocery store and the pharmacy in the  
20 grocery store, you have a dealership with collision repair  
21 services. They're close cousins, but strictly sense from an  
22 economic standpoint it's not a vertical integration.

23 THE COURT: Okay. Thank you.

24 BY MR. KASS:

25 Q. Now, doctor, just picking up on a relatively rare

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1 point, you would agree that if there are no interstate  
2 providers, and HB 1131 does reduce the sales to Sterling,  
3 then the effect of the law would be to shift sales from  
4 interstate providers, Sterling, to the local body shops.  
5 Right?

6 A. No, I would not agree with that.

7 Q. Well, you're not saying that there would be more cars  
8 that need to be fixed in the State of Texas?

9 A. No. But I'm saying that if HB 1131 -- if -- if HB 1131  
10 had the impact of reducing sales of Sterling, where those  
11 sales came from, whether they be intrastate or interstate  
12 providers predominantly, we don't know.

13 Q. If they're -- the interstate providers are relatively  
14 rare, and let just take it to an extreme, if there are none,  
15 then it would have the affect of shifting business to the  
16 local providers.

17 A. If you make the assumption -- if you assume away the  
18 existence of interstate providers, your question is  
19 correct. If you do not assume that away, I can't tell.

20 Q. Now, let's talk about these relatively rare interstate  
21 providers. Most of them, most of these consolidators when  
22 they expand, when they build new stores -- when they expand  
23 they don't do it by building new stores, what they do is  
24 they acquire a new shop, right?

25 A. I don't know that.

57 (Pages 112 to 113)

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1 Q. Okay.

2 A. I don't know that that's true.

3 Q. Okay. Well, let's put up PDX 710.

4 And this is a chart that Dr. Harrington used to discuss

5 the difference between Sterling's greenfield expansion and

6 the expansion through acquisition.

7 Now, you do understand that Sterling's model was to

8 build new greenfield facilities. Right?

9 A. Well, I understand that they have done both.

10 Q. Since the acquisition your understanding is that

11 Sterling's primary way of growth was through greenfield

12 facilities, true?

13 A. Through the expansion in the State of Texas I'm aware

14 that much of that has been greenfield. I do not know the

15 way in which they have expanded outside the State of Texas.

16 Q. And you would agree that when a firm, like Sterling,

17 builds a new greenfield facility, it adds capacity to the

18 marketplace. Right?

19 A. It adds capacity. That's correct.

20 Q. And if that greenfield facility generates sales, it's

21 likely to have an adverse economic impact on the existing

22 competitors, right?

23 A. That's correct.

24 Q. And it's going to shift sales from those existing

25 competitors to Sterling. Right?

Page 115

1 A. That's correct.

2 Q. Now, with a brownfield expansion, that's the middle

3 part of this slide, and that's when you expand through

4 acquisition, you're not adding capacity to the marketplace.

5 Right?

6 A. That's correct.

7 Q. And there's no change in market shares.

8 A. No. We don't know that.

9 Q. When you add -- when you're not adding capacity, if

10 they're not increasing their output, there's no shift in

11 market share from the existing competitors to the acquired

12 shop.

13 A. If you have no change in sales.

14 Q. And when a consolidator chooses to expand through

15 acquisition, it has to pay the existing shop in order to buy

16 it. Right?

17 A. Sure. There would be a market price for that business.

18 Q. And so it has to pay for the privilege of competing in

19 the market?

20 A. Well, you acquire the assets and then you're back in

21 business. And if you're greenfield you're buying the

22 construction and the land.

23 Q. Okay.

24 A. Both are investments.

25 Q. Okay. Now, I want to focus a little bit on Sterling's

58 (Pages 114 to 115)

Page 116

1 greenfield expansion plan and their model. And you had some  
 2 discussion about whether or not it was in fact an efficient  
 3 way of doing business. Right? You questioned it?  
 4 A. I questioned the efficiency of that model, yes.  
 5 Q. And you understand that Allstate is committed to this  
 6 model and does want to expand and believes that this can be  
 7 an efficient way of doing business. Right?  
 8 A. Well, the testimony of Dr. Harrington is consistent  
 9 with that.  
 10 Q. And Mr. Ruebenson as well.  
 11 A. That's correct.  
 12 Q. But, in your expert report, we put up PX 562, this is  
 13 your expert report, paragraph 7, you say that "No evidence  
 14 is presented that unambiguously proves that such  
 15 efficiencies exist at either level." Here you're talking  
 16 about both at the shop level and across the network, right?  
 17 A. Yes. What I'm addressing there are the two levels, the  
 18 insurance level and the collision repair service level.  
 19 Both of those industries there is no evidence that the  
 20 vertical integration improves efficiencies at either level.  
 21 Q. And you understand that vertical integration occurred  
 22 in 2001.  
 23 A. May 2001.  
 24 Q. May 2001. So it's still getting underway.  
 25 A. Well, it's over three years ago.

Page 117

1 Q. And they are only at 62 shops versus the 300 or so that  
 2 they were initially planned, right?  
 3 A. Yes. But they're all vertically integrated.  
 4 Q. Now, you used the words "unambiguously proves," but  
 5 you're not concluding that insurer ownership would lead to  
 6 the inefficient provision of collision repair services, are  
 7 you?  
 8 A. I have not conducted my own study. I am aware of the  
 9 evidence, the evidence that has been presented at trial that  
 10 there have been problems in the three years, three plus  
 11 years in which the vertical integration has taken place.  
 12 Q. But I'm asking for your own opinion as an expert  
 13 economist, not your take or characterization of other  
 14 evidence.  
 15 Did you not conclude that insurer ownership of  
 16 collision repair services would lead to the inefficient  
 17 provision of those services.  
 18 A. I cannot conclude that it is inefficient. I am aware  
 19 that they're losing money.  
 20 Q. Okay. You would agree that if Allstate's  
 21 recommendations lead to increased capacity utilization, then  
 22 there could be increased efficiencies.  
 23 A. Sure. That's true of any firm.  
 24 Q. Okay. Now, let's put up PX 559, and this is  
 25 Dr. Harrington's expert report and he testified consistently

59 (Pages 116 to 117)

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1 with this, but he says, on page 13, that "Substantial  
2 economies are likely at the organization level by spreading  
3 fixed costs over the large volume of repairs that is  
4 achievable through a multi-state network of repair shops."

5 Do you see that?

6 A. I see that.

7 Q. Okay. Now, you have not taken this opinion, studied it  
8 and rejected it, have you?

9 A. Well, I have rejected that opinion that you measure  
10 economies only on the basis of fixed costs.

11 Q. Okay.

12 A. And that's what Dr. Harrington testified to in his  
13 testimony. He said any firm that increases volume, average  
14 fixed costs decline. That's true everywhere but that does  
15 not address economies of scale.

16 Q. Okay. Well --

17 A. It ignores the variable cost.

18 Q. Okay. I would like to put up a trans-- a portion of  
19 your deposition transcript that's talking about this exact  
20 statement. It's page 104, lines 14 through 17.

21 And I asked you:

22 "Q. But you don't have an independent opinion  
23 that Dr. Harrington is wrong? You have not taken his  
24 hypothesis, studied it, and rejected it?"

25 And your answer is:

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1 "A. I have not."

2 A. I have not, nor has Dr. Harrington.

3 Q. Okay. Now, if we go back to PX 559, Dr. Harrington  
4 also says, if we go to the next paragraph it says, "The  
5 Allstate/Sterling initiative also offers the opportunity for  
6 significantly improved capacity utilization and load  
7 leveling among shops."

8 And, again, you have not taken this opinion, studied it  
9 and rejected it?

10 A. I have examined the evidence. Capacity utilization is  
11 very, very low. I have not looked at load leveling, but  
12 load leveling is important only if you have outlets in which  
13 capacity utilization is very, very high and you have long  
14 queues, but I am aware that there is very low capacity  
15 utilization among the Sterling outlets.

16 Q. And part of the low capacity utilization at least in  
17 Texas is due to HB 1131?

18 A. I can't agree with that.

19 Most of the stores now are outside the State of Texas.

20 Q. I'm asking about the Texas stores.

21 A. If in Texas -- I do not know that HB 1131 is the cause  
22 of low capacity utilization.

23 Q. You just --

24 A. I understand that the main problem with capacity  
25 utilization was the outflow of volume of business from other

60 (Pages 118 to 119)

Page 120

1 insurers.

2 Q. Well, that was in the Houston stores, not the Dallas  
3 greenfield stores that were built after the acquisition.

4 Right?

5 A. Well, it's true that a greenfield store has to make its  
6 own way, that's true. But normally a greenfield store, when  
7 it is -- that is not vertically integrated is hoping to pick  
8 up business from other insureds. Remember, Allstate only  
9 has 15 percent of the market.

10 A greenfield store normally would want to capture  
11 customers from a hundred percent of the market, but when you  
12 shut down 85 percent of the market because you virtually  
13 integrated, a greenfield store is not going to grow when  
14 it's vertically integrated, as it would, unless you channel  
15 business.

16 Q. Well, let's talk about whether Sterling's model makes  
17 sense. You're basically saying that Allstate and Sterling  
18 are wrong when it comes to their belief that they can  
19 achieve economies of sale?

20 A. I do not see the evidence. I don't know. They may be  
21 right, but I do not see the evidence that is consistent with  
22 that declaration.

23 Everything that I have seen suggests that there are  
24 problems with this model that have not been fixed, and I am  
25 not convinced, as I've stated in my deposition, that there

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1 are enormous economies of scale or which there are  
2 efficiencies. I'm not convinced of that.

3 Q. So you're basically saying that Allstate is wrong when  
4 they believe that they can achieve economies of scale?

5 A. If they are able to channel and convince all of their  
6 customers to go to Sterling shops, if they're successful in  
7 that, they will have large volumes and there may be some  
8 efficiencies there.

9 I will grant that high capacity utilization in any  
10 firm is more efficient than lower capacity utilization. I  
11 will agree to that. But I have not seen evidence that they  
12 have succeeded in that.

13 Q. Now, you've never talked -- turning to, you know,  
14 whether or not Allstate's wrong in supporting its Sterling  
15 initiative, you have never provided any business advice to  
16 any collision repair facility on a formal basis, have you?

17 A. I have not.

18 Q. And you're -- you're not a businessperson charged with  
19 making business decisions for the collision repair industry?

20 A. No.

21 Q. Now, you claim there are no efficiencies because  
22 Sterling hasn't succeeded.

23 A. I believe to capture -- let me be careful here, and  
24 let's be clear in the way I'm answering this question.

25 There may be some economies of getting high capacity

61 (Pages 120 to 121)

Page 122

1 utilization rates among large shops. There may be some  
 2 economies there, certainly higher capacity utilization is  
 3 more efficient. But firms don't go out and build bigger  
 4 plants unless they have the demand to fill them. That's why  
 5 plants are not all very large. That's why restaurants are  
 6 not huge. They're relatively small, because even though it  
 7 would be more efficient for a very large restaurant to have  
 8 lots of business, they would be very efficient in doing  
 9 that, they don't build 'em because there is not the demand  
 10 for 'em. They can't get the volume to go through.

11 The same point as here. We can look at a large plant  
 12 in the collision repair services and say, gosh, if that were  
 13 filled it would be very efficient. That's true. But it's  
 14 not filled.  
 15 Q. But the point that you're trying to make is that --  
 16 well, let's stop for a second and -- and you understand that  
 17 one of the -- you -- you agree that if Allstate and Sterling  
 18 are capable of generating enough volume they could operate  
 19 more efficiently than the local body shops?

20 A. I understand the argument, and the argument seems  
 21 sensible to me that if you build a larger shop and keep it  
 22 busy that there may be economies of scale. I don't know  
 23 that they're there, but there may be economies of scale.

24 There are also, remember, diseconomies of scale of  
 25 size. You can get to large that you can't coordinate the

Page 123

1 activities efficiently.

2 But it may be that a plant size, a footprint twice the  
 3 size of the average might be more efficient if you can keep  
 4 it filled. That might be the case.

5 Q. And one of the things you were saying was that one of  
 6 the reasons that you believe that insurer ownership is not  
 7 efficient is because you don't see a lot of insurers  
 8 vertically integrating in the other states. Right?

9 A. That's correct.

10 Q. Okay. Now, again, you understand that somebody has got  
 11 to go first and see how that works, right?

12 A. Yes.

13 Q. And your opinion is that insurer ownership has not  
 14 passed what you call the market test. Right?

15 A. That's correct. And remember, too, what I said in my  
 16 deposition, vertical integration is not a new concept.

17 Q. But let's take Wal-Mart, for example. That's somebody  
 18 that you mentioned in your direct testimony.

19 A. Yes.

20 Q. Okay. Now, when Wal-Mart started, back in the --  
 21 whenever it was, 1970s, it built large facilities, right?

22 Isn't that true?

23 It built large facilities?

24 A. Well, they had -- they had relatively large stores,

25 not -- not unlike what we saw at Sears and Montgomery Wards

62 (Pages 122 to 123)

Page 124

1 long ago.

2 Q. And they achieved substantial quantities of scale, you

3 would agree?

4 A. They obtained some benefits from large purchasing, just

5 as Sears used to.

6 Q. Okay. And if you were to look back in the 1970s or

7 whenever Wal-Mart, Staples, Home Depot began, you would

8 concluded that there are no efficiencies to be achieved

9 based -- if you were just to look at your market test,

10 right?

11 A. I don't know that I would have said there aren't

12 efficiencies to be achieved by large scale. We saw some

13 efficiency achieved in the '50s and '60s from Sears. Sears

14 built big plants. Sears were the large-scale stores in the

15 towns.

16 Q. Okay. Well --

17 A. I would not have argued that there weren't economies of

18 scale of large size stores.

19 Q. Let's turn to your deposition, page 167, lines 13 to

20 16, and we're talking about the marketing test in connection

21 with Wal-Mart and Home Depot.

22 (Videotape playing.)

23 "Q. If you were to look at these industries back in

24 the 1970s, wouldn't your market tests conclude that there

25 are no efficiencies to be achieved?

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1 "A. At that point in time, I would."

2 That's the testimony you gave.

3 A. Let me make sure I understand the context in which that

4 was asked.

5 What page was that?

6 I'm sorry.

7 Q. It was page 167, lines 13 through 16.

8 MR. POWELL: By way of optional completeness we

9 would like to read the next question and answer, Your Honor.

10 THE COURT: Well, let's wait and see. Let him get

11 there. You can stand up if you want to the whole time or

12 you can wait until he figures it out, Mr. Powell.

13 MR. POWELL: I'll sit down, Your Honor.

14 THE WITNESS: What lines? I'm sorry, Mr. Kass.

15 BY MR. KASS:

16 Q. 13 through 16.

17 A. Okay. On page 167.

18 Okay. I would like to read the rest of it.

19 Q. Feel free.

20 A. The question:

21 "Q. Okay. If you were to look at these industries

22 back in the 1970s wouldn't your market tests conclude that

23 there were no efficiency to be achieved?

24 "A. At that time in point (sic) I would.

25 "Q. Okay. And so if in the 1970s -- if you -- you

63 (Pages 124 to 125)

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1 would have been proven wrong?

2 "A. No. No. No. I'm saying that in the 1970s those  
3 economies weren't there and you did not see the large scale  
4 operators. But with changing transportation costs and other  
5 factors that changed, these economies became present and  
6 there were firms that went and captured those economies.

7 "Q. Okay. So what you're saying is that it's possible  
8 that in the future that there may be economies of scale but  
9 today there were not -- there are not?

10 "A. I'm saying in looking at retailers and we're  
11 trying to explain the evolution of the Wal-Marts, the Home  
12 Depots, and the Lowe's, that the -- that changes in factors  
13 of production, transportation being one of them was such  
14 that it enabled those economies to be achieved. And if we  
15 look at the 1950s and the 1960s, those economies were not  
16 there. That through time those changes can -- can develop  
17 with changes in factors of production."

18 Q. Now, there's no legislation that prevents Wal-Mart from  
19 operating in the State of Texas, is there?

20 A. No.

21 Q. I want to turn now to your next opinion, which centers  
22 around conflict of interest.

23 THE COURT: Before you do that I have one more  
24 question.

25 With regard to your -- this area, your main problem

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1 with -- and maybe it's economies of scale is not the right  
2 term, but your main problem with the model is that they can  
3 only go after 15 percent of the market, that that's what  
4 makes it -- is that the primary -- would it be fair?

5 I don't want to mischaracterize it.

6 THE WITNESS: No, Your Honor, that's correct. If  
7 you look at 15 percent of the market and you can only move  
8 40 percent of your 15 percent, you're down to 6 percent. So  
9 you're trying to handle a business and gain scale economies  
10 with only 6 percent of the available market, when without  
11 vertical integration you have available to you a hundred  
12 percent of the market.

13 THE COURT: So when you keep saying I'm not  
14 convinced that model is the -- is an efficient model, that's  
15 one of the things in the back of your mind?

16 THE WITNESS: That's the main thing, is how do you  
17 guarantee and assure yourselves of the volume flows in the  
18 large scale operation when you have eliminated 85 percent of  
19 the market that once was available to you.

20 THE COURT: Okay. Thank you, Mr. Kass.

21 BY MR. KASS:

22 Q. Now, you understand that one of the things that  
23 Sterling is doing is building brand reputation across its  
24 facilities.

25 A. Yes.

64 (Pages 126 to 127)

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1 Q. And anybody can use Sterling?

2 A. Yes. That's true.

3 Q. And are you saying that Allstate doesn't do enough  
4 business to support a collision repair center?

5 That's your testimony?

6 A. Let me see if I understand your question.

7 Does Allstate do enough business to support Sterling.

8 Q. Your testimony is Allstate only has 15 percent but it  
9 really needs a hundred percent of the market to be able to  
10 support a collision repair facility.

11 A. No, I'm saying that if you look at the model and you  
12 have only 15 percent of the insurance market, 85 percent --  
13 once you have the vertical integration, 85 percent of that  
14 market goes away.

15 Q. Maybe that 15 percent is still a lot of business.

16 A. If you can control that 15 percent --

17 Q. So if customers --

18 A. -- you may have the volume, but we're only at 23  
19 percent.

20 Q. So if customers like Allstate's recommendations and  
21 take their recommendations, they might be able to support  
22 the model. Right?

23 A. I don't know the answer to how large a percent of  
24 Allstate customers must be diverted to Sterling stores and  
25 not to PRO shops to get to the point to where you have

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1 efficient capacity utilization. I don't know where that  
2 point is.

3 Q. You don't --

4 A. I am aware from the evidence that, you know, that you  
5 aren't there.

6 Q. You don't know, but we looked earlier on that their --  
7 their projections, based on a ten mile radius, was between  
8 30 and 40 percent, that was the full optimal level that  
9 they -- that they were shooting for.

10 A. Well, if you're close, then you raise the question why  
11 is it that they're losing money.

12 Q. Okay. Now, let's talk about conflict of interest.

13 Let's talk about losing money first.

14 You understand that Allstate is working on working with  
15 Sterling to further improve their processes, improve their  
16 technology, their quality control procedures, as Ms. Mazanec  
17 testified about.

18 And you understand that they're investing now  
19 substantially in expansion, and that takes money, right?

20 A. Yes.

21 Q. Okay. Now, have you edited out all the expansion that  
22 layer doing for future growth to have a strong model for the  
23 foreseeable future to see whether or not they're covering  
24 their expenses today?

25 A. Well, if in fact you have an efficient model, and if in

65 (Pages 128 to 129)

Page 130

1 fact sufficient numbers of Allstate-covered individuals go  
 2 to the Sterling stores, the 62 that you own, you would  
 3 expect to see high capacity utilization. You would -- if  
 4 you expand you would want to do that on a foundation of a  
 5 profitable model. But in the evidence that I have seen, the  
 6 expansion plans that Sterling/Allstate has, of having 300  
 7 new stores around the country, I haven't seen those plans.

8 Q. It's not profitable yet, Allstate wants to build and  
 9 expand this model. That's your testimony?

10 A. I would say that in those -- in those urban cities, and  
 11 I showed it in my exhibit, in those urban cities for which  
 12 Allstate has insurance coverage and Sterling has shops and  
 13 the urban population is of a size similar to where you're  
 14 building the greenfield stores, if this model is sufficient  
 15 you would expect profits to accrue there, independent of  
 16 expansion plans in other cities.

17 Q. And you've not done a store-by-store analysis to  
 18 determine whether, for example, the Dallas stores were  
 19 turning a profit before HB 1131, even though they were only  
 20 a year old?

21 A. No. And that's exactly the evidence I would have  
 22 expected Dr. Harrington to bring to the table. And it  
 23 wasn't there.

24 Q. Okay. Did you review Ms. Mazanec's testimony?

25 A. I reviewed the deposition testimony and the trial

Page 131

1 testimony.

2 Q. And you're aware that she did talk about the Dallas  
 3 profitability. Right?

4 A. I'm not sure that I would conclude that -- from that  
 5 testimony that the Dallas stores are profitable.

6 Q. Let's turn now to your last opinion, conflict of  
 7 interest.

8 You're basically saying that Allstate wants to cut  
 9 corners. Right?

10 A. I don't think I put it that way. I -- I testified that  
 11 there is a profit incentive to substitute aftermarket and  
 12 crash parts for OEM parts, that there is profit in that.  
 13 And, in fact, the Allstate slide showed that there's 71  
 14 million dollars in that exchange.

15 Q. Well, we'll talk about the 71 million dollar document  
 16 in a minute.

17 But you understand that one of the things that Allstate  
 18 is doing is investing substantial amounts of money and  
 19 substantial resources in trying to improve Sterling and to  
 20 bring forth technologies that are rarely seen in smaller  
 21 shops. True?

22 A. I understand that argument.

23 Q. And you understand that to be the case.

24 A. I don't know. I don't know the extent to which they  
 25 have modernized all 62 facilities. I don't know.

66 (Pages 130 to 131)

Page 132

1 Q. Well, let's play a clip from your deposition, page 232,  
2 line 6 through 17.

3 (Videotape playing.)

4 "Q. Have you reviewed Allstate's documents where they  
5 are consistently trying to improve the quality at body shops  
6 and particularly at Sterling?

7 "A. Improve in what way?

8 "Q. Trying to make quality at Sterling and other body  
9 shops better.

10 "A. I have read documents about the investments that  
11 Sterling seeks to make in body shops to bring forth  
12 technologies in those shops that are rarely seen in the  
13 smaller shops. I am aware of that -- those declarations."

14 BY MR. KASS:

15 Q. You raised an issue of parts?

16 A. Yes.

17 Q. You understand that Sterling now uses more OEM parts  
18 than PRO shop. Isn't that your understanding?

19 A. Well, what do you -- how do you define OEM parts

20 because I was surprised by testimony that OEM parts

21 according to Allstate includes used parts.

22 Q. New OEM parts, Sterling now uses more new OEM parts  
23 than PRO shops?

24 A. I haven't seen that evidence.

25 Q. You didn't know one way or the other?

Page 133

1 A. Well, I have seen evidence that OEM parts is a high  
2 percentage, but I'm aware that the way they're measuring OEM  
3 parts includes recycled parts.

4 Q. My question was: You don't know one way or the other  
5 whether Sterling uses more new OEM parts than other PRO  
6 shops?

7 A. No.

8 Q. Now, you talked about the 71 million document, and  
9 that's PX 168, page 55. It's also PX 260, page 172.

10 MR. KASS: Pull that up. It's also page 123 of  
11 the outline.

12 It's PX 168. That's the document.

13 BY MR. KASS:

14 Q. This is the 71 million dollar document that you're  
15 talking about?

16 A. Correct.

17 Q. Now, you understand that this document does not even  
18 relate to Sterling but relates to all of PRO.

19 A. Right.

20 Q. And because Sterling is such a small percentage  
21 compared to PRO, any savings on parts related to Sterling is  
22 much lower. Right?

23 A. Correct. I would say on a smaller scale the numbers  
24 are lower. But remember, many of the Sterling shops were  
25 PRO shops.

67 (Pages 132 to 133)

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1 Q. Many of the 15?

2 A. Many of the 62.

3 Q. Okay.

4 MR. KASS: I pass the witness, Your Honor.

5 THE COURT: All right.

6 MR. POWELL: Your Honor, we have no further  
7 questions of Dr. House.

8 THE COURT: You can step down.

9 THE WITNESS: Thank you, Your Honor.

10 THE COURT: All right. Mr. Powell.

11 MR. POWELL: Your Honor, I think we don't have any  
12 other witnesses.

13 I think Mr. Yoxall has some document exhibit matters he  
14 needs to take up.

15 THE COURT: I was going to make sure we had all  
16 those.

17 You got all your designations or all those CDs or DVDs  
18 in?

19 MR. YOXALL: If we could address that, Your Honor.

20 THE COURT: Okay. I'm ready.

21 MR. YOXALL: Okay.

22 MR. SMITH: The plaintiffs, you want us to go  
23 first on our exhibits, Your Honor?

24 THE COURT: It doesn't make any difference.  
25 That's fine.

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1 MR. SMITH: Okay.

2 MR. POWELL: We're in our case, I wanted to get  
3 our case done and then we would rest and then if they have  
4 something --

5 THE COURT: It doesn't -- it's just fine whatever  
6 way you want to do it. They are technically still in your  
7 case, that will be fine.

8 MR. YOXALL: That's okay.

9 THE COURT: You're going to allow her to go during  
10 your case?

11 Mr. Powell would never do that.

12 (Laughter.)

13 MR. POWELL: I would never do that, Your Honor.

14 THE COURT: Nobody is getting any advantage from  
15 this. I just want to make sure the record has all this in  
16 there, and so y'all -- I'm leaving this up to y'all to make  
17 sure that everybody is getting there's in there.

18 Okay?

19 All right. That will just give you an extra minute or  
20 two to look at your notes.

21 All right. Go ahead.

22 MS. BASTA: Your Honor, may I approach the  
23 witness?

24 THE COURT: Yes.

25 MS. BASTA: Your Honor, we have three small

68 (Pages 134 to 135)

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1 housekeeping matters. First, we would like to offer into  
 2 evidence a new Exhibit, which would be PX 727. It's the  
 3 Allstate agency standards. A number of issues have been  
 4 raised through the court's questions, through Mr. Powell's  
 5 cross-examination of Mr. Daly and through the examination of  
 6 Dr. House today as to what the agency standards are and we  
 7 would offer that to clarify the record.

8 THE COURT: You said update, maybe I misunderstood  
 9 you. Is this already in or is this an updated version?

10 MS. BASTA: This is in response to those series of  
 11 questions.

12 THE COURT: Any objection to that?

13 MR. YOXALL: Timeliness, Your Honor. This is a  
 14 document that has never been offered, it's not on any  
 15 exhibit list. There was a discussion I believe it's the  
 16 January 2004 agency document, Your Honor.

17 And Exhibit 205, which actually Dr. House referred to,  
 18 which is a May 2004 document, indicates that Allstate is  
 19 still considering changing its agency standards to recommend  
 20 to its agents that they refer Sterling only.

21 The document Ms. Basta is trying to get into evidence  
 22 is a January 2004 document which we didn't see until about  
 23 10:30 last night, Your Honor.

24 THE COURT: What's your response to that?

25 MS. BASTA: Your Honor, again, this is raised --

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1 this document is consistent with what Mr. Daly's testimony  
 2 was of what the practice is today, which Mr. Powell raised  
 3 on cross-examination with him. And there has been no  
 4 evidence that the telephone has changed.

5 MS. BASTA: Could I address that?

6 THE COURT: Yes.

7 MS. BASTA: Mr. Ruebenson at page 129 of his  
 8 deposition Mr. Powell asked him:

9 "Q. So you haven't listed the agents for  
 10 Sterling stores to try to give them information so they can  
 11 recommend Sterling customers."

12 His answer was:

13 "A. My understanding is yes.

14 MS. BASTA: Mr. Daly's representation as to the  
 15 policy as it is today is what is consistent in 727.

16 THE COURT: Okay. I'll think about it.

17 MS. BASTA: Next we would like to --

18 THE COURT: I'll let you know in a minute. I'm  
 19 not going to defer that forever.

20 MS. BASTA: Next we would like to offer exhibits  
 21 that weren't sponsored through witnesses about but have been  
 22 objected to. PX 51, PX 91, PX 528, PX 577, PX 676, PX 684  
 23 through 688 and PX 691.

24 MR. HOHENGARTEN: Judge, I would object to  
 25 Plaintiff's Exhibit 51, hearsay and authentication.

69 (Pages 136 to 137)

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1 MS. BASTA: Your Honor, as to the authentication,  
2 this was a document that Mr. Hohengarten handed to  
3 Ms. Gardiner and Ms. Goldstein at Mr. Walne's deposition  
4 stating that this was a document that an attorney in his  
5 office had drafted. You have seen this document before I  
6 believe on the motion to dismiss that was filed by the state  
7 and as to hearsay it's the admission of a party opponent.

8 It's an admission of the Attorney General's office.

9 MR. HOHENGARTEN: May I respond?

10 THE COURT: Wait a minute. Off the record. I'm  
11 going to have to get those exhibits in here, so just a  
12 second.

13 MS. BASTA: Your Honor, I have copies.

14 THE COURT: Of everything?

15 MS. BASTA: Everything but the videos.

16 THE COURT: Are you going to make reference to  
17 those?

18 How are you going to make your document --

19 MS. BASTA: I've got it.

20 THE COURT: You have copies of all this?

21 MR. POWELL: We received a letter late last  
22 night. We pulled those.

23 THE COURT: You didn't have to tell me under what  
24 circumstances. I understand. Okay.

25 Back on the record.

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1 Okay. Go ahead, Mr. Hohengarten.

2 MR. HOHENGARTEN: Judge, this did come from our  
3 office. It is hearsay. Furthermore, asserted on this  
4 document, which is not authored, is a legal conclusion, and  
5 that is for the court. And I would further add, and it  
6 would be easy to show in a letter brief that this legal  
7 conclusion is wrong, and the court could easily discern that  
8 for itself probably within 15 minutes of taking a look at  
9 the law.

10 THE COURT: Where is the legal conclusion that  
11 you're talking about?

12 MR. HOHENGARTEN: Yes. The legal conclusion is  
13 that technically OAG would have authority to enforce meaning  
14 HB 1131 through TDLR -- excuse me -- although the TDLR cases  
15 often go to ADL.

16 THE COURT: You're going to have to help me. I  
17 don't know all the --

18 MR. HOHENGARTEN: Yes. That's quite  
19 understandable.

20 O-A-G, of course, is office of the Attorney General.

21 THE COURT: I got that one.

22 MR. HOHENGARTEN: Yeah. I assumed as much, but --

23 THE COURT: What's the next one?

24 MR. HOHENGARTEN: TDLR is the Texas Department of  
25 Licensing and Regulation, and they do a lot of miscellaneous

70 (Pages 138 to 139)

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1 licensing.

2 THE COURT: Okay.

3 MR. HOHENGARTEN: But it's already been stated in  
4 this court several times that repair shops are not licensed  
5 and not regulated, so how would this agency, which has no  
6 oversight over insurance or repair shops, and no licensing  
7 authority that's relevant to any issue in this case, why  
8 would this agency be referring something to the Attorney  
9 General under HB 1131?

10 HB 1131 is absolutely clear on this point that it is  
11 self enforcing through the private enforcement scheme that  
12 is created in that bill that a private litigant can bring an  
13 action to support --

14 THE COURT: What is ADL?

15 MR. HOHENGARTEN: That is the --

16 THE COURT: Administrative --

17 MR. HOHENGARTEN: -- administrative law division.

18 THE COURT: Okay.

19 MR. HOHENGARTEN: That's what they're talking  
20 about.

21 I have to assume, I assume this is correct, that the  
22 administrative law division in the OAG's office typically  
23 represents the Texas Department of Licensing and Regulation,  
24 though any of their referrals would go to that division.

25 But my point is is there would be no referrals because

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1 demonstrably, there is no argument about this under the law,  
2 this agency, TDLR, doesn't have any sort of oversight or  
3 enforcement function or administrative function with respect  
4 to HB 1131. It doesn't regulate or license insurance  
5 companies and it doesn't regulate or license repair shops.

6 THE COURT: What's your response?

7 MS. BASTA: Your Honor, to the extent that there  
8 has been a question about the OAG's enforcement authority,  
9 any statement that indicates that they have the authority to  
10 enforce under any mechanism we believe is relevant to that  
11 issue.

12 THE COURT: I overrule that. I sustain the  
13 objection. I overrule your objection.

14 So it's not coming in. So that's, what, 51.

15 Okay. Sustain the objection as to hearsay.

16 All right. 91. What's the deal on 91?

17 Anybody object to that?

18 MR. YOXALL: Yes, Your Honor. This is an article  
19 from Collision Week. We would just object to hearsay, Your  
20 Honor.

21 MS. BASTA: Your Honor, if I can respond to that,  
22 the defendants and the intervenors put in the Collision Week  
23 article regarding Caliber as Defense Exhibit 402 and we  
24 would agree -- and we agree on those same grounds that this  
25 should come in.

71 (Pages 140 to 141)

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1 MR. YOXALL: Your Honor, I don't believe the  
2 plaintiffs objected to that exhibit.

3 Also, I believe Dr. Zion had reviewed -- their expert  
4 had reviewed that article.

5 THE COURT: What are you trying to show here?

6 MS. BASTA: It was just an article -- Collision  
7 Week, you know, as we discussed with Dr. Zion is an industry  
8 publication and, you know, just like they were examining the  
9 Caliber issue, when insurer ownership came into being they  
10 examined that issue as well.

11 MR. YOXALL: I don't think --

12 THE COURT: I'm going to admit the article. There  
13 is an article out there that said it might be coming. So  
14 there is an article that says that. Whether it is or not, I  
15 mean, how does this -- whoever this person is that wrote  
16 that, I don't see that it has a person's name who wrote it.  
17 It doesn't even have a -- we don't even know who wrote  
18 that. It just could have been somebody -- but there was an  
19 article out there that existed. It's not like even by  
20 somebody who even knows anything about this industry. But  
21 anyway I'm going to admit it to show there was an article.  
22 All right. Overrule your objection.

23 Yes. How about 528?

24 MS. BASTA: Essentially the same grounds, Your  
25 Honor.

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1 THE COURT: No, I mean do they have an objection?

2 MR. YOXALL: Yes, Your Honor.

3 THE COURT: Are you going to have an objection to  
4 all of these?

5 MR. YOXALL: Not all of them. Hearsay. It's  
6 hearsay, Your Honor.

7 THE COURT: Is it the same as the last one?

8 MR. YOXALL: It's a hearsay objection, Your Honor.

9 THE COURT: Yes, no, maybe.

10 MR. YOXALL: Yes, it's a hearsay objection.

11 THE COURT: And this is an article about --

12 MS. BASTA: It's a snapshot of the collision  
13 repair industry as of 2003. We've heard a lot of  
14 conflicting testimony as to state of the industry since the  
15 acquisition and this is --

16 THE COURT: Does it say anything about this kind  
17 of vertical integration?

18 Is there -- I didn't see anything in there about it.

19 MS. BASTA: No, I don't believe it does, Your  
20 Honor.

21 MR. YOXALL: I don't believe it does, Your Honor.  
22 There's no testimony obviously that anybody looked at it or  
23 relied upon this article. There is no foundation for it as  
24 well.

25 THE COURT: Yeah, who -- well, what are you trying

72 (Pages 142 to 143)

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1 to do here?

2 MS. BASTA: It's just as to the state of the  
3 noninsurer-owned shops in terms of their composition and  
4 their make up as -- in the year 2003.

5 THE COURT: Yeah, but they didn't get a chance to  
6 cross-examine all these people. I'll sustain the objection  
7 to all that stuff. Okay. It's still hearsay.

8 MS. BASTA: 577 Is our next one.

9 MR. YOXALL: There's a hearsay objection, Your  
10 Honor, as well as authentication. This is a single page of  
11 a -- there's no indication what this document is from. No  
12 one has testified about it.

13 THE COURT: Well, it looks like it's from some  
14 Allstate document.

15 MS. BASTA: Yes, Your Honor.

16 THE COURT: What's CCC mean?  
17 Civilian Conservation Corps?

18 MR. YOXALL: WDA.

19 THE COURT: Yeah. There you go.

20 MS. BASTA: It's the estimating system, Your  
21 Honor.

22 THE COURT: It's what?

23 MS. BASTA: The estimating system.

24 THE COURT: But we don't know what it stands for,  
25 CCC? Is there some magic term?

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1 MS. BASTA: It's just the estimating term for the  
2 system that Allstate uses.

3 THE COURT: It is?

4 MR. YOXALL: Again, Your Honor, we haven't had the  
5 chance to cross-examine anyone about this document. It is  
6 hearsay. No one has proved it up as a business record or --

7 THE COURT: Yeah. There's nobody here to talked  
8 to about it. I sustain that objection.

9 MS. BASTA: The next one is 676, which is an ASA  
10 web site, Your Honor.

11 MR. YOXALL: We don't object to that.

12 THE COURT: Are you sure?

13 MR. YOXALL: I'm sure.

14 THE COURT: You better check with Mr. Powell.

15 MR. YOXALL: He'll let me know about it.

16 MS. BASTA: The next is 684 to 688, which are  
17 videos of the --

18 THE COURT: Wait a minute. I don't have those.

19 MS. BASTA: Those are videos, Your Honor.

20 THE COURT: These are the videos of --

21 MS. BASTA: The House and Senate proceedings. The  
22 transcripts are already in evidence.

23 THE COURT: Do you have any objection to that?

24 MR. HOHENGARTEN: My understanding is these videos  
25 are the same as the transcripts?

73 (Pages 144 to 145)

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1 THE COURT: That's my understanding.

2 MR. HOHENGARTEN: Well, based on that  
3 understanding we have no objection.

4 THE COURT: That there's not something different  
5 than what we have a transcript for.

6 MR. HOHENGARTEN: Yes.

7 MS. BASTA: Our understanding is it is just the  
8 proceedings, Your Honor.

9 THE COURT: I admit this into evidence although I  
10 have not reviewed it and base it upon your assertion that  
11 it's the same.

12 MS. BASTA: Yes.

13 THE COURT: If it's not, only what has been  
14 admitted that's in the transcript is what's -- you'll have  
15 to take it back and cut it out. Is that okay?

16 MS. BASTA: Yes.

17 THE COURT: It's admitted with that proviso.

18 MS. BASTA: And, Your Honor, we're moving into  
19 evidence -- or attempting to move into evidence PX 691,  
20 which was the Sterling video which was played during Judge  
21 Starr's opening statement.

22 MR. YOXALL: Your Honor, for all the reasons  
23 stated so eloquently by Mr. Powell prior to the opening, we  
24 would object to that as hearsay. I mean, there's so much in  
25 that, Your Honor, that is objectionable. I mean, they

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1 represented at the time they were playing it for  
2 demonstrative purposes.

3 THE COURT: Sustain the objection. I mean, what's  
4 in is the argument, so it will be there.

5 MS. BASTA: As a last matter, Your Honor --

6 THE COURT: I promise you I will review your  
7 arguments. What I haven't written I will look at it again,  
8 listen to it again. I really will.

9 MS. BASTA: As the last matter we would like to  
10 move in the various PDXs through the course of the  
11 examinations, those, for the record, would be 1 through 4,  
12 101 through 104, 204 through 206, 301, 304, 401 through 410,  
13 505, 601 through 603, 701 through 703, 705 through 713, and  
14 803.

15 THE COURT: What was the one after 703?

16 MS. BASTA: 705 Through 713. Some of those were  
17 used with Dr. House this morning.

18 THE COURT: And then what was the last one?

19 MS. BASTA: 803.

20 MR. YOXALL: Your Honor, we would object to all of  
21 those. Those are demonstratives. They're purely argument.  
22 Many of them we believe, honestly, we believe  
23 mischaracterize either the facts or the law. And the  
24 testimony is in, Your Honor. We believe those are hearsay  
25 and -- and should not be admitted in evidence.

74 (Pages 146 to 147)

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1 THE COURT: I'm not admitting the demonstratives  
2 in unless we're going to go back and cross-examine people  
3 with regard to those. We're not going to do that, I assure  
4 you, so I'll sustain the objection to that.

5 They are part of the record, just as demonstratives.

6 So they are part of the record, but they're not part of  
7 the evidence. They're part of the argument.

8 So I will include them as part of the record. How is  
9 that?

10 MS. BASTA: Thank you.

11 THE COURT: Okay.

12 MR. YOXALL: Just a couple of items, Your Honor.

13 THE COURT: Yes, sir.

14 MR. YOXALL: The first being there were two  
15 deposition videos I think you were waiting rule on, that's  
16 Edmond Fulgencio and Rick van Boxtel. Plaintiff would move  
17 to exclude those. We believe they are highly relevant.

18 THE COURT: I admit them.

19 Okay. Moving on. We filed a motion to exclude the  
20 deposition designations for four of their live witnesses on  
21 the -- based on the fact that they have testified here live,  
22 under the federal rules their depositions are hearsay.

23 THE COURT: I understand the argument. I  
24 understand that argument. Do you have any response to  
25 that?

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1 People that testified live, that's all you get is what  
2 they are live.

3 MS. BASTA: We have no problem with that, however,  
4 we would like to raise the issue of them affirmatively  
5 designating portions of Mr. Mattax and Mr. Reyes that were  
6 not counter fairness designations.

7 THE COURT: They were not what?

8 MS. BASTA: They don't constitute counter or  
9 fairness designations, that they were affirmatively raising  
10 different issues than the ones that we had designated.

11 THE COURT: I'm not following you. I'm sorry.  
12 Help me.

13 MS. BASTA: Their offensive use of Mr. Mattax and  
14 Mr. Reyes as opposed to a defensive use.

15 MR. POWELL: I'm talking about Mr. Ruebenson,  
16 Mr. Daly, Ms. Mazanec and Ms. Norton.

17 MS. BASTA: We have no problem, just as long as it  
18 also goes for Mr. Mattax and Mr. Reyes who we believe were  
19 designated without being in response to --

20 THE COURT: Anybody that testified live the only  
21 evidence in is what they testified live. I'm not  
22 considering their deposition. How is that?

23 Does that make it clear?

24 MS. BASTA: Yes.

25 MR. HOHENGARTEN: Perhaps I can just sit down now,

75 (Pages 148 to 149)

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1 but it seems to me that that ruling would not exclude the  
2 counterdesignations we made with respect to Mr. Mattax and  
3 Mr. Reyes. Those were counterdesignations. Neither of  
4 those witnesses testified in response to designations that  
5 the plaintiffs made from their deposition testimony.

6 And frankly, I don't understand what the problem is  
7 with us coming back with our counterdesignations asking the  
8 court to in fairness and in full context --

9 THE COURT: On counterdesignations, I'm only  
10 talking about the human beings that came in here and  
11 testified.

12 MR. HOHENGARTEN: Right.

13 THE COURT: Okay?

14 MR. HOHENGARTEN: Okay.

15 THE COURT: On the videos you get to have your  
16 counterdesignations in and they get theirs in, too.

17 MR. HOHENGARTEN: Thank you, judge.

18 THE COURT: I'm only talking about the human  
19 beings that came in here in the bright lights of this  
20 courtroom, they wilted under that tough cross-examination by  
21 both sides.

22 MR. HOHENGARTEN: Okay.

23 THE COURT: That's all I'm talking about and I did  
24 not me that clear.

25 Thanks, Mr. Hohengarten. I'm not trying to -- no.

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1 No. You're right.

2 MR. HOHENGARTEN: Thank you.

3 MR. YOXALL: With respect to the designations,  
4 Your Honor, and really the exhibits that have not been  
5 offered, do you want us to deal with that afterwards and get  
6 with your clerk and pull out the exhibits that have not been  
7 offered or admitted and also these deposition designations?

8 You have -- you know, we filed all the stuff prior to  
9 trial, Your Honor.

10 THE COURT: Yes. Generally the -- the rule is  
11 this.

12 Well, let's go off the record just a minute.

13 (Discussion off the record in open court.)

14 THE COURT: Okay. Back on the record.

15 All right. If there was an objection, and it wasn't  
16 brought up, it's not part of the evidence. Is that clear?

17 MR. YOXALL: Yes.

18 THE COURT: Is that what you need me to say on the  
19 record.

20 MR. YOXALL: That's what I needed. How would you  
21 like us to deal with the exhibit binders you have that have  
22 those exhibits in there? Because they were submitted to the  
23 court prior.

24 THE COURT: Just get those back from the clerks  
25 later on.

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1 MR. YOXALL: And I propose that maybe the Locke  
2 Liddell lawyers and the Akin Gump lawyers get together and  
3 then --

4 THE COURT: Absolutely, in the next few days with  
5 my clerks and make sure y'all go through everything. And if  
6 you can just give her a list, that would be helpful.

7 MR. YOXALL: I'm glad you said that, Your Honor.

8 THE COURT: And then she will pull them out. You  
9 don't need to come up here.

10 MR. YOXALL: Okay.

11 THE COURT: Y'all get together and go, okay,  
12 here's those numbers, and then we'll pull them out and  
13 sanitize it that way.

14 MR. YOXALL: We're going to file with the clerk,  
15 Your Honor, we've prepared a notice, it's kind of a strange  
16 title, notice to plaintiff's proposed exhibits to which  
17 defendants objected and the court has not admitted into  
18 evidence. And that's a list of all their exhibits that are  
19 not in and we're going to file it with the clerk and get  
20 with Akin Gump.

21 THE COURT: Okay. That sounds good.

22 THE COURT: All right.

23 MR. YOXALL: I believe that's all I have.

24 Actually, there are two exhibits that they have  
25 objected to which I would like to offer at this time, Your

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1 Honor.

2 THE COURT: Do you have them so I can look at them  
3 or do I need to go pull them?

4 MR. YOXALL: Let me give you mine.

5 THE COURT: No, because you're going to make  
6 reference to them during argument.

7 MR. YOXALL: Can we put them up here?

8 THE COURT: Sure. That would be great.

9 MR. YOXALL: The first one is Defendant's Exhibit  
10 121.

11 THE COURT: Is it coming?

12 MR. YOXALL: We need to -- not the ELMO.

13 There you go.

14 Your Honor, this is a document that Mr. Ruebenson  
15 identified in his deposition. It's a handwritten note from  
16 Chuck Paul, who is an Allstate executive, to Mr. Ruebenson.  
17 And attached to that is an e-mail he which is the second  
18 page, which is from -- there's been a lot of testimony, Your  
19 Honor, about Defendant's Exhibit 34.

20 THE COURT: Go back to that.

21 MR. YOXALL: Okay. Sorry about that.

22 THE COURT: Is that cross-pollenization. Is that  
23 what he's saying?

24 MR. YOXALL: Yeah. Exactly. I thought I had the  
25 cross-pollenization in writing. It was in the e-mail. "A

77 (Pages 152 to 153)

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1 lot of what CEO group is suggests is what you wanted to do  
 2 in early 2003." Which was in reference to Defendant's  
 3 Exhibit 34.

4 THE COURT: Did you cross-examine -- was he here?  
 5 MR. YOXALL: Mr. Ruebenson was here, Your Honor.  
 6 THE COURT: Is that --  
 7 MR. YOXALL: That Chuck Paul was Mr. Ruebenson's  
 8 superior, Your Honor.  
 9 THE COURT: Did you ask him about this when he was  
 10 here?  
 11 MR. YOXALL: Mr. Ruebenson? We did not, Your  
 12 Honor.  
 13 THE COURT: All right. Do you object?  
 14 MS. BASTA: Yes, Your Honor.  
 15 THE COURT: Sustain the objection. You had the  
 16 chance to cross-examine, you should have done it.  
 17 MR. YOXALL: That's the only one. That's the only  
 18 document.  
 19 THE COURT: Okay. What else?  
 20 MR. HOHENGARTEN: At this time defendants rest.  
 21 THE COURT: Thanks, Mr. Hohengarten.  
 22 MR. POWELL: And the intervenors rest also, Your  
 23 Honor.  
 24 THE COURT: Okay. Mr. Smith.  
 25 MR. SMITH: I think we already had rested, Your

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1 Honor. We intend to call no one in rebuttal.  
 2 THE COURT: Do you close?  
 3 MR. SMITH: We close.  
 4 MR. POWELL: Intervenors close.  
 5 MR. HOHENGARTEN: State defendants close.  
 6 MR. POWELL: I need to renew my motion. I looked  
 7 at the law and I do need to do that.  
 8 THE COURT: Do you want to do it orally or in  
 9 writing? I'll could it either way you want.  
 10 MR. POWELL: It's very short, Your Honor. I'll  
 11 make it orally if that's agreeable with the court.  
 12 Let the record reflect that with Mr. Hohengarten's  
 13 permission I'm making this on behalf of state-defendants and  
 14 the intervenors.  
 15 MR. HOHENGARTEN: Mr. Powell has it.  
 16 He has it, the permission.  
 17 THE COURT: I didn't hear what you said.  
 18 MR. HOHENGARTEN: He was saying, with the state's  
 19 permission he's making this argument.  
 20 THE COURT: Oh, he has your permission. Okay.  
 21 That's great. I understand.  
 22 MR. POWELL: Both of the state official  
 23 defendants, Attorney General Abbott and Controller Strayhorn  
 24 and the intervenors renew their federal rule of civil  
 25 procedure 52(c) motion to the court.

78 (Pages 154 to 155)

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1 Defendants and intervenors make this Rule 52(c) motion  
2 after both parties have closed the evidence and rested.

3 The Rule 52(c) motion is as follows:

4 There's no evidence that HB 1131 violates the dormant  
5 commerce clause of the United States Constitution for each  
6 of the following reasons:

7 Number one, as a matter of law the statute is not  
8 discriminatory on its face.

9 THE COURT: Don't read so fast.

10 MR. POWELL: Okay.

11 Number two, there is no evidence of any intent by the  
12 legislature of the State of Texas to discriminate against  
13 out-of-state entities or commerce coming into the State of  
14 Texas from out of state. The evidence is undisputed that  
15 the legislature's intent was to preclude insurer ownership  
16 of body shops, regardless of whether the insurance company  
17 or the body shop is domiciled within or without the State of  
18 Texas.

19 Number three, there is no evidence that HB 1131 has any  
20 negative impact on interstate commerce.

21 And number four, plaintiff's dormant commerce clause  
22 challenge to HB 1131 is precluded by the McCarran-Ferguson  
23 Act, specifically 15 USC, Section 1012(a).

24 On this last point defendants and intervenors  
25 incorporated into this motion their written joint renewed

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1 Rule 52(c) motion for judgment in favor of the  
2 state-defendants on the basis of the McCarran-Ferguson Act,  
3 which was filed September 29th, 2004, which is docket number  
4 168 on this court's docket sheet.

5 We urge that written joint renewed Rule 52(c) motion at  
6 this time.

7 For each of these reasons, defendants and intervenors  
8 move the court to enter judgment under Rule 52(c) that  
9 plaintiffs take nothing on their commerce clause challenge  
10 to HB 1131.

11 Thank you, Your Honor.

12 THE COURT: All right. At this time I'm going to  
13 deny your motion and rule on it at this time; but that does  
14 not preclude me, and I want you to understand, in my final  
15 judgment from reconsidering that and doing something  
16 different at that point and looking at all those same  
17 points.

18 Okay. Y'all want to take a little short break before  
19 you go into the final -- final, final argument?

20 Okay. Let's don't take very long.

21 We'll be back at 2:30.

22 (Recess taken.)

23 THE SECURITY OFFICER: All rise.

24 THE COURT: Okay.

25 THE SECURITY OFFICER: Be seated, please.

79 (Pages 156 to 157)

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1 THE COURT: Sorry it took a little longer.

2 All right. Warnings everybody wants?

3 Mr. Starr, do you want me to give you a warning after  
4 you've used a certain amount of time?

5 MR. STARR: Surely. Perhaps after 40 minutes,  
6 Your Honor.

7 THE COURT: You've got 20 minutes left.

8 And then how about y'all?

9 How are you going to divvy it up?

10 MR. HOHENGARTEN: That's fine.

11 THE COURT: And rebuttal?

12 MR. STARR: Yes. I would like to reserve whatever  
13 time I have for rebuttal, and if the court grants me  
14 additional time, it may not, I'll take a few minutes for  
15 rebuttal.

16 THE COURT: I'll give you ten minutes.

17 MR. STARR: Thank you, Your Honor.

18 THE COURT: Okay. I'm sure soft today.

19 MR. STARR: And we appreciate it, Your Honor.

20 THE COURT: Okay.

21 All right.

22 MR. STARR: Well, with the court's leave, Your  
23 Honor, I would like to begin by stepping back and recalling  
24 in very summary fashion what it is that Allstate was trying  
25 to achieve. I'm going to be very brief in this.

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1 Align incentive.

2 Nationwide facilities.

3 Interstate network.

4 Economies of scale.

5 Superior customer experience.

6 It may work. They want to try it.

7 What we know is this new idea may not please

8 everybody. It wasn't consumers, it was those that felt

9 potentially left behind in the marketplace of competition

10 that sought shelter from friends in the Texas Legislature,

11 and they knew it would take quite a lobbying effort. And so

12 they did, they mustered a veritable armada to stop this new

13 effort and what they had the potential to bring forth.

14 And the court has now seen that HB 1131 has this

15 dizzying array of restrictions with respect to both speech

16 and conduct. We believe, Your Honor, that it's both a gag

17 and a straitjacket. And at the bottom, that it is invalid

18 as protectionist, parochial legislation, that it's special

19 interest legislation.

20 And very briefly, our bullets, by way of the quickest

21 review.

22 I have reread this court's December 11, 2003 order on a

23 number of occasions. It is strong. It is correct. And

24 there is nothing that has been presented in our view that

25 changes this court's analysis, violative of the First

80 (Pages 158 to 159)

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1 Amendment. We believe, as I suggested in the opening, that  
2 by virtue of that it may be stricken in its entirety because  
3 of the interconnectedness. And I will be speaking for a few  
4 moments about that.

5 It is not severable. That's because of the legislative  
6 intent and design.

7 Third bullet. In our view it is protectionist  
8 legislation, both in purpose and in a separate analysis in  
9 effect.

10 Discriminatory purpose.

11 Discriminatory effect.

12 And then the Pike test, which the other side has said  
13 virtually nothing about, that it excessively burdens  
14 interstate commerce.

15 We surely are not estopped from asserting  
16 constitutional rights by virtue of participating in a  
17 process, which I will describe.

18 And we do not believe the McCarran-Ferguson Act applies  
19 at all, it is not the business of insurance.

20 I reserve any comments that I might have subject to the  
21 court's guidance for rebuttal, depending on what our  
22 brothers have to say.

23 That's our case.

24 So what's the other side's case?

25 And we believe this slide captures it well.

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1 One of their key points that really came through in the  
2 cross-examination of Dr. Zion is how do you know there's  
3 fraud in Texas, so there is no need to vertically integrate  
4 here. But, Your Honor, the court knows that's not true by  
5 virtue of Attorney General Greg Abbott's own pamphlet that  
6 talks about common scams in this industry, this industry.

7 Secondly they say, we've heard a lot about this risky  
8 business model, that somehow insurance companies are  
9 incentivized to cheat. It is a sort of greedy need to  
10 maximize shareholder wealth. It sounds a bit like Ralph  
11 Nadar. It sounds a lot like the nanny state. And it could  
12 be said of every business, but certainly every publicly-held  
13 company.

14 But the answers that emerged at trial, including from  
15 the court's own questions, had to do with competition,  
16 reputation, guarantees given to consumers, ethics. Ethics,  
17 business ethics. And for those who are unethical, lawsuits,  
18 including class action lawsuits.

19 And Your Honor engaged Mr. Ruebenson and he  
20 acknowledged, yes, that is certainly a risk if something is  
21 done wrong. And yet Mr. Ruebenson said Allstate still  
22 wanted to pursue that strategy.

23 Now, as evidence of their theory, they have offered  
24 snippets from about a hundred thousand pages that we've  
25 produced and the deposition testimony of a single incident,

81 (Pages 160 to 161)

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1 Mr. Fulgencio.

2 But the court will recall that Senator Carona stated on  
3 cross-examination that quality, Sterling's quality, was not  
4 an issue.

5 Now, the intervenors also say, well, look, Allstate  
6 submitted draft language to the legislature on the code of  
7 conduct, and it had its chance to lobby and it lost; and  
8 thus, at least this was the tone of some of the early  
9 statements before the court, this court should defer to a  
10 legislative judgment.

11 But as we tried to establish, that's not the law. That  
12 is why the dormant commerce clause jurisprudence is so very  
13 rich, as I'll try to remind the court very briefly in the  
14 course of these comments.

15 In fact, then it's crucial that the judiciary play a  
16 pivotal role in protecting the national economy.

17 They also say that San Antonio's own USAA, wonderful  
18 company, is technically affected by these restrictions, in  
19 terms of it being an in-state company. But what it also --  
20 the court is also aware is that there is no evidence that  
21 USAA had any intention whatsoever to engage in this. There  
22 was no harm, therefore. Indeed, the state's own documents  
23 to USAA in terms of its business plans.

24 They also say, well, there's some interstate body  
25 shops that can still operate in Texas, and many they say

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1 will do so, but -- but interestingly enough, no evidence was  
2 offered in this court. And I'm going to come back to that  
3 in terms of the need for concrete evidence under the legal  
4 standard that we think governs.

5 And just today, in the testimony and the  
6 cross-examination, Dr. House has said these kinds of firms  
7 are rare or at least relatively rare, as I understood his  
8 testimony.

9 They point to customer surveys, which they say show  
10 that some of the respondents express apprehension at the  
11 potential risk of a conflict of interest, but the fact  
12 remains that each one of those respondents may choose  
13 whatever shop he or she likes for repair service.

14 But the ultimate problem with these varying claims and  
15 defenses is that not only do they lack merit, in terms of  
16 fact, in terms of evidence, in terms of logic, in terms of  
17 reason, but upon careful analysis they're really not  
18 grounded in the Constitution itself. And this is a case,  
19 above all, that's about our Constitution and what the United  
20 States Constitution demands.

21 So we turn briefly to the First Amendment.

22 And this court, again, its critical findings,  
23 preliminarily in December 11 in that order. I'm not going  
24 to dwell on these findings, but it is very noteworthy, Your  
25 Honor, that the state is still relying on the same

82 (Pages 162 to 163)

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1 justifications for its commerce clause defense as it relied  
 2 upon last fall for its failed First Amendment defense in the  
 3 PI proceedings. And this court addressed those last fall.  
 4 Its opinion is very strong. Its analysis I believe is  
 5 unassailable. It should so find again that these defenses,  
 6 even now after a trial, do not justify 1131.

7 Now, the intervenors do have a First Amendment argument  
 8 that they have developed, in their most recent submission,  
 9 and that is that the Ohralik case, and this court treated  
 10 that in its December 11 opinion and order, and they say,  
 11 well, look, Allstate engages, and we have a slide on this,  
 12 in high-risk, secret conversations with policyholders, and  
 13 so without an opportunity for an independent advocate,  
 14 there's danger. And they're suggesting it would seem a sort  
 15 of Ralph Nadar type presence.

16 Well, we show here that Ohralik is factually  
 17 distinguishable -- I mean, the outrageous lawyer misconduct  
 18 there was beyond the pale. And they have provided no  
 19 evidence that anyone, anyone, any consumer, has been misled  
 20 by a call from Allstate. It just ends up not working.

21 I want to pick up on severability.

22 Your Honor, the violation of the First Amendment we  
 23 think spells doom for the entirety of the statute, because  
 24 the evidence, when one analyzes the specific provisions of  
 25 1131, and it all flows, it's quite coherent, but it's also

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1 defective. And if, as we urge the court to do, it stays the  
 2 course on the First Amendment, then under severability law,  
 3 and, of course, Texas law controls here, the Kirby decision  
 4 we believe guides this court to invalidate the statute in  
 5 its entirety.

6 And the test is are the provisions so clearly -- not  
 7 just independent, but so clearly independent. It's a  
 8 stepped-up standard that the Texas Supreme Court has  
 9 articulated, because it believes -- and that case has been  
 10 on the books for a long time now, 14 years. The Texas State  
 11 Supreme Court believes that in order to do honor to the  
 12 legislative intent, the legislature will be called upon to  
 13 give some independence of -- some indication of independence  
 14 and severability. Your Honor, one reason you can go this  
 15 way right now, and that is there is no severability clause.  
 16 It's very common if legislators want to do that. When we  
 17 look to other indicia of legislative intent, and you need  
 18 to, no severability clause, once you've made that  
 19 determination it can fall.

20 But then we see Senator Carona, who we believe from  
 21 his own statements -- and this is simply confirmatory, that  
 22 the legislature would not have enacted this bill.

23 Why?

24 Because he's saying that without the code 1131 would go  
 25 down in flames.

83 (Pages 164 to 165)

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1 And the very able intervenor's counsel has said in  
2 their proposed findings of fact we agree with that.

3 In fact, Mr. Walne here in the courtroom stated --  
4 here it is. This was the intent of someone actively  
5 involved in the process: Allstate could keep them but not  
6 sell them. No speech allowed.

7 And you can see again on what the intervenor said in  
8 the pretrial brief, the First Amendment speech provisions  
9 are an integral part.

10 Now, we say that just to supplement what we think  
11 flows, again, most importantly, from the lack of a  
12 severability clause, but this confirms what the court can  
13 discern on the face of the statute.

14 Your Honor, I would summarize 1131 as being a  
15 blunderbuss, a sledge hammer. It's anything but a scalpel,  
16 because, and the court has seen this before and it has noted  
17 this in its December 11th order, there's so many other laws  
18 on the books, there are a host of alternatives that show  
19 that this law was not necessary in order to protect the  
20 public interest, to protect the consumer.

21 And I do want to quote, Your Honor, from that bottom  
22 bullet, a case that we think is quite important as I've  
23 indicated before, it does come out of the Sixth Circuit, but  
24 it's so directly on point, that where there is a lack of any  
25 significant local benefit that does not already accrue under

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1 existing laws, the benefits of the statute do not outweigh  
2 even an incidental burden on interstate commerce.

3 So let's look at interstate commerce and the commerce  
4 clause. But to help understand our discrimination claim,  
5 again, that's only one of our claims, we have put together a  
6 timeline which we believe shows the protectionist essence of  
7 1131. This is context. Here is elsewhere. Let's look at  
8 context.

9 Indeed, the case law teaches that to determine whether  
10 a law was passed with the protectionist intent, the court is  
11 to focus on the historical -- and this is in the box in the  
12 middle, a Fourth Circuit case, saying focus on the  
13 historical background and the specific consequence of events  
14 leading up to the statute's enactment.

15 And, Your Honor, here's the timeline again. And we see  
16 that -- you know, when Allstate acquired Sterling Collision  
17 Centers, wisely or unwisely, but that's their decision and  
18 they're sticking to it, and that was three years ago, nary a  
19 peep was heard from various anti-Allstate opponents, who are  
20 now here in this courtroom.

21 It was only after, and there it is, the move into  
22 Dallas with a greenfield store that the wheels were put in  
23 motion.

24 Now, notice, no consumer complaints, no enforcement  
25 actions by the Attorney General of Texas. But in

84 (Pages 166 to 167)

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1 particular, the move struck Mr. Walne, a very good  
2 businessman, very successful businessman, as particularly  
3 threatening.

4 And so, and we now know this, the local body shop  
5 industry came together and drafted 1131 for sponsorship by a  
6 very good friend of Mr. Walne, the distinguished Senator  
7 Carona, who was here and testified.

8 Despite an utter lack of evidence, no consumer  
9 complaints, no other evidence that insurer ownership harmed  
10 consumers, with no other law in the United States of America  
11 forbidding this, with the lieutenant governor, a businessman  
12 himself, saying show me the evidence, notwithstanding that,  
13 a full divestiture statute was passed.

14 But then in response to the lieutenant governor's  
15 concerns, Senator Carona promised, his words, hard, credible  
16 evidence.

17 Notice those two words. Hard. I'm going to give you  
18 hard evidence, governor, and it's going to be credible,  
19 governor.

20 That what?

21 The law was necessary.

22 No such evidence was adduced and yet it was enacted.

23 Your Honor, any doubt that 1131 was protected (sic) not  
24 to pass, not to protect consumers, but to protect profits of  
25 local body shop owners, is resolved by examining, again, I'm

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1 going to be very brief on this, the statements of those who  
2 knew the law best, the purposes best.

3 And we see from Representative Flores the sentiment  
4 best of all, to protect the local independent folks back  
5 home.

6 Now, the intervenors say, oh, you're being unfair, this  
7 is isolated, this is a solitary legislator. But look at the  
8 other statements that he made or his office made.

9 But he wasn't alone. Representative Driver.  
10 Representative Wise. You've seen these before.

11 Representative Driver in fact was fixated during the  
12 hearings on the new store provisions.

13 Could I see 1016, please, that further expansion might,  
14 what?

15 Erode future profits.

16 But as we saw in this courtroom, it was Senator Carona  
17 who was the champion. And he embarked on a mission of full  
18 divestiture after, and only after, Mr. Walne approached him  
19 to do something about what?

20 The encroachment into the Dallas market. Encroachment  
21 is also known as competition because, of course, Mr. Walne  
22 had recently built, and I'm sure it's a very fine one, a two  
23 million dollar facility.

24 And Senator Carona agreed with Mr. Walne that it was in  
25 the best interest of consumers that, what?

85 (Pages 168 to 169)

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1 Body shops make a profit.

2 And these are not isolated statements. He was not  
3 going to allow insurance companies to sneak into is this  
4 business and he wasn't going to allow any competitive  
5 advantage.

6 Now, in his testimony, Mr. Walne, the ASA's corporate  
7 representative, revealed the -- the view motivation from the  
8 lobbying perspective behind 1131.

9 And there was a timeline that was put together by Ms.  
10 Gardner during the cross-examination. We think that tells  
11 the protectionist tale; that is, again, as we saw before,  
12 right after Allstate makes its move into Dallas, Mr. Walne  
13 made his move into the halls of government.

14 Mr. Vandergriff, who is here, worked side by side with  
15 Mr. Walne. He was the CCAR representative at trial. We'll  
16 come back to CCAR. He formed CCAR, his description is a  
17 single-purpose coalition, legislative clout. To do what?

18 To stop the train wreck threatened by Sterling's  
19 greenfield expansion. He wanted to stop Sterling before it  
20 moved into new markets like Dallas where his firms had a  
21 dozen shops.

22 After that Mr. Vandergriff was asked by his able  
23 counsel on direct, as we see on the screen, why he was  
24 concerned about the conflict of interest. He basically  
25 ignored the question and replied that his biggest concern,

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1 like Mr. Walne's, was the need for a level playing field so  
2 that his guys would not be the losers. This was at that  
3 time the repeated refrain. He testified his primary  
4 motivation was a level playing field, he being Mr. Walne.

5 Now, throughout the legislative process, Your Honor,  
6 the level playing field mantra occurred again and again.  
7 And PX 6, the bill analysis that the state cites in support  
8 of its conflict of interest argument, itself cites the  
9 desire for a level playing field. This was -- and here is  
10 the slide that has examples of this repetition.

11 Indeed, the intervenors themselves cited the need for a  
12 level playing field in their First Amendment brief and then  
13 in their pretrial brief.

14 But the court addressed this last fall, December 11th,  
15 and I'm now quoting, "The state cannot undertake to level  
16 the playing field for the purpose of protecting local  
17 business from competition so that local companies may  
18 maintain their profit margins."

19 But that was the point of 1131.

20 Notably, Your Honor, that mantra has disappeared. It  
21 disappeared during the post-trial briefing and in the  
22 proposed findings.

23 Your Honor, the dictionary teaches -- and I used this  
24 before, and the court doesn't need a definition, but what is  
25 a pretext?

86 (Pages 170 to 171)

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1 It essentially is, my gloss, a politically palatable  
2 appearance, and now here is Mr. Webster, "assumed in order  
3 to cloak a real intention or state of affairs."

4 And that's what this is.

5 As our witness Bob Thompson explained, he attended a  
6 very unsettling meeting, that's his description of it, with  
7 1131's backers and the Senator Carona where he listened to  
8 the discussion and he was driven, in his words, crazy.

9 Why?

10 Because all they were talking about was competition,  
11 but, his words, nobody mentioned the customer. His  
12 testimony.

13 And he testified that he asked in the meeting -- in  
14 the meeting in Austin what about the consumers.

15 And Thompson's testimony, not contradicted, said nobody  
16 answered that question, quote, "It just --" again, this is  
17 Thompson's testimony, "It just kind of disappeared."

18 Your Honor, the 30(b)(6) witness, a public servant,  
19 Assistant Attorney General Mattax, made, as I have indicated  
20 at the opening, some very important and, of course, binding  
21 admissions confirming the intent.

22 The Assistant Attorney General said what we already  
23 know, the state didn't want Allstate to expand. He also  
24 admitted that -- go on, if you would.

25 That even if -- and here's the listing, it's a whole

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1 bunch of nonproblems. But notice that, even if Allstate's  
2 speech was entirely truthful and customers are not deceived,  
3 and on, and on, and on, 1131 would still have been enacted.  
4 Somehow, even if all those things are so, 1131 would still  
5 serve the public interest.

6 That cannot be.

7 The state's other 30(b)(6) witness made equally  
8 critical binding admissions. He stated, as much as I'm sure  
9 the state and the intervenors wished he hadn't, that  
10 Sterling's quality was not a motivation for HB 1131,  
11 instead, there it is, what the legislature was trying to do  
12 was just actually go after the Allstate/Sterling business  
13 model.

14 And so we've seen, Your Honor, that the legislative  
15 history is brimming with protectionist rhetoric.

16 You had this slide before you before. Here are  
17 indications from the case law coming out of the Eighth  
18 Circuit that when the record brims this way, this is enough  
19 to trigger strict scrutiny.

20 And I want to move now quickly to the legal standard  
21 that we think should guide the court.

22 Ones a discriminatory purpose is found, and we believe  
23 it's manifestly clear here that's what they had in mind, the  
24 Supreme Court in Hughes against Oklahoma indicated that the  
25 strictest scrutiny applies.

87 (Pages 172 to 173)

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1 Why?

2 Keeping the national economic union.

3 Now, discriminatory effects, so that would be purpose,  
4 so discriminatory effects are still subject to the same

5 searching standard, and we summarize it as the business

6 shifting test, which was first enunciated by one of the

7 state in the intervenor's favorite cases, Exxon v Maryland.

8 We see that quote here on the screen and the court has seen  
9 that earlier today.

10 Now, once a statute is found to be discriminatory, what  
11 happens?

12 The onus shifts to the state to come forward to justify  
13 the statute under the very strict and the final case here,  
14 Maine v Taylor standard. And that means the state has to  
15 come up not with arguments, Your Honor, but with real  
16 evidence that demonstrates, and here it is, there are no  
17 alternative means that could promote this local purpose as  
18 well without discriminating against interstate commerce.

19 Your Honor, that's a test that state statutes  
20 invariably fail. Maine v Taylor is the only case in modern  
21 history that has survived Supreme Court scrutiny, and that's  
22 again the Maine Fisheries case where they proved through  
23 evidence, scientists on the stand in Portland, Maine,  
24 proving to a United States District Judge that the Maine  
25 fisheries would be jeopardized if that particular form of

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1 bait fish was introduced. Real evidence. States invariably  
2 flunk it.

3 And now here are other quotes that we think again are  
4 quite salient and important in guiding the courts  
5 reflections as it deliberates.

6 The Supreme Court has stated again and again -- this  
7 is our last quote here on this, in terms -- the Lewis case,  
8 the virtual per se invalidity. And this set of slides has  
9 quotes. Our brief is adorned with others. You have them in  
10 the binder. This guides the court to we think a very  
11 reflected and representative set of examples of a vast body  
12 of law.

13 Now, on the next slide we see a quote from McNeilus.  
14 And it bears the repeating here, because there the Court of  
15 Appeals for the Sixth Circuit in Cincinnati said the state  
16 gives away the gain when it concedes to discriminating  
17 against an interstate competitor's business model.

18 Now, Your Honor, the state asked during the opening,  
19 well, who's being discriminated against here.

20 And we believe the case is answered by this. And I  
21 will, with the court's leave, play the briefest clip from  
22 Mr. Reyes' deposition. Again, a 30(b)(6) witness and so his  
23 admission is binding on the state.

24 (Videotape playing)

25 "What the legislature was just trying to do is just

88 (Pages 174 to 175)

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1 actually go after the unfair business model."

2 That is at page 59, the citation is to line 16 and

3 17.

4 And with those binding words, in the words of McNeilus  
5 of the Sixth Circuit, the state has given away the gain.

6 Now, the state does have responses. They first engage  
7 in a defense that we essentially have dubbed selected  
8 discrimination. It's okay to selectively discriminate the  
9 targets of discrimination.

10 But this is rebuffed by the law. And there are  
11 examples of an entire body of law that says that's not so.

12 And why is it?

13 It's not a body count. It's the principle of our  
14 dormant commerce clause jurisprudence. Selected  
15 discrimination, targeted distinction, is still invalid  
16 discrimination under our Constitution.

17 And on this slide a number of cases that support this  
18 position.

19 And, by the way, we see again the McNeilus cite, which  
20 our brothers on the other side have taken a bit out of  
21 context, because what McNeilus says is this: The fact that  
22 the burden is born predominantly, I'm quoting, by one  
23 out-of-state firm mattered -- matters not at all. Your  
24 Honor, that supports us. We are the out-of-state firm that  
25 is bearing the brunt of 1131.

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1 And then the Lewis quote, again, at the bottom, as you

2 know, that's a very important case in our presentation

3 because there, this is the Florida ban on the out-of-state

4 bank's provision of investment services, directly burdens

5 interstate commerce, even though, and here it is, this is

6 right here in the United States, some kinds of interstate

7 competitors have free entry into the local market. That's

8 this case. Another case, similarly situated. They say,

9 well, look, local body shops and insurer shops, it's -- it's

10 apples and oranges.

11 Indeed, in their opening statement the position was,

12 well, that disposes of this case. But with all due respect

13 to my brothers on the other side, that is not the law of the

14 land.

15 The test of whether firms are similar situated is very

16 simple. And the Supreme Court held this in 1984, in the

17 Bacchus Imports case, in a very interesting Hawaiian case.

18 But here is the principle: Discrimination occurs as long

19 as there is some competition. Some. Notice some. Not

20 much. Not a lot. Not total. Some competition between the

21 locally produced products and the products, and it could be

22 services, from out-of-state.

23 Now, Mr. Walne, Vandergriff, and Stafford, very able

24 businessmen. Each testified in court that they competed

25 with Sterling.

89 (Pages 176 to 177)

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1 By their own testimony, which we credit, we do not  
2 contradict that in any way, they are similarly situated.

3 That's the discrimination part of the analysis.

4 We turn now to the so-called second-tier, and that's  
5 the Pike test, drawn from Pike v Bruce Church, from 30,  
6 almost 40 years ago. We would say, Your Honor, that at a  
7 minimum 1131 excessively burdens interstate commerce coming  
8 into and outside the State of Texas. That is, even if one  
9 assumes that there is no discrimination, no protectionism --  
10 even if the court accepts the notion, we hope it won't,  
11 that Texas can selectively discriminate against Allstate,  
12 still the statute falls under Pike.

13 Now, the intervenors have sought to evade Pike. I  
14 think they understand it's a problem for them. So they  
15 say -- not the state, but the intervenors.

16 They say, okay, look, we've got some Third Circuit case  
17 law coming out of Philadelphia. But, Your Honor, it's  
18 wrong, and we note this, the more recent case reflecting the  
19 ever growing body of dormant commerce clause jurisprudence,  
20 district court saying it doesn't appear to be good law. And  
21 that's the best they have got.

22 Let's now go and look not at what the Third Circuit  
23 says, but let's see what the Supreme Court says.

24 And so I want to, with the court's indulgence, quote  
25 that first bullet from Pike, "Where a statute regulates

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1 evenhandedly --" we don't think it does here, but assume  
2 arguendo, "-- to effectuate a legitimate local public  
3 interest --" we don't think that's satisfied here, but let's  
4 assume it is, "-- and its effects on interstate commerce are  
5 only incidental, it will be upheld --" proviso, "-- unless  
6 the burden imposed on such commerce is clearly excessive in  
7 relation to the putative local benefits.

8 And so we examine very briefly the burdens.

9 1131 indisputably denies Allstate further access to the  
10 Texas market, the freeze, in effect. It certainly imposes a  
11 straitjacket on our business operations and the ability to  
12 compete. And that, by the way, was the very burden that was  
13 at issue in the Pike case itself involving an Arizona  
14 statute.

15 But there's another thing I mention in this. And there  
16 has been a lot of commentary and even testimony about other  
17 states. And I want to zero in on that because it's part of  
18 the Pike analysis. Because 1131, upon reflection, imposes  
19 extraterritorial burdens. And I want to draw the court's  
20 attention in particular to the Carbone case, which I have  
21 noted before.

22 Now, Carbone -- the majority struck down the statute.  
23 It was an opinion by Justice Kennedy and it was joined by  
24 Justice Scalia, and Justice Thompson, and Justice Stephens  
25 and Justice Ginsburg. But, anyway, the court struck down

90 (Pages 178 to 179)

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1 the statute there which involved the protection, for very  
 2 benign reasons I must say, of a local waste disposal service  
 3 on discrimination grounds. So that's what the majority but  
 4 said. But then in her concurring opinion, and that's what  
 5 we're drawing from, Justice O'Connor said the statute has  
 6 got to go, but she struck it down or voted to strike it down  
 7 on a Pike analysis. And in her concurrence she cited to  
 8 settled holdings of the court in Wyoming against Oklahoma,  
 9 Healey versus Beer Institute.

10 And then here is what she wrote: The court must  
 11 consider the practical effect of a law not only by  
 12 considering the consequences of the statute itself, but also  
 13 by considering what affect would arise if not one but many  
 14 or every, but many jurisdiction adopted similar legislation.

15 So when we here, oh, 49 states, 49 states, they're  
 16 making our point.

17 The court is called upon not to say we can do whatever  
 18 we want here in Texas and go the Texas way. The court, as  
 19 an Article III court, is called upon by the case law to say  
 20 in our national economic union what happens if this in fact  
 21 is passed by these other states, and we know it's under  
 22 consideration in these other states.

23 Now, the testimony in this case has not waived. 1131  
 24 has stopped Sterling dead in it's tracks But not just in  
 25 Texas but nationwide. Texas is an important part of the

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1 market. And this law is very important.

2 So when we engage in the balancing that the court  
 3 commands, on one side we're seeing, and our 1042 illustrates  
 4 this, we think that the putative local benefits are  
 5 featherweights upon close analysis.

6 One of the reasons is that there are more than  
 7 enough -- and that's our looking on the other side, there  
 8 are so many ready alternatives in place. Again, this court  
 9 has engaged in this kind of analysis in its December 11  
 10 hearing.

11 What?

12 The anti-steering law.

13 As the court has noted in the course of the trial, the  
 14 litigation throughout, as well as in its December 11 order,  
 15 the risk of reputational harm, and then competition itself.

16 It's a good way to lose a policyholder, to treat the  
 17 policyholder, and it's a bad way to attract new  
 18 policyholders to treat a claimant shabbily.

19 Your Honor, I made a statement last -- when we were  
 20 here in trial, and I'm going to with apologies put it up.  
 21 But I did say that there's going to be a key piece of  
 22 evidence that is not going to be produced, that no one -- so  
 23 we were very straightforward -- will ever come forth with a  
 24 policy demonstrating that Allstate directed Sterling to  
 25 reduce quality to save money. No such policy exists.

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1 We stand by that. Allstate stands by that. And the trial  
2 record is barren of any evidence of that sort of  
3 exploitation.

4 Why would Allstate do that after 73 years of service to  
5 the people of this country?

6 Then on the other side of the scale, again, back to the  
7 burdens, in addition to those alternatives, the  
8 straitjacket, the denial of further access to Texas, those  
9 extraterritorial effects, and Justice O'Connor said, judges,  
10 when you're thinking about this, even if you're not  
11 satisfied there is discrimination, think about  
12 extraterritorial effects. And she wasn't speaking alone.

13 She was drawing from the jurisprudence of the court. She  
14 didn't think there was discrimination there. And it was a  
15 kind of a tough case. That's Carbone that I'm talking  
16 about.

17 But we believe when you're in Pike land, as it were,  
18 when you're in Pike's territory, Your Honor, in exercising  
19 you're Article III powers, I think the court will come to  
20 the conclusion, just as Justice O'Connor did in a tougher  
21 case, in Carbone, the scales are just like that, that 1131  
22 is excessive in its burdens on interstate commerce.

23 THE COURT: 18 minutes left.

24 MR. STARR: I beg your pardon?

25 THE COURT: You've used 42 minutes.

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1 MR. STARR: Thank you, Your Honor.

2 Well, I'm going to be brief on this and would turn to  
3 the evidence presented at trial. Happily it was a five day  
4 trial. And there are our witnesses. There were seven of  
5 them. We talked a fair amount about them in the course of  
6 this presentation.

7 Now, the state, Your Honor, came forward with all of  
8 one witness. That's it. Distinguished public servant, but  
9 there it is. There is the state's case: Senator Carona.

10 Now, the intervenors, to be fair, came forward with  
11 four witnesses: Three competitors, and then, of course, as  
12 we have seen today Dr. House.

13 I'm going to move through the key trial testimony in a  
14 very summary fashion.

15 George Ruebenson, senior vice president, sitting in the  
16 witness chair and as we see from that first bullet he  
17 explained the underlying reason for the Sterling initiative,  
18 and that is, customer satisfaction.

19 And he talked about the effect of 1131 on Sterling's  
20 expansion. And we see in the last sentence on that slide,  
21 "It is my recommendation --" Dr. House may disagree with  
22 this, but he's not responsible to the board and he's not  
23 responsible to the shareholders but Mr. Ruebenson is and he  
24 said, "It is my recommendation, and my boss's  
25 concurrence --" that's the CEO of a very respected company,

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1 "-- that if we prevail here we will expand the network."

2 He did not equivocate. Not we're going to restudy it.

3 The going has gotten rough. Teddy Roosevelt, they're  
4 getting going.

5 Now, he also explained a number of documents.

6 He testified that insurer's pay 90 percent - I'm going  
7 very fast on this - of collision repairs. That's a high  
8 percentage. But Allstate alone pays out five billion  
9 dollars a year. And he noted the various methods that of  
10 settlement that insurers provide to their customers, and  
11 Allstate's desire to provide them. Maybe it will work;  
12 maybe it won't, but with a new option.

13 And he talked about the way that Allstate decided to  
14 change the game.

15 The strategy is very simple: A meaningful change for  
16 customers. And the strategy -- and this was as explained  
17 within the Allstate family, within the community, is not a  
18 severe reduction strategy, and that's Allstate talk for the  
19 cost of repair, and not a design to reduce consumer choice.  
20 And these are business records, they are contemporaneous  
21 business records.

22 And after the acquisition, as Mr. Ruebenson explained,  
23 Allstate initially intended, and this has come out today  
24 during the cross-examination of Dr. House, here is the plan,  
25 we're going to be rolling out these greenfield shops all

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1 across the United States of America. Start with 38, but  
2 with an end plan of more than 300. But the expansion plans  
3 have been put on hold. And that was so even after this  
4 court, rightly, in response to our moving, enjoined the  
5 invalid speech restraints. Necessary but not sufficient.

6 Bob Thompson. One of Sterling's founders. He  
7 explained the superiority of the greenfield expansion  
8 strategy, and that was the strategy that Sterling was  
9 driving. And he explained on cross why the state's theory  
10 that, well, other interstate suppliers are going to be  
11 hopping right in there and fill the gap when Sterling is  
12 absent from the market is just full of holes.

13 And we heard colloquy today that touches on that. What  
14 Mr. Thompson said, he's the businessman who used to repair  
15 these things in his backyard as a high school kid, he knows  
16 the business, the market was driven by venture capital and  
17 it dried up. You've got to a source of capital. It dried  
18 up. Venture capital goes to where the promise is greatest.

19 The incentives are different. We want to realign  
20 incentives. But in response to the court's question Mr.  
21 Thompson used the word crazy again that the conflict of  
22 interest argument is crazy.

23 And why?

24 This goes to integrity, Your Honor, and a reputation or  
25 integrity. He said there in that very bottom line, we will

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1 not compromise the customer."

2 I think what you heard today was an undercurrent of,  
3 oh, yes, they will. A dark and Hobbesian world.

4 It's what we heard today. Oh, they're going to cheat.

5 No, they are not.

6 Now, Mr. Thompson also explained some documents. And  
7 he discussed this concept of innovation. We're always ready  
8 to improve. It's as simple as that. It's a fancy word.  
9 It's a Japanese word: Kaizen. But he described how the  
10 Kaizen application led to the design of this prototype store  
11 that became the blueprint for the nationwide network.

12 Ken Zion. His testimony. He provided three opinions.  
13 They're summarized there. The court is familiar with it,  
14 but look at number 1. We didn't hear much about that  
15 today. Not a word about rampant fraud and waste in this  
16 industry. Not a word about Greg Abbott's common scams in  
17 this industry.

18 And Dr. Zion, who spent 30 years plus in the industry,  
19 has a Ph.D., provided testimony refuting some of the state's  
20 key arguments. And he explained -- this is kind of a neat  
21 way of putting it -- no magic umbrella. We've all sinned.  
22 There's fraud here. And he also explained, as we see in the  
23 second quote, "The state's corner-cutting defense just does  
24 not hold water." Sounds like Ralph Nadar.

25 He explained that contrary to the argument offered by

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1 our very able and worthy adversaries, independent body shops  
2 are not providing an advocate for consumers. In fact, Mr.  
3 Walne submitted in response to Your Honor's question, well,  
4 can't bite the hand that feeds him.

5 Dr. Zion reviewed Greg Abbott's own warnings. But he  
6 also discussed there are other ways. California has much  
7 that's wrong but here they're on to something. They have a  
8 bureau of auto repair and it regulates the repair practices  
9 at all the body shops, no matter who the owner is. And if  
10 the great State of Texas were genuinely concerned with  
11 protecting consumers, here's just another example,  
12 establish the California version here in Texas of auto  
13 repair. Establish its own bureau.

14 But look at the findings of that state, commissioned by  
15 the legislature. Those are large numbers.

16 Instead, the response was to do away with the first  
17 guiding light, as he put it, in his 30 years in the  
18 business.

19 Bill Daly. National manager for the PRO shops before  
20 he took over the reigns at Sterling. He's been in hundreds  
21 of body shops in his career. He was pretty well-positioned  
22 to explain the differences between the new Sterling model  
23 and those other shops. And as to the uniqueness of  
24 Sterling, compared with other consolidators, he said, and  
25 here it is in the record, and this is not contradicted,

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1 "There are no shops that follow a consistent operation model  
2 as we at Sterling have attempted to do or embarked on a  
3 consistent greenfield strategy as we've attempted to do."

4 And, indeed, he said, in response to a question, yes,  
5 we suspended a Sterling shop when they were not up to snuff.

6 He testified about the latest version of a quality  
7 assurance program, one that exists nowhere else in this  
8 industry.

9 And he reviewed the call script that the court has  
10 scene which explicitly explains to customers you've got a  
11 choice. You're in good hands, but you've got a choice. He  
12 explained that agents are not permitted to refer -- we're  
13 talking about agents. My Allstate agent can't do this,  
14 refer business to Sterling or even to a PRO shop. They are  
15 to direct, and these are professionals, the claimants to  
16 call centers and they are then in turn read the script.

17 Mr. Daly also explained the Sterling Texas success  
18 timeline. We've heard a lot of doubting Thomases around the  
19 courtroom of late, but here it is. The timeline drives home  
20 the point that in contrast to the state's gloomy view, it  
21 was 1131 and not the insurer pullout that took place nearly  
22 two years prior to the enactment of 1131 that caused the --  
23 the decline. I'm just going to go ahead and call it a  
24 nosedive in business.

25 Indeed, the testimony was that Sterling was exceeding

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1 all expectations before 1131 took hold. I recall Microsoft  
2 starting out nonprofitably and so did Dell Computer.

3 The timeline is compelling. We leave this, Your Honor,  
4 for the court's review. We think it's powerful.

5 Sharon Mazanec, she's here in the court. She testified  
6 passionately about this. She is committed to this. She's  
7 been in this industry for a long time. She talked about the  
8 commitment to quality. She's been in other places, a one of  
9 a kind dedication to continuous improvement, again. That's  
10 that Kaizen philosophy again.

11 And she explained when answering a question from the  
12 court that the reason business hadn't picked up all that  
13 after the preliminary injunction, we're thankful for it, was  
14 entered late last fall, was that Sterling was still a bit  
15 afraid. There's this chilling effect.

16 She reviewed documentary evidence. And one of the  
17 things that she reviewed was this new way of doing things.  
18 I can't figure it out, but she's very proud of this. And  
19 she thinks this is just a terrific way to do business, and  
20 it would be great in those other 300 shops if we could open  
21 them up.

22 JoBetsy Norton testified what it was like:  
23 Representative Flores; rollover; not an accident.

24 But what happened in Austin?

25 She talked about that real impetus for 1131. Dallas

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1 body shop owners did not want to compete with Sterling.

2 Consistent with what Mr. Thompson, the founder of  
3 Sterling said, consumers were never mentioned.

4 It was really about protecting body shops back in their  
5 district.

6 She also confirmed about Senator Carona's promise. The  
7 lieutenant governor said show me the beef. Never produced.

8 But she also said clear that ASA, which has a  
9 representative here, is targeting other states. They're  
10 following Sterling and heading to legislative halls in other  
11 states.

12 But California, for one, has rejected this kind of  
13 legislation. Did that two years ago.

14 Now, the court also heard the testimony of the  
15 economist, Dr. Harrington, and he explained the four  
16 opinions set forth there. This is going to be very, very  
17 brief. He testified to the economic justification, so from  
18 an economic standard. Dr. House doesn't buy it, but there  
19 it is, from a very distinguished student of this particular  
20 industry.

21 It's simple. Allstate is a big consumer and since it  
22 was not receiving the quality its customers demanded,  
23 customer complaints, it did something sensible, and that's  
24 vertical integration.

25 He explained the key economic issues in this case.

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1 He explained why given the small size of Sterling in  
2 Texas, the 15 shops, the frozen number, that there can be no  
3 unfair competition by Allstate or Sterling. And this  
4 becomes absolutely clear when one exams 1081. You have seen  
5 it before. 4,600 local shops. And Allstate, for its part,  
6 is no Microsoft, and the court is familiar with the modest  
7 market share.

8 Now, Dr. Harrington walked through the various areas  
9 of agreement that he has with Dr. House, in terms of the  
10 expert report, and we think these are important admissions  
11 in terms of Dr. House's agreement, he did agree vertical  
12 immigration can help consumers. He agreed there's fraud in  
13 the industry, and that without 1131 Sterling would have more  
14 cars to fix. And he also acknowledged that interstate  
15 consolidators are rare and that greenfield expansion is more  
16 likely to shift business from existing shops.

17 Now, he also -- and I think this is where I want to  
18 leave the court, with these thoughts, and that's the  
19 economic facts that distinguish this case from Ford and  
20 Exxon. The court has been through this. It's been  
21 elaborately briefed. But in a nutshell this shows that when  
22 a chain builds a greenfield facility the marketplace is  
23 upsets. And that model, the greenfield model, is what 1131s  
24 opponents were expressly attacking. There's abundant  
25 testimony about it.

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1 And so Exxon -- and the intervenors have said in their  
2 post-trial brief that the Exxon trilogy controls this case.  
3 And we've argued now at some length that there are these  
4 various grounds of distinguishing. We've set those forth in  
5 the bullet points.

6 One of the things that is so very important here is  
7 that other interstate firms can promptly replace the  
8 business, but not so with Allstate and Sterling.

9 And Exxon and the Ford cases and the International  
10 Harvester cases were, Your Honor, we think very important in  
11 one respect, and they were franchise cases. And franchise  
12 cases we know create and trigger special considerations  
13 because of the potential for exploitation.

14 Now, Exxon gives us the business-shifting test. And  
15 this was discussed and -- and examined during Dr. House's  
16 cross-examination. They -- my learned brothers on the other  
17 side kind of denigrate this because they say, look, you're  
18 reading from a footnote. But look at that footnote, because  
19 it's grounded in the law. First of all, the footnote is a  
20 law. The Supreme Court says it. That's something I think  
21 most judges would take very seriously. Even if one  
22 denigrated the fact it's in a footnote, there it is with  
23 Hunt and Dean Milk, and it's been used many times since that  
24 time.

25 Now, to determine whether 1131 passes or flunks this

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1 test, it's key to asking, this is where economics does come  
2 in, to ask the right economic questions, and we've been  
3 through that.

4 The first question is does 1131 adversely impact local  
5 providers.

6 Surely the answer is no. They wanted it, 1131. And  
7 there are no in-state repair shops owned by insurance  
8 companies.

9 The second question asks, well, does 1131 reduce sales  
10 to interstate firms by denying them access to local  
11 markets.

12 And the answer is yes.

13 And here we know the answer was yes with a capital,  
14 why, because this law was aimed specifically and expressly  
15 at a particular interstate firm, Allstate.

16 There was a dormant commerce clause version of a bill  
17 of attainder.

18 We next question to answer, whether the lost sales go  
19 predominantly to the local body shop.

20 And the answer is yes. With those, as we just saw,  
21 4600 local body shops, but a handful of interstate shops,  
22 just simple arithmetic tells us the answer.

23 The last question is whether the lost sales would be  
24 promptly replaced, as Exxon instructs, by a rapid expansion  
25 of other interstate firms in Texas.

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1 And the answer there is no.  
 2 No evidence was brought forward -- a lot of talk, but  
 3 no evidence of any existing interstate firms with ready  
 4 ability and willingness to expand in Texas at all, let alone  
 5 Sterling.

6 THE COURT: One minute.

7 MR. STARR: Your Honor, if we could go to 1100.

8 We would guide the court as it comes to a decision here  
 9 to recall the statements of those who sponsored and then  
 10 those who testified, or both. We think the key to a  
 11 decision is right here.

12 Representative Flores, Senator Carona, and the 30(b)(6)  
 13 witness, "We were attacking a particular business model."

14 That is a violation of the Constitution.

15 I thank the court.

16 THE COURT: Mr. Hohengarten.

17 MR. HOHENGARTEN: Thank you, judge.

18 May it please the court.

19 THE COURT: Yes, sir.

20 MR. HOHENGARTEN: With the time I have, Your  
 21 Honor, I intend to focus primarily on the commerce clause  
 22 claim. I do want to spend a little bit of time on the First  
 23 Amendment issues as well, because I think they are  
 24 important, but both my presentations will be on the commerce  
 25 clause.

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1 Now, specifically with respect to the commerce clause,  
 2 what I intend to do is discuss the controlling legal  
 3 principles that dispose of this case and then apply those  
 4 legal principles to the evidence that has -- has been  
 5 presented at trial.

6 As the Ford case teaches, and I know the court has  
 7 heard over and over again about the Fifth Circuit's Ford  
 8 Motor Company case, as that case teaches and as Justice  
 9 Benevides writes in the opinion, the place to begin the  
 10 analysis under the commerce clause is the issue of  
 11 discrimination.

12 Because if there's not discrimination -- can we see  
 13 slide 7, please?

14 THE COURT: Do you have -- you're going to give me  
 15 a list of all those slides later on?

16 MR. HOHENGARTEN: I would be happy to.

17 THE COURT: It would sure help me. Thanks.

18 MR. HOHENGARTEN: Sure. Sure.

19 If there is not discrimination in the statute, we have  
 20 the Pike balancing test. Here, as the court said in Pike,  
 21 where a statute regulates evenhandedly to effectuate a  
 22 legitimate local public interest, and its effects on  
 23 interstate commerce are only incidental, it will be upheld  
 24 unless the burden imposed on such commerce is clearly  
 25 excessive -- " important phrase, " --clearly excessive in

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1 relation to the putative local benefits."

2 Now, a little later I'll get into the significance of  
3 that phrase "putative local benefits," but for now I just  
4 want the court to note that in the absence of discrimination  
5 the Pike balancing test applies.

6 And Judge Benevides says something very interesting in  
7 Ford. And perhaps I can get the ELMO. Let's see if I can  
8 focus in.

9 THE COURT: This is in the Ford case?

10 MR. HOHENGARTEN: Yes. It looks like -- I know  
11 the judge is not going to be able to read that. I'm trying  
12 to zoom in, so rather than be hung up on the technology --

13 THE COURT: That's okay. You can put it down  
14 there. I've got better eyes than you think.

15 MR. HOHENGARTEN: It's all right. It's all  
16 right.

17 Judge, it's a simple quote, but it's very, very  
18 telling.

19 THE COURT: What page is it on?

20 MR. HOHENGARTEN: Yes. This is page 499. So it's  
21 264 F.3d, page 499. Or excuse me, it's 500.

22 And Judge Benevides says because of the wide variation  
23 in scrutiny under the respective tests, this inquiry, that  
24 is whether or not the statute discriminates, is often  
25 dispositive of the underlying issue.

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1 And what he means by that is that the issue of  
2 discrimination is so critical because if the statute  
3 discriminates then the state law is subjected to strict  
4 scrutiny.

5 And another way that the test has been put, a statute  
6 that discriminates against out-of-state economic interests  
7 is virtually per se invalid.

8 That is a tough, tough standard to meet. And Mr. Starr  
9 is absolutely correct when he says if the state laws are  
10 subjected to that standard they usually fail.

11 It is just a standard that is difficult to meet.

12 But here's the important part for us, judge, as I'll  
13 explain in a minute.

14 There is no question that this statute does not  
15 discriminate against out-of-state economic interest.

16 So we go to the Pike test, which is far, far more  
17 lenient. And I'll -- and a much, much lower hurdle for the  
18 state to clear in order for the court to find that this  
19 state law is valid under the commerce clause.

20 Now, before we go any further on the Pike balancing, I  
21 want to back up and talk very, very carefully about what we  
22 mean by discrimination under the commerce clause, because we  
23 agree that's the key.

24 If it's discrimination, tough standard of review for  
25 the state law. If a statute is nondiscriminatory, as I will

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1 show the court in a few minutes, a -- basically a very, very  
2 easy standard of review for the state law that is being  
3 challenged.

4 Could I see --

5 THE COURT: Basically your argument is -- I want  
6 to make sure I understand that.

7 MR. HOHENGARTEN: Sure.

8 THE COURT: Since you don't have a slide on that,  
9 is that it's nondiscriminatory and that it applies to  
10 everybody?

11 MR. HOHENGARTEN: Well --

12 THE COURT: In-state, out-of-state? Or no?

13 Let me make sure.

14 Why is it not discriminatory?

15 MR. HOHENGARTEN: I'm going to get into this.

16 THE COURT: Okay.

17 MR. HOHENGARTEN: But I would be happy to answer  
18 it now.

19 THE COURT: No, that's okay.

20 MR. HOHENGARTEN: But I promise the judge I'm  
21 going to address that here in just a couple of minutes.

22 What do we mean when we say a statute discriminates  
23 under the commerce clause?

24 Judge, this is so key to this case, because there have  
25 been a lot of quotations and a lot of statements that we

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1 believe the plaintiffs have been taking out of context.

2 THE COURT: Isn't that what I just said?

3 MR. HOHENGARTEN: But it's going to be a little  
4 bit more elaborate.

5 THE COURT: Of course it's going to be more  
6 elaborate than my off-the-cuff comment. I'm sure. The  
7 Fifth Circuit it's going to put it in much better words than  
8 I will. I would like that to be on the record.

9 (Laughter.)

10 MR. HOHENGARTEN: I had not necessarily concede  
11 that's true.

12 THE COURT: Okay.

13 MR. HOHENGARTEN: But to move on, this is the  
14 key. And we have to -- have to keep remembering that it's  
15 different treatment of in-state and out-of-state economic  
16 interests that benefits the former and burdens the later.  
17 So we have to have discrimination against out-of-state  
18 economic interests --

19 THE COURT: Right. Right. So your argument is,  
20 look, these local insurance companies, like the county  
21 mutuals, can't do it either?

22 MR. HOHENGARTEN: Correct. Nor can USAA, nor can  
23 any corporation that is -- nor can any insurance company  
24 that is a Texas insurance company. They cannot do it.  
25 And as I'll get to in a minute, that is the critical

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1 difference between this case and Lewis.

2 THE COURT: I'm sorry. I didn't mean to keep  
3 jumping ahead of you.

4 MR. HOHENGARTEN: I'll be happy, judge, to address  
5 your questions.

6 THE COURT: I'll try not to interrupt you  
7 anymore.

8 MR. HOHENGARTEN: Can we see slide 4?

9 The discrimination has to go not only to out-of-state  
10 economic interest and favor in-state economic interest, but  
11 it is critical that the court know that this discrimination  
12 has to be among similarly situated in-state and out-of-state  
13 interests. That is, you have to compare, as the courts have  
14 done in other cases, apple growers in-state to apple growers  
15 out-of-state, or you have to compare in-state insurance  
16 companies to out-of-state insurance companies, or you have  
17 to compare out-of-state banks to in-state banks.

18 But what you cannot do -- what you cannot do, and  
19 Allstate has repeatedly tried to do just this throughout  
20 this case, is say that the commerce clause that the statute  
21 discriminates for the purposes of the commerce clause if it  
22 takes aim against a company like Allstate because it is an  
23 insurance company. That is the key distinction in this  
24 case.

25 No one is discriminating against Allstate because it is

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1 an out-of-state economic interest. The same rules apply to  
2 in-state economic interests here, i.e., Texas insurance  
3 corporations.

4 The only reason that Allstate cannot own a repair shop  
5 is because it is an insurance company.

6 And so there is no discrimination under HB 1131 as  
7 between similarly situated in-state and out-of-state  
8 interests. In-state insurance companies can't do it and  
9 out-of-state insurance companies can't do it. Anyone else  
10 can do it, as far as I'm aware. Any company with the  
11 capital, any company with the wherewithal, any of the  
12 consolidators, they can come in and build as many stores as  
13 they view as profitable.

14 THE COURT: Does it also mean the statute could be  
15 as discriminatory as it chose to be for local interests,  
16 provided -- or would that fail this test, provided it does  
17 it to all insurance companies?

18 In other words, it's okay, we can protect Herb's  
19 against all insurance companies and we can protect, you  
20 know, Craig's and all the other collision -- we can choose  
21 to protect them.

22 MR. HOHENGARTEN: That is precisely my point,  
23 judge. In my opening statement I made just that point. I  
24 said protectionist against whom, protectionist against  
25 what. Allstate never finishes the concept.

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1 If the protection is from insurance-owned repair shops,  
2 and there's no discrimination between out-of-state and  
3 in-state, there is absolutely nothing wrong with that under  
4 the commerce clause. It doesn't even rise to a viable  
5 commerce clause claim. The judge could decide it as a  
6 matter of law.

7 Now, what I want to do is break down the three ways in  
8 which a plaintiff can prove up discrimination.

9 And this is why I was sort of trying to hold off when  
10 the court asked its question, because the issue of  
11 discrimination is a little bit more complicated, and it's  
12 complicated for this reason.

13 Basically discrimination can be proven up by a  
14 plaintiff in one of three ways. It has to be at least one  
15 of these three ways.

16 It can be proven up because the statute discriminates  
17 as between in-state and out-of-state economic interests on  
18 its face, or it can read the statute or read the bill and  
19 see that there's discrimination. That's number one.

20 Two, the plaintiff can prove up discriminatory purpose,  
21 that there's evidence to show that even if you cannot see it  
22 in the bill, or the statute, its -- its purpose is really to  
23 discriminate against out-of-state economic interests.  
24 That's two.

25 Three is discriminatory effect.

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1 It has to be one of those three things in order for  
2 Allstate to prove discrimination. And I'd like to go  
3 through those one at a time.

4 First of all, I think it is indisputable, and I'm on  
5 facial discrimination now, the first type, that HB 1131 does  
6 not discriminate on its face. There is no jot, no iota in  
7 that bill, that statute, that could be reasonably or fairly  
8 construed to discriminate against out-of-state economic  
9 interests because they're out-of-state economic interests.

10 And I have always read the plaintiff's pleadings to  
11 concede this point. I did not even think that we had an  
12 issue until my learned opponent raised the Lewis case.

13 And, in fact, in the opening statement Mr. Starr went  
14 so far as to say, "In a nutshell, Your Honor --" and I'm  
15 reading from the trial transcript, "-- we are Lewis, we are  
16 not Exxon."

17 And then the previous page, "Instead, Your Honor, now  
18 I've alluded to it twice, the disposition we believe here is  
19 guided by the Lewis case."

20 Now, Lewis was also a case about facial  
21 discrimination. That was the case in which the Florida  
22 statute said that out-of-state banks could not provide  
23 investment services but in-state banks could.

24 That is not the situation we have here with 1131.

25 That was a clear case of facial discrimination, because

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1 out-of-state banks and in-state banks are similarly  
 2 situated. And I still have it up on the board, similarly  
 3 situated, in-state and out-of-state economic interests.  
 4 And the Florida statute that was struck down clearly  
 5 discriminated in favor of its in-state banks and against  
 6 out-of-state banks, because it allowed the former to do what  
 7 the latter could not.

8 Now, you don't have to take my word for this, because  
 9 the Fifth Circuit goes through this quite clearly in the  
 10 Ford case. And I very much recommend to the court, it is a  
 11 bounty in terms of deciding how this case should be  
 12 decided. And it does many things, and one of the things it  
 13 does is actually discuss Lewis. And this is on -- something  
 14 I printed out from West Law, but I believe it's 501, judge,  
 15 that it is on page 501 of the case.

16 And the court, Judge Benevides says, "At issue in Lewis  
 17 was a Florida statute prohibiting out-of-state banks, bank  
 18 holding companies, and trust companies from owning or  
 19 controlling a business within the state that sells  
 20 investment advisory services."

21 The Florida statute, here's the key, placed no similar  
 22 restriction on in-state banks, bank holding companies, or  
 23 trust companies.

24 So for this case to be Lewis, for Allstate to be Lewis,  
 25 we would have to have a much different statute than the one

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1 that is being challenged here.

2 HB 1131 would basically have to say out-of-state  
 3 insurance companies can't own car repair shops but we're  
 4 going to let our in-state insurance companies own car repair  
 5 shops.

6 Emphatically, Your Honor, Allstate is not Lewis. And I  
 7 think the Fifth Circuit opinion makes that very clear.

8 So if we're envisioning now a very short list with  
 9 facial discrimination as one, discriminatory purposes two,  
 10 and discriminatory effect as three, we can just scratch  
 11 facial discrimination off the list. Doesn't exist. There  
 12 is no evidence. It's decided as a matter of fact and law.

13 So we move to the next item, discriminatory purpose.

14 And, of course, when we talk about discriminatory  
 15 purpose, I think it's very clear to start with the  
 16 legislative history. And the most important documents, I  
 17 submit to this court, are the bill analyses.

18 Could we see Exhibit DX 243?

19 And because I know my time is limited here, I really  
 20 just want to do this.

21 Could we get a blowup at the top?

22 Just to remind the court that we went through with this  
 23 Senator Carona, and we showed the court that in these  
 24 documents, which were created at the time this bill was  
 25 moving through the legislature, all of the legislators and

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1 their representatives in the Texas legislature were saying  
 2 consistently that the problem, the purpose -- excuse me --  
 3 the purpose of HB 1131 is to eliminate that conflict of  
 4 interest, because -- and perhaps we can highlight this -- a  
 5 possible -- it's second line from the top -- a possible  
 6 conflict of interest could arise if an insurer paid for a  
 7 consumer repair -- for a consumer's repair work completed at  
 8 an auto repair facility owned by the insurer.

9 And the House Bill analysis is very similar, and that  
 10 is PX -- Plaintiff's Exhibit 5. And I want to emphasize  
 11 it. In fact, perhaps we could just pull it up very, very  
 12 briefly, and blow up the top.

13 Because these are the best documents to discern  
 14 legislative purpose. And at the very first line, "Under  
 15 current law an insurer's interest in repair facilities is  
 16 not regulated. Insurer-owned repair facilities may  
 17 eliminate checks and balances thereby compromising consumer  
 18 protections. A possible conflict of interest could arise if  
 19 an insurer paid for a consumer's repair work completed at an  
 20 auto repair facility owned by the insurer."

21 There was another document that I don't want to call it  
 22 up on the board simply because I want to use my time  
 23 wisely. It's Plaintiff's Exhibit 6. It's the house  
 24 research organization document that basically summarizes the  
 25 position of the respective interested parties on this bill,

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1 and that document is also very, very consistent in pointing  
 2 out that supporters of the bill believe that there's  
 3 potential conflict of interest and that unfair competitive  
 4 practices may result.

5 So when you look at the official legislative history,  
 6 it's always been clear that this is the purpose and intent  
 7 of HB 1131. It is not, as suggested by my learned colleague  
 8 in opening statement, that the lawyers for the intervenors  
 9 and the state went to some back room and came up with the  
 10 after-the-fact rationalization for this law. The  
 11 rationalization, the reason, the explanation has been  
 12 consistent throughout.

13 Then I think we move to, as we're looking at our  
 14 legislative history, the house floor debates, the house  
 15 committee hearing and the senate committee hearing. I don't  
 16 think it's necessary for us to pull them up. They are  
 17 Defendant's Exhibit 10, Defendant's Exhibit 2, and I believe  
 18 Defendant's Exhibit 4. Those are the transcripts that the  
 19 court has in evidence and all the parties have tried to put  
 20 these in and they are transcriptions of the floor debates  
 21 and the hearings.

22 And here's the point, judge. If the court reads those  
 23 documents in fairness and fully, in context, there is no  
 24 evidence, no evidence whatsoever, that any legislator ever  
 25 implied or suggested that the purpose was to discriminate

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1 against out-of-state economic interests.

2 All of their comments, so many of which have been just  
3 shamelessly taken out of context in Allstate's presentation,  
4 go to taking aim at insurer-owned repair shops. Allstate is  
5 being discriminated against as an insurance company, not  
6 because it's an out-of-state economic entity.

7 And these -- these comments just do not do justice to  
8 the truth in this case. And I will make the court a solemn  
9 promise that if it takes the time to read those transcripts  
10 in full, the court will conclude that there is no question  
11 that all of those comments go to protecting shops from  
12 insurance companies owning repair shops. And there is  
13 nothing wrong with that under the commerce clause. Nothing.

14 So if we look at all of the legislative history, we see  
15 that there is no evidence of discriminatory purpose, not a  
16 scintilla of evidence that there is discriminatory purpose.

17 As I said, the protectionist rhetoric of the  
18 legislators only goes to the issue of insurer ownership.  
19 The purpose is to discriminate against Allstate because it  
20 is an insurance company and not because it's out-of-state.

21 And, in fact, the evidence has showed that Allstate is  
22 not even out-of-state. I think that just sort of adds  
23 absurdity onto more absurdity that Allstate has several  
24 subsidiaries that are Texas corporations, so Allstate is a  
25 Texas corporation, as well as an out-of-state corporation,

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1 because they have many, many subsidiaries that are  
2 incorporated in the various states under the insurance laws  
3 of those many states.

4 Finally we have the testimony of Senator Carona, which  
5 was unimpeached. Senator Carona very carefully explained  
6 what the purpose was of HB 1131, and all of his testimony  
7 was consistent with the bill analyses, the legislative  
8 transcripts, the house research organization summary, and  
9 everything else, every other piece of credible evidence that  
10 was presented at this trial.

11 And so when we get to the end of this, and I'm still on  
12 discriminatory purpose, we go back to our imaginary list,  
13 the short list of the three ways that you can discriminate,  
14 and we can scratch off discriminatory purpose as well.  
15 There is simply no credible evidence, there is no -- there  
16 is not a scintilla of credible evidence that the legislators  
17 or anyone, anywhere, in any deposition, in any context, in  
18 any form, ever suggested that Allstate was going to be  
19 discriminated against because it was out-of-state and we  
20 wanted to protect our in-state insurance companies or  
21 in-state repair shops. It never happened.

22 And, again, I submit the court could just decide it as  
23 a matter of law because it's simply not controverted once  
24 the evidence is considered fairly and in its totality.

25 So that leaves us with discriminatory effect. Allstate

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1 has to show discriminatory effect because it clearly cannot  
 2 show the other two. We're on the third type of  
 3 discrimination that the plaintiff would have to prove up if  
 4 it's going to show that the statute is in fact  
 5 discriminatory and get that strict scrutiny, which is very  
 6 hard for the state laws to pass.

7 The first question I think the court needs to ask with  
 8 respect to discriminatory effect is how is such an effect  
 9 even possible under the neutral language of HB 1131. Where  
 10 is the effect.

11 Now, the plaintiffs rely very heavily on the McNeilus  
 12 case, and that was a discriminatory effects case. But,  
 13 again, their reliance is misplaced, because in McNeilus  
 14 there was a clear showing of discriminatory effect. And it  
 15 was very clear, even though the language in the state law  
 16 that was being challenged was neutral, there was other  
 17 evidence adduced that showed that in fact the law had a  
 18 discriminatory effect.

19 And I'm reading now from page 442 of the Lewis case.  
 20 "The McNeilus court says on its face Ohio statute is neutral  
 21 in application." I just said that to the court. "Whether a  
 22 manufacturer is located --" in this case it was truck  
 23 remanufacturers, "-- is located within the state of Ohio or  
 24 outside of it, it must comply with the state's requirements  
 25 to obtain a license."

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1 But here is the key, judge, and I'm quoting, "Looked at  
 2 more closely, however, the statute has a discriminatory  
 3 effect. As McNeilus urges, --" the plaintiff challenging  
 4 the state law, "-- the binding agreements that the statute  
 5 requires it to obtain from local dealers are much harder for  
 6 an out-of-state remanufacturer to obtain. As the statute's  
 7 drafters surely recognize, in-state truck chassis dealers  
 8 stand to gain nothing from signing binding agreements with  
 9 companies like McNeilus, because such companies do not buy  
 10 their chassis from Ohio dealers." They buy them  
 11 out-of-state. "In contrast, in-state remanufacturers who do  
 12 buy their chassis from those dealers will have no problem  
 13 satisfying the licensing requirement."

14 And so if the court takes a close look at McNeilus, I  
 15 think it will agree with the intervenors and the state that  
 16 Allstate's reliance on McNeilus is terribly misplaced.

17 As I was saying, under the language of the statute how  
 18 can the discriminatory effect even be possible.

19 It's clear that any auto repair shop can come into  
 20 Texas. It could be a small one. It could be a group of  
 21 shops. It could be huge. It could be Wal-Mart giving, as I  
 22 gave as my example on my opening statement, car repair  
 23 centers adjacent to every store it owns in the State of  
 24 Texas. Actually nothing prohibits it.

25 And not only can big companies and small companies that

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1 repair cars enter the Texas market, they're already here.  
 2 As Mr. Vandergriff testified, and as Mr. Walne testified,  
 3 and even as Bob Thompson testified, who was Allstate's  
 4 witness, these companies are already here in Texas. And  
 5 some of these larger repair networks and chains are VT,  
 6 Inc., Automotive Investment Group, AutoNation, Sonic, the  
 7 Boyd Group, Car Star, Maaca. Judge, they're already here.  
 8 There are chains who are trying to achieve the economies of  
 9 scale and centralized administration that Allstate touts in  
 10 its business model.

11 And, judge, this is a very, very clear, or very, very  
 12 important point on discriminatory effect. And that is  
 13 because of a question that the court asked Mr. Starr in  
 14 opening statement that was extremely apt, and I'll explain  
 15 why.

16 I'm again reading from the trial transcript. This is  
 17 on page 67 of volume 1. I'm going to see if this can --

18 Can we have the ELMO, please?

19 If we can get some better results here.

20 Well, Judge, tell me if you can't see that. I have a  
 21 hard time seeing it. But I've underlined --

22 THE COURT: I can see it.

23 MR. HOHENGARTEN: Okay. "The court: Are you  
 24 ready to admit that there's -- and don't do it if you don't  
 25 want to -- if there were other national competitors,

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1 interstate competitors, that would be able to step in the  
 2 gap and be competitive in this market of repair, but it just  
 3 kept you out, then it would be like the Exxon case?"

4 And Mr. Starr says, "Well, it would be more similar,  
 5 but it wouldn't be exactly like it."

6 And I probably would have answered the same way.

7 But the court persists. The court then goes on to  
 8 basically give a grocery example. And the courts says  
 9 "Let's say the grocery men in the country are upset over  
 10 Wal-Mart going into the grocery business and there's some  
 11 statute passed that Wal-Mart can't sell groceries. I don't  
 12 know how you do it, but assume that they do."

13 And the court goes on, "But on this particular ground  
 14 you would have national interstate commerce, whether it is  
 15 Safeway or whether it is some other national grocery chain  
 16 that's there that would be -- that would be more like Exxon,  
 17 wouldn't it?"

18 And then Mr. Starr answers, and unfortunately it's on  
 19 two pages, but Mr. Starr says, "It would be more like Exxon,  
 20 and because it would be another out-of-state competitor  
 21 prepared to step in."

22 And then later Mr. Starr says, "But what we also know  
 23 is the market structure here there is no -- and that was our  
 24 PDX showing the fence around Texas --" which we have all  
 25 seen many, many times in this trial, "-- there is no

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1 Safeway, as it were, ready to come in. There is no Shell or  
2 Texaco, if you will."

3 The point being this is not Exxon, because Exxon said  
4 other interstate competitors would be active if Exxon wasn't  
5 allowed to directly own the filling stations.

6 The point I'm trying to make here, judge, is obvious.  
7 There are other interstate competitors, in Texas, and around  
8 this country, that could step in, if Allstate as an  
9 insurance company is not allowed to own auto repair  
10 facilities.

11 Most emphatically it does not --

12 You can turn the ELMO off now.

13 It does not result in a situation where there is no  
14 other interstate firm to pick up or fill in the gap.

15 So with regard to discriminatory effect, all we're left  
16 with, really, is the speculative testimony of Allstate's  
17 expert, Mr. Harrington. That's it. That's the only thing  
18 in evidence. And Mr. Harrington speculates that if Sterling  
19 leaves the market then those lost sales of services and  
20 parts will go to intrastate providers of those services and  
21 those parts.

22 But I think as Mr. House so clearly showed, that is  
23 pure speculation. Nobody knows. Nobody knows. And there's  
24 no evidence showing where these lost sales will go if HB  
25 1131 is upheld. It will simply be a function of the

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1 market. It will have absolutely nothing to do with HB  
2 1131.

3 It is just as likely that the Sterling business could  
4 go to an interstate competitor as to an intrastate  
5 competitor. And, in fact, it is more likely, based on  
6 common sense, that the lost sales would go to an interstate  
7 competitor, because if Allstate decides to spin off  
8 Sterling, to sell it, it is almost surely going to be a big  
9 company, like AutoNation or Sonic, with a lot of capital,  
10 that will come in and purchase these stores, so that the  
11 interstate presence would be even greater at the end.

12 Now, I can see judge that's one scenario. There could  
13 be others. But the point is we don't know. There is a  
14 series of contingencies. There is the fluidity of the  
15 market. And no one can say -- and this is just common  
16 sense: No one can say that the end result of upholding 1131  
17 would be that the business Sterling is doing would be going  
18 primarily or predominantly to intrastate firms. It is pure  
19 speculation and it is far, far, far from that which would be  
20 needed to invalidate a state law which was passed and signed  
21 into law by the duly-elected legislature and governor.

22 Furthermore, I think Dr. Harrington's analysis misses  
23 the point entirely, even setting aside the speculative  
24 problems. The issue, as shown by the Exxon case is the flow  
25 of goods and services across state lines.

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1 And Dr. House, who's testimony -- excuse me, Mr.  
 2 House -- Dr. House said that for an economist the practical  
 3 test is are goods moving across state lines, because  
 4 Mr. Starr is correct, we are a national market, and we're  
 5 much stronger because we're a national market. And we don't  
 6 want to just protect parochial interests, because that is  
 7 bad economic policy, so we want goods to be able to flow --  
 8 goods and services to be able to flow into this state just  
 9 as easily as goods and services are generated intrastate,  
 10 and that makes sense.

11 But when you start looking at the correct issue, which  
 12 is flow of goods, and Exxon -- the Exxon case teaches this,  
 13 Allstate's argument breaks down entirely.

14 There will be no effect on the flow of goods and  
 15 services in this case if HB 1131 is upheld.

16 And let me explain to the court why, and it's something  
 17 that Dr. House said earlier and I will just remind the  
 18 court.

19 What are we talking about here?

20 What is the reality of what is happening on the ground?

21 We are talking about car repair. And it is not  
 22 disputed in this record, and it is simply a matter of common  
 23 sense that people go to have their car repaired because it's  
 24 near their house.

25 Now, they may be willing to drive five miles and in

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1 some cases they may even be willing to drive ten miles, but  
 2 they're going to go to some place that is convenient to  
 3 where they live and work.

4 And so the services that are provided are never going  
 5 to be provided across state lines, except in very marginal  
 6 cases, where we have Texans who are living on a border with  
 7 some other state, but I think the court would agree that  
 8 that's simply not material.

9 In the vast majority of cases people are going to go  
 10 to -- to -- to obtain these services are going to go to  
 11 whatever store is close by and that's where the service will  
 12 be provided.

13 But let's move to goods, that is the parts that are  
 14 used to fix the car. Again, no impact on the flow of goods  
 15 from out-of-state at all, whether you're an interstate  
 16 competitor or an intrastate competitor. Whatever your  
 17 situation is, many parts will continue to flow into the  
 18 state from out-of-state and some parts will be acquired in  
 19 Texas, and that will happen because of market forces and not  
 20 because of anything HB 1131 says.

21 So when we examine this from the correct perspective of  
 22 flow of goods and services and not as Dr. Harrington would  
 23 suggest, the label of whether a company is in fact  
 24 out-of-state or in-state, I think Allstate's case, its  
 25 effort to prove up discriminatory effect becomes tenuous to

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1 the point of again being an issue that could be decided as a  
2 matter of law. There is simply no evidence - unless you  
3 want to treat -- unless Your Honor wants to treat  
4 Dr. Harrington's speculative testimony as evidence - that  
5 there is a discriminatory effect on interstate commerce.

6 So now we scratch off the third -- if we go back to our  
7 imaginary list, the third way that a plaintiff can prove up  
8 discrimination, and that is discriminatory effect.

9 THE COURT: You've used 40 minutes.

10 MR. HOHENGARTEN: Excuse me?

11 THE COURT: You've used 40 minutes.

12 MR. HOHENGARTEN: Oh, my. Okay.

13 Regarding the Pike balancing test, as I noted earlier,  
14 it is so important which test you go under, because as Judge  
15 Benevides noted, you know, it's virtually dispositive of the  
16 case.

17 Discrimination you get strict scrutiny.

18 If, however, it is nondiscriminatory, then you go to  
19 the Pike test. And I'm going to bring back up slide 7.

20 Now we're back to the Pike test. And I said that the  
21 Pike test is one that the states, quite handily, almost  
22 always meet. And what I meant by that is that we have to --  
23 we have to pick this language apart a little bit. And let's  
24 start by "putative local benefits."

25 What are putative local benefits?

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1 Could we see slide 12, please. No, that's not it.

2 Let me try again. Could we see slide 8.

3 Let's try slide 12 again. No. Just a moment, judge.

4 THE COURT: Sure.

5 MR. HOHENGARTEN: Okay. Here we go. I think  
6 we're back on track.

7 And this is key. Remember, this is part of the Pike  
8 balance, putative local benefits versus clearly excessive  
9 burden on commerce.

10 "Consistent with the use of the term putative in the  
11 Pike balancing, this court will not second-guess the  
12 empirical judgment of lawmakers concerning the utility of  
13 this legislation."

14 So we basically have a rationality test. The court  
15 does not go behind the legislation and try to figure out  
16 whether or not in fact the legislation is as effective as  
17 the legislators thought. It doesn't try to second-guess the  
18 weighing of the information that was before the legislature  
19 when it made its determination that the statute would be  
20 passed.

21 And, again, as I told the court, Ford really is the  
22 bounty for figuring out how to decide this case, because  
23 Ford also gets into the issue of what exactly the courts are  
24 supposed to do when they look at putative local benefits.

25 I don't think it's going to help to put this on the

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1 ELMO, so I will just read. Here Judge Benevides is quoting  
 2 from Kassel versus Consolidated Freightways Corp., and  
 3 Justice Brennan authored that case, and he said in  
 4 determining those benefits, that is putative local benefits,  
 5 a court should focus ultimately on the regulatory purposes  
 6 identified by the lawmakers and on the evidence before or  
 7 available to them that might have supported their judgment.

8 Now, this is key because this is the standard review  
 9 and this is why it's too easy to meet the Pike balancing  
 10 test.

11 I'm quoting again: Since the court must confine its  
 12 analysis, the court must confine its analysis to the  
 13 purposes the lawmakers have for maintaining the regulation,  
 14 the only relevant evidence concerns whether lawmakers could  
 15 rationally have believed that the challenged regulation  
 16 would foster those purposes. It is not the function of the  
 17 court to decide whether, in fact, the regulation promotes  
 18 its intended purpose, so long as an examination of the  
 19 evidence before or available to the lawmakers indicated that  
 20 the regulation is not wholly irrational in light of its  
 21 purposes.

22 Now, think about that for a minute.

23 What the court needs to do is look at what the  
 24 legislature was looking at and look at the purposes of the  
 25 statute, the stated purposes. And we've gone into that time

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1 and time again, conflicts of interest, preventing unfair  
 2 competitive practices. And then the court has to decide  
 3 that the regulation the legislature came up with is not  
 4 wholly irrational in light of its stated purposes.

5 That is why I said, and that is why Judge Benevides in  
 6 Ford says, the standard of review is everything. If the  
 7 statute doesn't discriminate it gets a very, very lenient  
 8 treatment under the Pike balancing test. And part of the  
 9 reason for this is because of the putative local benefits,  
 10 part of the analysis that is -- if the law is correctly  
 11 applied, it is very, very easy for the states, generally  
 12 speaking, to meet that standard of review.

13 THE COURT: That's page what?

14 MR. HOHENGARTEN: Oh. It's 503 and 504 of 4.

15 And then -- and this is slide 8 -- we have, as in Ford,  
 16 the state's asserted purposes to prevent vertically  
 17 integrated companies, purposes going back to what Judge  
 18 Brennan was saying, to prevent vertically integrated  
 19 companies from taking advantage of their incongruous market  
 20 positions and to prevent frauds, unfair practices,  
 21 discrimination, impositions, and other abuses of our  
 22 citizens' are legitimate state interests.

23 And some of these legitimate state interests asserted  
 24 by state in Ford have been asserted in this case as well and  
 25 they have been present from the very, very origins and

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1 beginnings of HB 1131. So that disposes of putative local  
2 benefits. But then we get to the next part of the test.

3 And if I could see slide 7 again. Again the Pike  
4 balancing test. The statute is going to be upheld unless  
5 the burden imposed on such commerce is clearly excessive,  
6 clearly excessive in relation to the putative local  
7 benefits.

8 So we're not talking -- we don't think there is any  
9 burden here, no burden on interstate commerce. But even  
10 assuming for the purposes of argument that some burden was  
11 shown, clearly that burden cannot be, as in the Pike  
12 balancing test, clearly excessive in relation to the  
13 putative local benefits.

14 There are simply -- there is simply little to no  
15 evidence that there would be a clearly excessive burden, for  
16 all of the reasons that Dr. House pointed out in his  
17 testimony and for some of the reasons I've alluded to in my  
18 closing argument, that is, there are interstate competitors  
19 in Texas who could fill the gap.

20 I believe Judge Starr's statements that there was no  
21 Safeway in this case or Texaco or Shell was inaccurate.  
22 There are interstate competitors.

23 But perhaps most importantly it goes back to the flow  
24 of goods issue and the flow of services issue. That is what  
25 the U.S. Supreme Court is concerned about in the Exxon

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1 case. We don't want state law barriers that prevent the  
2 flow of out-of-state goods and services. We want  
3 competition because that is better for the economy. We want  
4 a healthy market. We want to see competition, and we want  
5 to see competition across state lines.

6 HB 1131 has no effect on that whatsoever. The only  
7 thing HB 1131 does is Allstate cannot expand its stores  
8 because it is an insurance company. Every other entity who  
9 is a noninsurer can build a greenfield, acquire shops,  
10 consolidate, do whatever they think is in their best  
11 economic interest. The issue of whether Allstate can do  
12 this is simply a matter of ownership. It has nothing to do  
13 with the provision of goods and services across state  
14 lines. It simply has to do with whether Sterling is going  
15 to be owned by an insurance company or if Allstate chooses  
16 to divest because its model is not working, or for whatever  
17 reasons, Sterling will presumably be owned by some other  
18 entity and will be providing exactly the same services and  
19 providing the same parts which come partially interstate but  
20 also across state lines. And there will be no effect on  
21 commerce whatsoever. At most there would be the very  
22 incidental effect, which the court has made clear, still  
23 takes to you the Pike balancing test.

24 If the statute regulates evenhandedly, meaning it's not  
25 discriminatory, and its effects on interstate commerce are

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1 only incidental, so there can be some of that, it just has  
2 to be incidental, it will be upheld unless the burden  
3 imposed on such commerce is clearly excessive. I don't see  
4 how you get to clearly excessive when there hasn't been a  
5 credible showing there is going to be any burden on  
6 commerce.

7 Allstate presently is the only company that was doing  
8 this. We have Caliber, but some murkiness about what  
9 percentage of ownership is by Zurich Farmers. But for the  
10 purposes of this trial we have Allstate and we have its 15  
11 stores. How can we believe for a minute -- how can any  
12 reasonable person conclude that HB 11's effect on Allstate  
13 and its Sterling stores in Texas would have a clearly  
14 excessive burden on interstate commerce?

15 Any burden, and this is assuming for the purposes of  
16 argument that there is a burden, would be incidental,  
17 immaterial.

18 And I urge the court very, very much to simply review.  
19 I know the court will, but I want to emphasize it in my  
20 closing argument, the testimony of Dr. House, because I  
21 think his testimony really shows why there is no burden on  
22 interstate commerce, much less a clearly excessive burden.

23 How much time do I have left?

24 THE COURT: Let's see, seven minutes.

25 MR. HOHENGARTEN: Seven minutes?

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1 I think it's important to talk a little bit about  
2 severability and the First Amendment issues. And I'll try  
3 to do so quickly.

4 I think severability can be covered fairly easily. All  
5 the court needs to do is refer to section 311.031 in the  
6 government code. It's the -- the code construction act, and  
7 it goes directly to severability of the statutes.

8 Again, I don't think we're going to have much luck  
9 because this machine is not letting me zoom in, but if we  
10 can see the ELMO again.

11 Yeah.

12 THE COURT: I can read it.

13 MR. HOHENGARTEN: Oh, good.

14 Well, as the court can see, if any statute contains a  
15 provision for severability, then the provision prevails in  
16 interpreting that statute.

17 So if HB 11 said it was severable then that would  
18 prevail, but here all the parties agreed HB 1131 doesn't say  
19 anything about severability, so that's why we're here  
20 deciding what to do when the statute is silent.

21 B just goes on to say if the statute provides a  
22 provision for nonseverability then that provision prevails.

23 But C is really the key. In a statute that does not  
24 contain a provision for severability or nonseverability, any  
25 provision of the statute or its application to any person or

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1 circumstances -- excuse me -- if any provision of the  
2 statute or its application to any person or circumstance is  
3 held invalid, the invalidity does not affect the other  
4 provisions or applications of the statute that can be given  
5 effect without the invalid provision."

6 So what we have in the government code is the  
7 presumption of severability as long as the provision that's  
8 being struck down can go away while still giving effect and  
9 coherence to the remaining provisions.

10 And here I would submit that is exactly the case,  
11 judge, because I think it's born out most plainly by the  
12 court's own preliminary injunction. The court has  
13 enjoined - we, of course, hope the court will vacate that  
14 injunction - four provisions in the code of conduct. But  
15 enjoining those four provisions did not in any way  
16 compromise, and this is the key, HB 1131's general  
17 prohibition against insurer ownership of auto repair shops.  
18 That is the entire thrust of the statute. That is really the  
19 key policy that is being implemented: Insurance companies  
20 can't own auto body shops.

21 I'm going to choose my words very carefully here, but  
22 it would be absurd for the court to strike down the entire  
23 statute and say it's now a free-for-all again simply because  
24 it decided that it was going to convert its preliminary  
25 injunction into a permanent injunction with respect to those

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1 four provisions in the code of conduct.

2 We submit that --

3 THE COURT: You picked that word carefully?

4 (Laughter)

5 MR. HOHENGARTEN: Well, Mr. Starr said it, so I  
6 was inspired to say I'm choosing my words carefully.

7 THE COURT: I'll enjoy reading those kind of words  
8 by one side or the other. Whoever I rule against I'm sure  
9 will go the court's absurd ruling --

10 MR. HOHENGARTEN: Absurd is a truly a blunt  
11 instrument, but --

12 THE COURT: Okay.

13 MR. HOHENGARTEN: -- I think the court sees my  
14 point.

15 THE COURT: I do. I understand your point.

16 MR. HOHENGARTEN: Because companies like Allstate  
17 then would have as their goal, if they think they might end  
18 up challenging the law if the bill gets passed, of getting  
19 in there some provision that's unconstitutional. So then  
20 they can challenge it and say now the whole statute has to  
21 fall because it's not really severable.

22 THE COURT: I don't say I understand this, Mr.  
23 Hohengarten, but I've struggled with the Code Construction  
24 Act on my years on the Court of Appeals.

25 MR. HOHENGARTEN: Yes. Well, if you don't, then

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1 I'm just not being clear.

2 All I'm saying is that the four provisions the court  
3 has enjoined, which are under the code of conduct, which is  
4 of course tied to the grandfather clause --

5 THE COURT: You're saying those are clearly  
6 severable --

7 MR. HOHENGARTEN: From the general provision of  
8 preventing insurer ownership.

9 And moreover, to the extent there would be any further  
10 invalidity as a result of a severability issue, clearly what  
11 the court would want to sever is the grandfather clause.

12 That is the part that's really integral to the code of  
13 conduct, not the general prohibition.

14 The court will recall the grandfather clause is what  
15 allows Allstate to do what no other insurance company can  
16 do, but in return for that special status, it gets

17 grandfathered in because it already owned shops or had  
18 broken ground by a state certain, it can keep its shops but  
19 it is subjected to a code of conduct which only applies to  
20 an insurance company that meets the exception.

21 THE COURT: So I want to make sure I understand  
22 that.

23 The grandfather clause is linked to the code of  
24 conduct?

25 MR. HOHENGARTEN: Yes. But the general

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1 prohibition is not.

2 THE COURT: So if I ruled your way, make sure I  
3 understand this -- if I happened to find that -- that the  
4 general prohibition was okay and I thought that the code of  
5 conduct was bad, and threw it out, then I would also throw  
6 out the grandfather clause, which meant Allstate couldn't  
7 own anything?

8 MR. HOHENGARTEN: Correct. Now, we don't think --

9 THE COURT: That's a very, very adroit argument.  
10 I have to tell you that.

11 MR. HOHENGARTEN: Thank you.

12 THE COURT: That's a very unique argument. So you  
13 get what you want either way?

14 MR. HOHENGARTEN: I'm hoping to.

15 THE COURT: Okay. No matter how I go and no  
16 matter how I enter the maze, I come out looking at you?

17 MR. HOHENGARTEN: That's correct, judge.

18 THE COURT: Okay. I want to make sure.

19 MR. HOHENGARTEN: But I'm hoping that, but we'll  
20 see if that's --

21 THE COURT: Actually I hadn't thought through  
22 that, but that's an interesting argument.

23 MR. HOHENGARTEN: If I could take a couple of  
24 minutes on the First Amendment issue.

25 THE COURT: No, but you can -- I'll give you a

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1 couple of minutes. Go ahead.

2 MR. HOHENGARTEN: I'll endeavor to be very, very  
3 brief.

4 We don't think that those four -- we still submit to  
5 the court that those four provisions are constitutional  
6 under the First Amendment. So I want to be very clear about  
7 my position with respect to severability. We believe the  
8 court should vacate the injunction.

9 THE COURT: Don't misunderstand. I don't think  
10 you're giving anything up at all. You want me to correct my  
11 prior, quote, absurd, end quote, ruling, and correct that  
12 and go down the line with you. I understand that.

13 MR. HOHENGARTEN: But we do want the judge to  
14 vacate for this reason. When we were at the preliminary  
15 injunction hearing we at that time conceded that the speech  
16 was not misleading because discovery was in its infancy. We  
17 had just started into written discovery. At the time of the  
18 preliminary injunction hearing the state and intervenors had  
19 only deposed two Allstate witnesses, Mr. Daly and  
20 Ms. Mazanec, and we didn't have any evidence of misleading  
21 speech.

22 Now, at the completion of discovery and at this trial  
23 we do have that evidence, and that evidence is in the  
24 cross-examination of George Ruebenson by Mr. Powell. And  
25 here is the evidence.

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1 The problem is that Sterling has brownfield stores  
2 which Allstate's own employees, namely Kathy Mazanec have  
3 subjected to withering criticism, they're terrible stores.

4 And the legacy stores as they all call them now are  
5 brownfield stores. And those are old stores that were  
6 acquired by Allstate when they acquired Sterling.

7 The script that is in evidence does not make any  
8 distinction between a brownfield store and a greenfield  
9 store.

10 If you are an Allstate customer in Houston, you are  
11 told to go to a Sterling store, even though Sterling's own  
12 top management knows that there are very, very serious  
13 problems with those stores.

14 THE COURT: Okay. I understand that argument.

15 MR. HOHENGARTEN: Okay. And that's basically it,  
16 that they have failed all these stores, that there have been  
17 withering criticism in internal documents. They know what's  
18 going on. They are very honest with themselves internally.  
19 They never, ever tell that to the consumer.

20 THE COURT: All right. I understand that.

21 MR. HOHENGARTEN: The second point I will make is  
22 it is a situation much like Ohralik, which the intervenor  
23 cited in their posttrial brief, that is subject to -- excuse  
24 me -- inherently subject to abuse. And here is why.

25 This whole process starts when an Allstate policyholder

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1 has an accident. There's been a wreck. There's been an  
 2 accident. Allstate knows that most of the time its  
 3 policyholder is going to call Allstate, perhaps its  
 4 insurance agent or perhaps a claim center, and want to know,  
 5 first thing on the cell phone, am I covered, I've just had  
 6 an accident, is my insurance going to be there to protect  
 7 me. And that is when Allstate moves in with the hard sell  
 8 as far as recommendations, because they are having a  
 9 conversation with that consumer, that policyholder regarding  
 10 coverage.

11 And then the issue becomes, well, where do I take my  
 12 car to have it fixed. And Allstate suggests one option, and  
 13 one option only, and that is Sterling. Now, yes, the script  
 14 shows that they use the magic language, "you're free to  
 15 choose," but they only mention Sterling. And, again, when  
 16 it's an insurance agent there's that relationship of trust.

17 Here is the important part, judge. There is nobody  
 18 else in on this conversation. Just like in Ohralik, this is  
 19 a private conversation going on between an Allstate  
 20 policyholder and an Allstate employee at a claims center or  
 21 an Allstate insurance agent. And we know, the evidence is  
 22 so clear, that Allstate has been desperately trying to move  
 23 up its assignment numbers so that it can get the volume it  
 24 needs to run the Sterling stores profitably.

25 THE COURT: Okay.

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1 MR. HOHENGARTEN: And that is why we believe these  
 2 provisions are constitutional because they really do simply  
 3 compel Allstate to tell the whole story and say that there  
 4 are these other PRO shops which are on Allstate's own list.

5 Allstate doesn't have to have a shop as a PRO shop if  
 6 it doesn't think it meets the standards --

7 THE COURT: Okay. I gave you too much time.

8 MR. HOHENGARTEN: Okay. I'm sorry, judge. I  
 9 didn't mean to cross the line. I'll sit down now.

10 MR. POWELL: Your Honor, may I just hand up the  
 11 slides I was going to hand up on the McCarran-Ferguson Act  
 12 and then I won't make the argument?

13 THE COURT: Whatever argument you were going to  
 14 make he made.

15 MR. POWELL: Yeah. That's right. He didn't touch  
 16 on the McCarran-Ferguson Act, if I can just hand up my  
 17 slides.

18 THE COURT: You can hand them to him and I'll get  
 19 them after the argument.

20 MR. POWELL: That will be fine.

21 THE COURT: That will be fine.

22 MR. SMITH: Your Honor, severability, government  
 23 code, 311.031, the Texas Supreme Court in Kirby expressly  
 24 applied that section and so the Kirby analysis is in fact  
 25 the governing analysis taking that part of the government

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1 code into account.

2 With respect to commercial speech, Ohralik and the  
3 like, the State of Texas now stands here and says that  
4 Allstate is just like a lawyer who is violating the most  
5 fundamental precepts of the legal profession in terms of  
6 solicitation and solicitation of people in the most  
7 vulnerable position.

8 With all due respect to the Assistant Attorney General,  
9 I believe his argument is extreme and I would guide the  
10 court not to accept it. It would I believe fall terribly  
11 into error to compare Allstate with its history of  
12 compliance with the law with a lawyer who was skating on the  
13 edge at a minimum of serious sanctions and perhaps of  
14 sanctions of the most important kind. This case is not  
15 Ohralik, and we have a slide that indicates that.

16 The idea that a policyholder is as vulnerable as an  
17 18-year-old young lady sitting or lying in her hospital bed  
18 with some lawyer coming in saying hire me, is, shall I quote  
19 Chief Justice John Marshal, too extravagant seriously to be  
20 maintained. But we've heard it here, and I'm disappointed  
21 that the State of Texas thinks that of Allstate, that  
22 because Allstate would like Sterling to succeed, and we have  
23 here our slide, which is PDX 1006, that we would violate a  
24 law that's already on the books, Your Honor.

25 What he just said is they're going to be tempted -- and

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1 we heard that from Dr. House today. So let's just call it  
2 what they're calling it. You're going to violate, Allstate,  
3 the anti-steering statute. Total speculation, as well as a  
4 remarkable -- and I think we now understand something that's  
5 very fundamental here.

6 His view of interstate commerce is a view that have  
7 been discredited, and Dr. House's view has been discredited  
8 in jurisprudence for 60 years now, and it certainly has been  
9 discredited in terms of you must draw an express line, a  
10 line that says, Texas versus Oklahoma, or Texas versus  
11 everyone else. That's not the law.

12 I'm going to come to Ford, which is essentially their  
13 case. If they lose on Ford, and they do, they have lost  
14 with respect to dormant commerce clause.

15 I quote from Hunt versus Washington State Apple. And I  
16 think the state and intervenors have no answer for this.

17 Could you pull up PDX 1037, please.

18 You don't have to draw the fence in the express way  
19 that both Dr. House and I think General Hohengarten are  
20 suggesting, because there it is, the second bullet, Your  
21 Honor, goes directly to the core of their argument, a  
22 facially neutral law - that's what they're saying, it's  
23 facially neutral - reveals its true discriminatory purpose  
24 and effect even if not all interstate firms are caught  
25 within its net.

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1 Now, Your Honor, I think the point here is they're  
 2 saying Allstate is a Texas company as well. Surely they  
 3 can't be serious. Surely if they thought that our  
 4 headquarters in Northbrook Illinois were situated here in  
 5 Dallas, that Allstate would have been treated the way it was  
 6 treated in Austin, I think is fanciful. This is not  
 7 Connecticut. This is not Nebraska. This is not Nashville,  
 8 Tennessee, the home of large insurance companies.

9 The point is they are -- the logic of their position is  
 10 we don't care if they're all out of state, because we get to  
 11 draw a line that just says insurance companies, it doesn't  
 12 matter whether they're -- where they are in fact  
 13 headquartered.

14 And that's what Justice O'Connor was getting at and  
 15 what we talked about in our virtual representation slide in  
 16 our opening that emphasizes the vital importance in a  
 17 federal court to bear in mind the relative power  
 18 politically - and there it is, South Central Timber, PDX  
 19 1200 - of the fact that those being affected are  
 20 predominantly out of state. Of course they do business  
 21 here; otherwise, we wouldn't be in court here.

22 Large companies may have subsidiaries, but Allstate is  
 23 Northbrook, Illinois. State Farm is, you know, Omaha,  
 24 Nebraska. No, it's not. It's in Bloomington, Indiana.

25 And that's a very critical point. Who has power.

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1 We're talking about political power here. And we know that  
 2 the body shops exercised an enormous amount of clout in  
 3 Austin and that's why it's important for the court to be  
 4 aware not of politics in the raw since but in the  
 5 jurisprudential and constitutional sense, that that is why  
 6 it falls to the court to protect against exactly this sort  
 7 of thing.

8 I want to say a word to switch back to the ingenious  
 9 argument, I view it as not ingenious but remarkable, that  
 10 the General would actually suggest the death penalty, and I  
 11 would simply guide, with respect to Allstate, so strike out  
 12 the grandfathered provisions, and certainly that would come  
 13 as a bit of a surprise to the lieutenant governor, who when  
 14 I was at Sam Houston High School and studying the Texas  
 15 Constitution, one of the things that we learned is that the  
 16 lieutenant governor is very important, and he said no. He  
 17 said no in terms of divestiture. So now the Assistant  
 18 Attorney General of the State of Texas, representing Greg  
 19 Abbott, is saying that he now wants the court to tell  
 20 Allstate to get out of Texas.

21 Now, his basic concern, I think, I'll come to  
 22 commercial speech, if the court will permit me, is this is  
 23 Ford, if you just stay with the Ford case as well -- and I  
 24 want to first pull up PDX 1094 and guide the court to the  
 25 distinctions between the Ford case and the Allstate case,

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1 and then -- and so that's there, PDX 1024, we summarize the  
2 distinctions, we would guide the court in particular to the  
3 lack of access and to no prompt replacement, which is a very  
4 important point.

5 Your Honor, Mr. Hohengarten has essentially invited the  
6 court to engage in speculation, as opposed to staying with  
7 the facts of record.

8 Could we call up PDX 1099?

9 These are the potential, quote, competitors, but the  
10 testimony remained speculative as opposed, and there they  
11 are, Abra, Boyd Group, AutoNation, and all the way down to  
12 Caliber. No evidence in this record with respect to present  
13 intent or availability or ability to in fact enter the Texas  
14 market and to pursue a greenfield strategy. No one has the  
15 greenfield strategy. This is unique.

16 So I think Mr. Hohengarten's arguments are with all  
17 respect entirely theoretical. Namely, well, something could  
18 happen. Lightning could strike, and someone would come up  
19 with the same idea.

20 But there's a fundamental flaw in his analysis. He  
21 overlooked the reason that Allstate, an innovator in this  
22 industry, has said we want to move into this area, and that  
23 is to realign the incentives, the five billion dollars in  
24 cost and see if we can't address the issue that is endemic  
25 to the industry, and that is waste in the system.

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1 With respect to Pike and Ford, I think there's a  
2 fundamental misunderstanding here as to what Pike involves.  
3 Pike -- I think Mr. Hohengarten, and the transcript will  
4 reveal this, has essentially said, and this is my  
5 characterization but I don't think it's unfair, that Pike is  
6 essentially toothless but extremely deferential.

7 That's not the law. He's essentially saying if you  
8 move into Pike territory you sort of automatically uphold  
9 the law. That is not so.

10 I'm now quoting from Pike, which applying by definition  
11 the Pike analysis struck down the Arizona statute.

12 And why did it strike down the Arizona statute?

13 Among other things, it imposed a straitjacket. That's  
14 Pike language. That's not discrimination language.

15 In addition, and this is something that I think my  
16 brother on the other side has not taken into account at all,  
17 because this is right on point, the necessary -- this is  
18 Justice Stewart for a unanimous court, "The necessary  
19 tendency of the statute which does not discriminate is to  
20 impose an artificial rigidity on the economic pattern of the  
21 industry."

22 What the court knows from this testimony is there will  
23 not be an expansion nationwide to 300 greenfield facilities  
24 if HB 1131 is upheld. That is a very significant burden.  
25 And the idea that somehow interstate commerce is not

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1 affected by this is an argument that I think just defies  
2 comprehension.

3 Interstate commerce is exactly what Allstate and  
4 Sterling are engaged in, and this is an attack on a  
5 particular business model.

6 Their point is, well, maybe, just maybe someone could  
7 come in, but could is not good enough. This is not  
8 government work. This is the Constitution of the United  
9 States.

10 Discrimination. It's okay to discriminate because  
11 you're an insurance company, and we're targeting all  
12 insurance companies.

13 Do I have any time available?

14 THE COURT: You've still got some time.

15 MR. SMITH: Thank you.

16 I cannot leave this podium, with the court's indulgence  
17 that is, without saying that if this -- and this is  
18 repetitive, but it's so important in light of what we just  
19 heard. If this were the home in the seat of insurance  
20 companies, can you imagine this law, and I'm asking the  
21 court to speculate, being passed.

22 I don't think so. I don't think the Illinois  
23 legislature is about to pass such a law. There is no need  
24 for it in Illinois. There is no need for it in Texas. It's  
25 been rejected everywhere but in Texas. And only here.

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1 And why?

2 Because of the power of this particular community. And  
3 it just is ignoring this extraterritorial effect. Not a  
4 word about that, not a word from Mr. Hohengarten, and yet  
5 that's part of the law.

6 Now, PX 6.

7 THE COURT: Couple of minutes.

8 MR. SMITH: Yes. Thank you, Your Honor.

9 A conflict of interest could arise. He used this. He  
10 also referred to PX 5 to the same effect. But PX 6 is not  
11 only speculative, could, there is no analysis of alternative  
12 laws on the books that do service, that carry out the office  
13 that this bill was supposedly aimed at, namely, assuring  
14 ethical conduct by insurance companies. I mean, that's most  
15 benignly stated. But PX 6, also, if you read on, talks  
16 about the level playing field.

17 Let me close.

18 We've heard about Dr. House --

19 THE COURT: What exhibit was that?

20 MR. SMITH: I'm sorry. That was PX 6.

21 And then he also, Mr. Hohengarten, referred to the same  
22 effect to PX 5.

23 THE COURT: All right.

24 MR. SMITH: Thank you.

25 I close with this.

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1 We have heard lifted up today a vision of interstate  
 2 commerce articulated by Dr. House. I heard every word of  
 3 his testimony. Your Honor, his vision may have some  
 4 respectability in economics and literature, I doubt it, but  
 5 I know to a moral certainty that it has no foundation in the  
 6 higher law of our Constitution.

7 His approach, his vision, his definition now  
 8 embraced -- he wasn't the state's expert, but his vision  
 9 lifted up by the intervenors was rejected by Wickard v  
 10 Fillburn and very recently by the Supreme Court of the  
 11 United States in Camps Owatonna/Newfound. We will get you  
 12 that citation. It's in our materials.

13 Interstate commerce is so vital. Cardosa called it the  
 14 sink or swim principle. They want this tape to sink. With  
 15 respect to this particular arena they want no more  
 16 greenfields built. And they know it. It's reasonably  
 17 foreseeable. That's it.

18 I'm sorry, could you put that up one more time?

19 Because, let me close, union not division, they  
 20 targeted a specific business model and now they're saying  
 21 because we didn't draw an express line it's A-OK. That is  
 22 not the law of the land. That is not what Ford holds.

23 And by the way, one of the points I would leave the  
 24 court with, with respect to the Ford case, is that it sort  
 25 of thought that Lewis was a discrimination case, Your Honor,

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1 with all due respect Lewis speaks for itself and Lewis --  
 2 we're comfortable with Ford, but this particular that I  
 3 mention is important, Lewis in fact struck down the Florida  
 4 statute on Pike grounds. On Pike grounds. Which Mr.  
 5 Hohengarten would lead the court into error by saying is  
 6 essentially toothless. And so did Justice O'Connor in  
 7 Carbona.

8 Your Honor, the law is not toothless. The law is  
 9 demanding. Thou shalt treat economic players equally. And  
 10 they have singled out Allstate for unequal treatment and  
 11 gagging their speech. The entire statute should fall.

12 I thank the court for its indulgence.

13 THE COURT: Well, I hope y'all don't expect me to  
 14 rule from the bench. I won't today.

15 But this has been a really great job by both sides. I  
 16 appreciate all your work.

17 I'll let you know as soon as I can. I really will do  
 18 my best to get to it. I know it's an important case for  
 19 both sides. And I understand the timing, I know the  
 20 legislature is going to be meeting soon. I understand all  
 21 those kinds of issues that come up, so I will try to get a  
 22 ruling just as quickly as I can.

23 But it's just been a pleasure. I can't thank y'all  
 24 enough. It makes me excited about being a lawyer to see the  
 25 quality job done by both sides.

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1 Okay. Anything else?

2 Any last minute stuff y'all need?

3 MR. POWELL: I do have my slides, Your Honor.

4 THE COURT: I'm going to look at your slides. If  
5 you will just leave them with me, I promise you I will do  
6 that. Anything else?

7 MR. POWELL: No. We appreciate the court's  
8 attention.

9 THE COURT: Oh, no. It didn't take any extra  
10 effort. It was just really enjoyable.

11 Okay. I can't think of anything else.

12 There was one thing I thought y'all were going to  
13 submit to me later. Was there something else?

14 MR. HOHENGARTEN: Yes, judge. On October 29 the  
15 state will submit its post-trial brief.

16 THE COURT: Okay. That's right. I remember  
17 that.

18 MR. HOHENGARTEN: We had a little different time  
19 for the state because of my -- I was going to be out of the  
20 office for two weeks.

21 THE COURT: I remember that. That's fine.

22 MR. HOHENGARTEN: I think it's going to be as  
23 brief as the intervenors was, certainly not significantly  
24 longer.

25 THE COURT: Okay. That's fine. No problem there.

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1 Okay. I'll -- I'm working on it. I've been working on  
2 it. I'll keep working on it.

3 Thank y'all very much. I'll miss seeing y'all about  
4 every two weeks.

5 MR. HOHENGARTEN: Yeah. We'll be back.

6 THE COURT: Okay. Thank you.  
7 I'll come down and shake your hand.

8 But it's been fun.

9 (End of proceedings 10/19/04.)

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1 CERTIFICATION

2 I, PAMELA J. WILSON, CSR, certify that the foregoing is

3 a transcript from the record of the proceedings in the

4 foregoing entitled matter.

5 I further certify that the transcript fees format comply

6 with those prescribed by the Court and the Judicial

7 Conference of the United States.

8 This the 20th day of October, 2004.

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11 \_\_\_\_\_

12 PAMELA J. WILSON, CSR

13 Official Court Reporter

14 The Northern District of Texas

15 Dallas Division

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