

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 (September 23, 2004

VOLUME 4
TRANSCRIPT OF TRIAL
BEFORE THE HONORABLE ED KINKEADE,
UNITED STATES DISTRICT JUDGE

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13 Also Present: Avery Gardiner
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 Amanda Basta
 15
 16
 17
 18

Proceedings reported by stenographic machine,
 19 transcript produced by computer.
 20
 21

Court Reporter: PAMELA J. WILSON, CSR
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1 PROCEEDINGS:
 2 THE SECURITY OFFICER: All rise and come to order.
 3 The United States District Court in and for the
 4 Northern District of Texas at Dallas is now in session, the
 5 Honorable United States District Judge Ed Kinkeade
 6 presiding.
 7 God save the United States and this Honorable Court.
 8 THE COURT: Okay. Are we ready?
 9 MS. GOLDSTEIN: Yes, Your Honor.
 10 MR. YOXALL: We're ready, Your Honor.
 11 THE COURT: Okay. Ms. Goldstein, you're up
 12 again?
 13 MS. GOLDSTEIN: Yes. I'm going to continue with
 14 Ms. Norton.
 15 THE COURT: Okay. Hi, Ms. Norton. I know you
 16 remember you're still under the oath.
 17 JO BETSY NORTON,
 18 having been duly sworn testified as follows:
 19 (DIRECT EXAMINATION)
 20 (Continued.)
 21 BY MS. GOLDSTEIN:
 22 Q. Ms. Norton, how long were the hearings in the House?
 23 A. The hearing in the House was only about two hours.
 24 Q. And how long were the hearings in the House?
 25 A. The Senate and commerce hearing was only about 30

Page 4

1 minutes.

2 Q. In all of your conversations with the lobbyists and the
3 legislators, did anyone identify a specific consumer harm
4 stemming from consumer ownership?

5 A. No.

6 Q. Did Senator Carona or Representative Flores discuss any
7 specific customer complaints with you?

8 A. No.

9 Q. You mentioned yesterday Lieutenant Governor Dewhurst's
10 statement and Senator Carona's response.

11 Do you remember that?

12 A. Yes.

13 Q. After Senator Carona's response promising hard,
14 credible evidence, was any presented to the legislators?

15 A. No, it was not.

16 Q. After the Senate Committee hearings, why didn't you go
17 to Lieutenant Governor Dewhurst and ask him -- or, I'm
18 sorry, let me rephrase that.

19 After the Senate Committee hearings why didn't you go
20 back to Lieutenant Governor Dewhurst, given that he had made
21 that earlier statement?

22 A. You know, I think he had done a huge thing early on,
23 and I think by the time the bill got out of the Senate
24 Business and Commerce Committee, it had a lot of momentum,
25 it was pretty well wired and it was going to roll over us

Page 5

1 anyway, so it wouldn't do any good.

2 THE COURT: Is that "roll over" the kind of the
3 term of when you're going to get -- when you're going to
4 lose?

5 That's kind of what they tell you when they're going to
6 vote against you?

7 I think I heard that when I was down there on judge
8 bills.

9 THE WITNESS: I think so.

10 THE COURT: I remember some Senator saying he was
11 going to roll over the judges. I think he did. That's
12 interesting.

13 Okay. Go ahead.

14 BY MS. GOLDSTEIN:

15 Q. Yesterday when you talked about rolled over, was there
16 a specific incident that you were using those words for or
17 is that a general term?

18 A. I think what I was just talking about was more
19 general. I mean, we actually did have -- Representative
20 Flores actually used the term "roll over" with us when we
21 met with him.

22 Q. From your perspective what do you understand was the
23 complaint that people had gone to the legislators about?

24 A. The complaint was basically the local body shops, you
25 know, back in the districts, or specifically the PRO shops

3 (Pages 4 to 5)

Page 6

1 not wanting competition from an insurer-owned competitor.

2 Q. What was it that Allstate and Sterling were doing that
3 people were complaining about?

4 A. I think the biggest thing they were doing was the
5 introduction of the new shops in the Dallas area, and there
6 was a fear expressed about expansion, both in Dallas and --
7 and the rest of the state.

8 MS. GOLDSTEIN: I'll pass the witness, Your Honor.

9 THE COURT: Okay.

10 Mr. Yoxall.

11 MR. YOXALL: Yes, Your Honor.

12 (CROSS-EXAMINATION)

13 BY MR. YOXALL:

14 Q. Hello, Ms. Norton.

15 A. Good morning.

16 Q. Good to see you again.

17 Ms. Norton, you testified yesterday about the
18 individuals -- or you identified some of the individuals who
19 testified in favor of the bill at these House -- the House
20 hearing and the Senate hearing, correct?

21 A. I did.

22 MR. YOXALL: Let me put up Defendant Demonstrative
23 Number 2.

24 BY MR. YOXALL:

25 Q. Now, this is a list of the insurance opponents of House

Page 7

1 Bill 1131, correct?

2 A. I think that's correct.

3 Q. I believe you were the first witness to testify against
4 the bill at the -- at the House hearing on April 6th. Is
5 that right?

6 A. I think that's right.

7 Q. And then Ms. Mazanec, who testified here yesterday,
8 testified at the hearing?

9 A. She did.

10 Q. And Ms. Borrows, who's from Allstate, I believe she
11 works in a claim center that's right?

12 A. That's correct. She's responsible for all the claims
13 in Texas.

14 Q. And Tim Swift, he was I believe regional director of
15 Sterling over the Houston shops, correct?

16 A. That's correct.

17 Q. And Mr. Moon, Mr. Rodriguez and Mr. Carbajal were
18 Sterling employees I believe that also came up from Houston?

19 A. I'm not sure where they came from, but I know that
20 they're employees that work in the body shops.

21 Q. And, anyway, Mr. Swift was from Houston?

22 A. That's right.

23 Q. Now, Mr. Sullivan did not testify at the House hearing,
24 he testified at the Senate hearing?

25 A. That's correct.

4 (Pages 6 to 7)

Page 8

1 Q. Were you at that hearing?

2 A. I was.

3 Q. And Mr. Sullivan is from -- is he a lawyer?

4 A. He is.

5 Q. And he's from Allstate corporate back in Northbrook.

6 Is that right?

7 A. Yes, he is.

8 Q. And he didn't participate in any of the meetings that

9 preceded the -- the hearing over that two month period, did

10 he?

11 A. No, he did not.

12 Q. He came in just to show up at that Senate meeting and

13 talk to the legislators?

14 A. Yeah. I brought him in to testify at the -- the Senate

15 hearing.

16 Q. Now, Cindy Taylor Cryer, you know her, don't you?

17 A. I do.

18 Q. And she is a USAA lobbyist?

19 A. She is. I mean, she's an employee of the USAA but she

20 handles their lobbying.

21 Q. And Ann O'Ryan is a lobbyist with AAA in the

22 Inter-Insurance Exchange?

23 A. Yes. I don't know her very well.

24 Q. Now, Ms. Cryer from USAA, USAA is a Texas-based

25 insurance company?

Page 9

1 A. Yes.

2 Q. And she was testifying against the legislation?

3 A. I think she was.

4 Q. Now, Ms. Norton, you also testified yesterday about

5 some of your experience at the Department of Insurance.

6 How long -- how long were you there?

7 A. Roughly a year and a half in the -- the TDI proper and

8 then probably a year, year and a half at the Office of

9 Public Insurance Company.

10 Q. The Department of Insurance obviously regulates the

11 insurance business in Texas. Correct?

12 A. It does.

13 Q. And you're familiar with the -- the structure of the

14 Department of Insurance?

15 A. I am.

16 Q. And you also worked in this separate consumer division?

17 A. I did.

18 Q. And so were you familiar with consumer complaints about

19 the insurance industry?

20 A. Yes.

21 Q. And in those jobs were you familiar with some of the --

22 some of the various insurance companies that are registered

23 with the Department of Insurance?

24 A. I'm sure I was to some extent.

25 Q. For example, Allstate County Mutual is a Texas-based

5 (Pages 8 to 9)

Page 10

1 county mutual, correct?

2 A. That's correct.

3 Q. And that's located in Irving?

4 A. That's right.

5 Q. And Progressive County Mutual is a Texas-based county

6 mutual located here in Texas?

7 A. The county mutual structure is a unique Texas company

8 structure.

9 Q. Right. And you're familiar with that structure?

10 A. Yes.

11 Q. And there's numerous county mutuals in Texas?

12 A. I think there are 24.

13 Q. That are based in Texas?

14 A. There's only 24. The statute -- there's only 24 county

15 mutuals.

16 Q. Texas Farmer's Bureau would be another one?

17 A. I think they have one.

18 Q. Mid-Century would also be another Texas-based county

19 mutual?

20 A. I know that Farmers has a Mid-Century Company, I'm not

21 sure if it's their county mutual.

22 THE COURT: Let me stop you.

23 The legislation only allows 24? Is that what you're

24 about to say?

25 THE WITNESS: There are only 24 county mutuals in

Page 11

1 Texas.

2 THE COURT: Could there be 25?

3 THE WITNESS: No.

4 THE COURT: It only allows 24?

5 THE WITNESS: Um-hum.

6 THE COURT: Yes?

7 THE WITNESS: Correct.

8 THE COURT: Okay. Go ahead.

9 BY MR. YOXALL:

10 Q. Ms. Norton, yesterday you testified that you were

11 regional director -- you were regional counsel, excuse me,

12 for Allstate.

13 A. That's right.

14 Q. And your region is Texas?

15 A. That's correct.

16 Q. Now, you previously -- you were in charge of Texas and

17 Arizona. Is that right?

18 A. That's right.

19 Q. Currently how many regional counsels are there?

20 A. There are either 13 or 14. New Jersey is -- I

21 believe -- 13 or 14.

22 Q. And the job of the regional counsel is purely

23 legislative or dealing with the departments of insurance in

24 the various states?

25 A. Right. And providing kind of in-house counsel to the

6 (Pages 10 to 11)

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Page 12

1 region.

2 Q. Right. You're a lawyer. Correct?

3 A. Correct.

4 Q. And before you became regional counsel, you testified

5 yesterday that you worked with the Legislature I believe

6 from about 1992 to about nineteen --

7 A. '97.

8 Q. '97.

9 So you worked in the Legislature for I believe Senator

10 Armbrister, correct?

11 A. Right. For a brief period of time.

12 Q. And Senator Teel Bivins?

13 A. Right.

14 Q. And Senator Ike Harris?

15 A. That's right.

16 Q. And some of your jobs -- you were either General

17 Counsel I believe for Teel Bivins; is that right? Senator

18 Bivins?

19 A. In his Senate office?

20 Q. Yes.

21 A. Correct.

22 Q. And you were Legislative Director also for Senator

23 Bivins?

24 A. That's right.

25 Q. And what was your role for Senator Ike Harris?

Page 13

1 A. I served as the Committee Director and General Counsel

2 for the two committees that he was the Chair of.

3 Q. And what Committees were those?

4 A. The Senate Jurisprudence and the Senate State Affairs.

5 Q. In those five years in the Texas Legislature, I assume

6 you dealt with lobbyists quite a bit?

7 A. I did.

8 Q. And you attended a lot of meetings with lobbyists and

9 representatives of parties who were either in favor of or

10 against bills.

11 A. I did.

12 Q. And you testified in your deposition, Ms. Norton, that

13 it was important to you, when you worked in the Legislature,

14 that those parties bring to you full, complete, truthful

15 information about their positions. Right?

16 A. I think getting information is important to the

17 process.

18 Q. Getting all the information is important to the

19 process?

20 A. I think getting relevant information is important to

21 the process.

22 Q. And getting complete information is relevant to the

23 process, true?

24 A. Sure.

25 Q. And truthful information is also important?

7 (Pages 12 to 13)

Page 14

1 A. Sure.

2 Q. Because the legislative staff members and the
3 legislators, they use that information to make their
4 decision about whether they should pass or not pass a bill.
5 Right?

6 A. They do.

7 Q. That's the purpose of those meetings, whether they're
8 private meetings or whether they're joint meetings or
9 whether it's testimony before the legislator, there should
10 be truthful, complete information that's presented to the
11 legislators, true?

12 A. You know, I'm going to agree in part and disagree in
13 part. I don't think in every single situation you provide
14 every bit of information, volumes of information. I think
15 it depends very much on the circumstance of the bill,
16 whether you're the proponent of the legislation, whether
17 you're an opponent. I think different circumstances dictate
18 the amount and what kind of information that you give.

19 Q. But it's certainly important for the parties, either
20 the supporters or the opponents, to provide relevant
21 information to the extent the staff members or the
22 legislators have questions on issues, it's important to
23 provide relevant information to those issues, right?

24 A. I think it's specially important if people ask you for
25 information that you provide it.

Page 15

1 Q. So it's your testimony that the legislators have to ask
2 to get information?

3 A. That's not what I said. I think I said earlier that it
4 totally depends on the dynamics of a particular bill and
5 what side you're on.

6 I think you often provide a lot more information if
7 you're the proponent of a bill, because you're trying to
8 prove the need for something, whether it be good or bad. I
9 think you're the opponent of the bill, a lot of times it's a
10 little more of a reactive role, that you answer questions,
11 you provide relevant information, but it's certainly not the
12 same type of situation if you're the proponent of the bill.

13 Q. Certainly parties aren't required to bring truckloads
14 of information down to the legislator and have them look at
15 everything. Right?

16 A. That's right.

17 Q. But the parties should provide relevant information?

18 A. Right.

19 Q. Now, it's not typical for the legislators --
20 legislators to go out and hire their own experts, is it?

21 A. No, it's not.

22 Q. Or to do their own economic studies, that's not
23 typical, is it?

24 A. No. I mean, the legislator, when they have big issues
25 they typically will have interim studies where they -- you

8 (Pages 14 to 15)

Page 16

1 know, they have a longer process between the biennial
2 sessions to really study issues.

3 Q. But that's not the typical process?

4 A. I mean, the interim -- interim studies happen every
5 interim. I don't understand the question.

6 Q. Sometimes it happens, sometimes it doesn't, right?

7 Interim studies?

8 A. The Lieutenant Governor and the Speaker determine what
9 issues are going to be studied in the interim.

10 Q. In providing information to the Legislature in your
11 role you relied on people back at Allstate to give you
12 information about insurance ownership of body shops,
13 correct?

14 A. I did get information from the people in Northbrook.

15 Q. Let's talk about a few of those people.

16 You relied on John Edelen for information; is that
17 right? E-D-E-L-E-N.

18 A. I got information from John Edelen.

19 Q. You also relied I think on Cathy Lazaroff for
20 information as well?

21 A. I have a lot of -- because of my role I have a lot of
22 people that kind of help me get information, so I don't know
23 where all the information that I got came from.

24 I didn't specifically ask Cathy for information. I
25 know we probably got information from her.

Page 17

1 Q. You had conference calls with Ms. Lazaroff regarding HB
2 1131.

3 A. They may have been on conference calls that I was on,
4 but I don't recall specific conversations with her about it.

5 Q. But she -- but your recollection is she was involved in
6 this process.

7 A. You know, I don't have a recollection of that
8 specifically. I've seen -- I know that she's been involved
9 in this litigation somehow, y'all have deposed her or
10 something, so I really couldn't speak to her involvement
11 with me. I didn't talk to her directly.

12 Q. In any event, you relied on information from others
13 back at --

14 A. Right.

15 Q. Now, Ms. Norton, yesterday you testified in here that
16 the first time I had a real feel that there was going to be
17 legislation was toward the end of 2002. Does that sound
18 accurate?

19 The transcript is right up there on top, but it's --
20 it's page 117?

21 A. Okay. Okay. I've got it.

22 Q. See there, it's lines -- lines 1 and 2 of page 117.

23 A. I see that.

24 Q. Now, you were aware, Ms. Norton, weren't you, of the
25 California legislation prior to the end of 2002?

9 (Pages 16 to 17)

Page 18

1 A. I was, generally.

2 Q. And you were also aware that there was interest in

3 Texas in -- in promoting legislation against

4 insurance-opened body shops, were you not, before the end of

5 2002?

6 A. I think I knew there was a possibility that there could

7 be legislation in Texas.

8 MR. YOXALL: Let's put up Defendant's Exhibit

9 Number 6. Let's highlight the -- the top.

10 BY MR. YOXALL:

11 Q. This is an e-mail from you to William Vainisi on April

12 18th of 2002. Is that right?

13 A. Yes, it is.

14 Q. And Mr. Vainisi, he's your boss, correct?

15 A. He is.

16 Q. He's back in Northbrook?

17 A. He is.

18 Q. And what is his title?

19 A. Assistant vice president.

20 Q. And this e-mail arose because you had had some

21 contacted with -- is it David Durden at the Department of

22 Insurance?

23 A. I think in the e-mail I reference a -- an inquiry I had

24 from David.

25 Q. And you're -- you're writing Mr. Vainisi to give him an

Page 19

1 update as to what was going on in Texas. Right?

2 A. It looks like that, yeah.

3 Q. And it references in the middle of that first

4 paragraph, I provided the Department with information on the

5 Sterling acquisition and expansion. Is that right?

6 A. Correct.

7 Q. And then down in the second paragraph you say, "As far

8 as the legislative action, there's not much that can be done

9 at this time."

10 Right?

11 A. Let me explain. On the David Durden --

12 Q. Let me ask you to answer the question. Is that an

13 accurate -- did I --

14 A. I mean, it's my words. Yeah. It's my words.

15 Q. And if you go down to the next paragraph, the third

16 paragraph, you said that, "I anticipate this being a

17 difficult practice to defend based on past experience in the

18 direct repair area (sic) and the fact that this affects only

19 Allstate and our image has been taking a public beating. A

20 lot will depend on the California experience."

21 Now, when you said that, the California experience,

22 that was the California legislation, right?

23 A. Right.

24 Q. And you were familiar with the California legislation

25 back in April 2002, because it was going on at the time.

10 (Pages 18 to 19)

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Page 20

1 Right?

2 A. You know, I assume it is. As I said earlier, I was
3 really occupied with the regulatory reform things. I
4 probably received information on California, but certainly
5 did not have the time to be looking at another state when I
6 was up to my eyeballs in my own Texas stuff.

7 Q. Right. You're -- you're -- the regional counsel out
8 there, Dehlia Chilgren, C-H-I-L-G-R-E-N, she's the regional
9 counsel in California, right?

10 A. She is.

11 Q. And she was periodically sending out reports to the
12 other regional counsels about what was going on in
13 California, right?

14 A. Dehlia sent some e-mails on to California.

15 Q. So you are aware this information was going on out
16 there to prohibit insurance ownership of body shops in
17 California?

18 A. Yes.

19 MR. YOXALL: Let's go to Defendant's Exhibit 7.

20 BY MR. YOXALL:

21 Q. Now, this is another e-mail from you to Mr. Vainisi's
22 in August of 2002. Right?

23 A. Correct.

24 Q. And you're highlighting a visit that Bill Beaman had
25 with Senator Carona?

Page 21

1 A. Actually it's a guy named Beaman Floyd.

2 Q. Actually, you're right. You're writing the bill but
3 it's Mr. Beaman who had the meeting.

4 Now, Mr. Beaman is counsel for the Texas Coalition for
5 Affordable Insurance?

6 A. Um-hum.

7 Q. They're a lobbyist group?

8 A. It's a group of five insurance company associations
9 that have kind of banded together to work on the significant
10 regulatory reforms that we were facing.

11 Q. Ms. Norton, they lobby the Legislature, right?

12 A. Correct. I'm a member. And Beaman Floyd kind of
13 served as our executive director. And he lobbies on behalf
14 of the companies.

15 Q. And Mr. Beaman had met with Senator Carona sometime
16 before August 4th of 2002?

17 A. It would appear.

18 Q. And in the second sentence Mr. Floyd Beaman is saying
19 that Carona appears to have a problem with Sterling.

20 Right?

21 A. Yes.

22 Q. He also mentions that Senator Carona had had some kind
23 of problem with one of his own vehicles and with respect to
24 dealing with -- with Allstate. Right?

25 THE COURT: Remind me, who is Beaman?

11 (Pages 20 to 21)

Page 22

1 THE WITNESS: Beaman is the -- he's a lobbyist but
2 he serves as the executive director for this loose coalition
3 of insurance companies.

4 MR. YOXALL: Let's pull up Defendant's Exhibit 8.

5 BY MR. YOXALL:

6 Q. Now, Ms. Norton, I showed this document to you in your
7 deposition. You've seen it before, right?

8 You had seen it before the deposition?

9 A. I think so. I'm just looking at the title page. I'm
10 not really sure what's --

11 MR. YOXALL: Let's go to the -- the first slide.

12 Actually the first slide, it's entitled Legislative and
13 Regulatory Design Team. You want to just page over.

14 Keep going.

15 There you go.

16 Go back.

17 There you go.

18 No.

19 BY MR. YOXALL:

20 Q. Now, this was a legislative and regulatory design
21 team. And if you see down at the bottom, the core members,
22 Mr. Vainisi was one of the members, right?

23 A. His name is listed there, yes.

24 Q. In this legislative and regulatory design team, it had
25 been -- it had been put together in early 2002 to deal with

Page 23

1 the issues of insurance ownership of body shops. Right?

2 A. I -- I have no idea.

3 I mean, I know -- I guess the document is what it is,
4 but I don't know of a specific legislative and regulatory
5 design team. That's just not something that I dealt with.

6 Q. Mr. Vainisi was your boss?

7 A. Yes, he was.

8 Q. And you talked to him about legislative issues all the
9 time, right?

10 A. I do.

11 MR. YOXALL: Let's go over two pages.

12 One more.

13 BY MR. YOXALL:

14 Q. This legislative and regulatory design team, this
15 document says that they were going to finalize the Texas
16 team by September 15th of 2002. Right?

17 A. That's what it says.

18 Q. So legislation in Texas regarding insurance ownership
19 was not a big surprise to Allstate, was it, Ms. Norton?

20 A. I think the fact that legislation was actually filed in
21 Texas -- I would -- I would say it was still a surprise.

22 You know, we knew there was legislation in California.
23 We knew that the industry was making noise in Texas. But we
24 have a very different Legislature than California. We had a
25 very different dynamic.

12 (Pages 22 to 23)

Page 24

1 In California there were no Sterling shops.
 2 In Texas Allstate had already made a significant
 3 investment in Sterling and that, given kind of the politics
 4 of our Legislature, we -- it was not at all a certainty that
 5 they could find a legislator to carry the legislation.

6 Q. You thought the Texas legislator wouldn't have much
 7 interest in this issue?

8 A. I knew they were extremely interested in insurance
 9 companies, just because of what I was dealing with from
 10 about March through the next June.

11 THE COURT: On homeowner's issues?

12 THE WITNESS: On the homeowner's. And I think it
 13 was a very anti-insurance industry climate.

14 BY MR. YOXALL:

15 Q. And Allstate was very concerned about the California
 16 issues, right?

17 A. I know that Dehlia worked on the Sterling issue in
 18 California, so --

19 Q. Let's go over one page.

20 In the middle, with respect to the issues in
 21 California, where it says, "Current Allstate/Sterling
 22 oversight model does not provide a basis in fact and in
 23 practice to counter these arguments."

24 Do you see that?

25 A. I see that.

Page 25

1 Q. And if we could go back up above to the first bullet
 2 point, the arguments are the arguments of the proponents
 3 that the carrier-owner is focused on the owner-repairer's
 4 cash flow and not the quality of repair. Those are the
 5 arguments made in California.

6 A. You know, I don't know if those arguments were actually
 7 made in California or if this is, you know, brainstorming
 8 trying to anticipate, you know, the worse things people
 9 could say or arguments people could use. I'm not sure
 10 exactly where this came from.

11 Q. In any event, this Allstate document says what the
 12 arguments are and it also says that the Allstate/Sterling
 13 oversight model cannot counter those arguments. Right?

14 A. I mean, I guess the document says what it says. I
 15 don't know what was meant by that. I don't know the context
 16 of this document. And I don't know specifically what the
 17 oversight model is that's being referenced.

18 Q. In any event, it's an Allstate document, correct?

19 A. I'm assuming it's something that we produced, but, I
 20 mean, like I said, I didn't have anything to do with this
 21 particular document.

22 Q. Let's go up one more page.

23 Down in the middle, "Observations based on state
 24 review, in Texas."

25 "We anticipate a fight and we are moving to get out in

13 (Pages 24 to 25)

Page 26

1 front of it."

2 That's what this document says. Right?

3 A. Yes.

4 Q. Now, Ms. Norton, with respect to the arguments that
5 were being made, in Texas, that you were dealing with, they
6 were conflict of interest -- right?

7 Is that right?

8 A. There weren't -- I mean, at what point in time?

9 Q. I'm talking about when the Texas -- when the Texas
10 process started and you started dealing with the issues.

11 A. So you're talking about after the legislation session
12 when we started seeing the bill and having discussions,
13 right?

14 Q. I'm talking about -- yeah, early -- I'm bringing you up
15 to January of 2003. Okay?

16 A. Okay.

17 Q. The arguments that were being made were conflict of
18 interest -- is that right?

19 A. Yes.

20 Q. Unfair competition?

21 A. Yes.

22 Q. And quality issues. Right?

23 A. The quality issues came out of the one meeting that we
24 had with Senator Carona and the group of body shop and
25 dealerships who made kind of vague allegations, but never

Page 27

1 did we hear about repairs, that Sterling was providing poor
2 quality repairs.

3 Q. And at that time, Ms. Norton, you weren't aware, in
4 your role as regional counsel, of any quality issues with
5 respect to Sterling.

6 A. I was not.

7 Q. Let's pull up Defendant's Exhibit 12.

8 Let's highlight it. This is a February 19th, 2003
9 e-mail from you to Brian Pinkerton?

10 A. Yes, it is.

11 Q. And you highlight the three arguments, the primary
12 point is conflict of interest, right?

13 Is that right?

14 A. Is what.

15 Q. The primary point --

16 A. I mean, that's what I said in that e-mail.

17 Q. And the second point is unfair competitive advantage.
18 Correct?

19 A. Yes.

20 Q. You didn't say competitive advantage, you said unfair
21 competitive advantage?

22 A. These are notes from a meeting that I had with dealers
23 and body shop owners. These were kind of pretextual things
24 that they let out there and I'm letting our corporate
25 relations team know kind of what came up in this meeting.

14 (Pages 26 to 27)

Page 28

1 Q. And all I'm asking you, from your notes --

2 A. You're asking me why I used the words I used, and I
3 said I was trying to report on what those specific people
4 said.

5 Q. Right. And I'm asking you, these are your notes that
6 you apparently made at that meeting, was that right?

7 A. That was kind of my summary that I was sending up to
8 Brian.

9 Q. And you're a notetaker at these meetings?

10 It's your standard practice to take notes?

11 A. Yes.

12 Q. You said it was -- there was an unfair competitive
13 advantage argument being made, as opposed to just them
14 arguing competitive advantage, right?

15 A. I mean, I don't think I would put much stock into --
16 this was my first time from hearing from them. I don't know
17 that there's that much difference between unfair competitive
18 advantage and competitive advantage. I mean, it was about
19 competition.

20 Q. The opponents were concerned that it would be unfair
21 for the insurance companies to own body shops, correct?

22 A. I think yes.

23 Q. And then the last argument was quality of repair. And
24 you say from your notes that you took at that meeting that
25 they cited several instances where the cars had not been --

Page 29

1 or had been repaired poorly by Sterling. Right?

2 A. Yes. They didn't cite specific consumers. They said
3 we don't think the quality is very good. I think, you know,
4 it was vague references that were never ultimately
5 supported, never names, never cars, never incidents.

6 Q. And you didn't have any information from your own
7 people, like John Edelen, or anybody else back at Allstate,
8 that there were quality issues?

9 A. I did not.

10 Q. With respect to the conflict of interest issue, did you
11 have any information from your folks back at Allstate, in
12 particular Mr. Edelen, with respect to anybody raising the
13 idea in California or anywhere that there might be a good
14 conflict of interest argument to be made?

15 A. I don't know.

16 Q. You didn't have any information to that effect?

17 A. I didn't -- I don't know.

18 Q. You didn't have any of that information?

19 A. I said I don't know.

20 Q. Okay. Let's pull up Defendant's Exhibit 48.

21 THE COURT: Let me go back to that just a minute.

22 All of those -- back to the one that was just up. And
23 highlight it the way it was highlighted, or as close as you
24 can. If you don't remember, it doesn't matter.

25 That's fine.

15 (Pages 28 to 29)

Page 30

1 All these comments from employees at Sterling; is that
2 who you were meeting with?

3 THE WITNESS: No. This was what I called kind of
4 the ambush meeting where I went to meet with Senator Carona
5 and took my lobbyist and we go into the room and it's the
6 auto dealers and the body shops --

7 THE COURT: Okay. These aren't your people
8 reporting this?

9 THE WITNESS: No.

10 THE COURT: These are the concerns in that meeting
11 of the PRO shop owners --

12 THE WITNESS: And the --

13 THE COURT: -- the lobbyists for the industry.

14 THE WITNESS: And the auto dealers.

15 THE COURT: And the what?

16 THE WITNESS: The auto dealers.

17 THE COURT: The auto dealers. Okay.

18 THE WITNESS: And so what I tried to do was just
19 to communicate back this is kind of what we were kind of
20 peppered with, trying to get the arguments as best I could
21 remember --

22 THE COURT: So you're trying to --

23 THE WITNESS: -- back to somebody in the home
24 office.

25 THE COURT: What is this Sterling does select

Page 31

1 repair to lower the cycle time?

2 Is that talking about you do certain things, make it
3 look like it's faster --

4 THE WITNESS: What paragraph?

5 THE COURT: It's in the middle right there.

6 THE WITNESS: Oh, I think what they were saying is
7 that Sterling did easier repairs so that their cycle time
8 would look really good on paper and that other shops may do
9 other repairs that take longer time so their cycle time
10 would look higher.

11 THE COURT: Okay. Let's see. There's another
12 one.

13 Okay. Go ahead.

14 BY MR. YOXALL:

15 Q. Let's go back to Defendant's Exhibit 48.

16 Ms. Norton, did anybody at Allstate ever tell you that
17 Allstate, before it purchased Sterling, conducted some
18 consumer surveys of its own insureds and other consumers,
19 asking them about this proposed purchase by Allstate?

20 A. I didn't really know there was a survey back then.

21 Q. This was done back in June of 2001.

22 MR. YOXALL: Let's go to page 12.

23 The very bottom.

24 Let's highlight those two last hyphenated parts.

25 BY MR. YOXALL:

16 (Pages 30 to 31)

Page 32

1 Q. Apparently, and under the summary of findings,
2 consumers, either Allstate or the insureds or other
3 consumers, some of them had positive comments, most often
4 revolving around trust. Right?

5 Do you see that?

6 A. I see that.

7 Q. So some people had no problem with this, they thought
8 it was reasonable. Right? At least according to this
9 document.

10 A. It says what it says.

11 Q. And then on the negative side, respondents most often
12 commented about conflict of interest, skepticism over
13 Allstate's motivations and general distrust/dislike of
14 Allstate in concerns about quality. You see that?

15 A. I see that.

16 Q. And those were some of the same concerns that were
17 voiced to you by the proponents of the bill in Texas, right?

18 A. I guess I don't see what one has to do with the other.

19 Q. You didn't have this information, did you?

20 A. I did not have this -- this information.

21 Q. Let's go to Exhibit 45.

22 Let's go to the second -- well, highlight this.

23 Do you know who Melissa Loew with?

24 A. I don't.

25 Q. This was another survey done around the same time, the

Page 33

1 next page.

2 MR. YOXALL: If you could highlight the copy list
3 at the bottom, the CC list.

4 BY MR. YOXALL:

5 Q. Do you see Mr. Edelen received this survey?

6 Do you see that?

7 A. I see that.

8 Q. Do you see Mr. Ruebenson received this survey?

9 A. I see that.

10 Q. Did you ever deal with Jeff Brask in the first column?

11 A. No.

12 Q. Mr. Brask never provided you information with respect
13 to any issues in the Texas Legislature?

14 A. Not directly. As I said, I ended up having to use
15 middlemen often because I don't know everybody that works in
16 home office or everybody that works in claims.

17 MR. YOXALL: Let's go to page 13. Page 13.

18 Again, this is another survey. Actually, go back to
19 page 12. Highlight the very bottom. Appropriateness for
20 Allstate.

21 BY MR. YOXALL:

22 Q. Like the last survey, in these comments at the bottom,
23 there were some people that had positive reaction, "This
24 will help to keep costs down."

25 "It's a good thing."

17 (Pages 32 to 33)

Page 34

1 Do you see that?

2 A. Yes.

3 Q. And the second line, "Companies are diversifying more
4 and more. It's a good thing."

5 Do you see that?

6 A. I do.

7 MR. YOXALL: Go to the next page, please. And
8 highlight the comments at the top, received from consumers.

9 BY MR. YOXALL:

10 Q. Other consumers thought it was a conflict of interest.

11 "They're saving money at my expense. It's like an HMO. I
12 don't want Allstate to have total control."

13 Do you see that?

14 A. I see that.

15 Q. And, again, these were negative comments in reaction to
16 the Allstate/Sterling purchase. But you didn't have this
17 information, right?

18 A. I guess here's what I'm having trouble figuring out,
19 why this would be relevant to anything.

20 I know that any time that a business is going to
21 acquire something or make some big change in their business,
22 they're going to do surveys, they're going to do all kinds
23 of things to see if it's a good business thing. They want
24 to know what consumers might think about it.

25 Just because consumers, when they're sitting there

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1 blank, not even ever having thought about an insurance

2 company owning a repair facility -- I mean, I think there's

3 value to the company how do they feel before they have ever

4 had the experience. It doesn't mean consumers are concerned

5 about it once the entity is there.

6 I mean, I think that's what the real issue is about

7 whether -- what consumers' concerns are, not some in the

8 future. You know -- I don't see the relevance to this or --

9 Q. I understand you don't see the relevance, Ms. Norton.

10 My question is you didn't have this information at the
11 Texas Legislature.

12 A. Why would I have had it?

13 Q. I'm just asking you.

14 You didn't have the information, --

15 A. I did not have it.

16 Q. -- yes or no?

17 Now, you remember yesterday when Judge Kinkeade asked
18 you about the fraud issue, about statistics on fraud?

19 A. Yes.

20 Q. If you want to look at page 132 of the transcript
21 yesterday.

22 Let me get you to -- ask you one question -- reference
23 you to another spot first, page 155.

24 MR. SMITH: Of the transcript?

25 MR. YOXALL: Of the transcript, yes.

18 (Pages 34 to 35)

Page 36

1 MR. SMITH: Okay.

2 BY MR. YOXALL:

3 Q. Do you see page 155?

4 A. I do.

5 Q. You stated yesterday, "We ended up again trying. I
6 mean, we kind of worked out along the same lines trying to
7 find out what the harm was. There wasn't really any
8 evidence produced about anything negative about Sterling
9 other than this whole competition and it's just the
10 Allstate/Sterling relationship."

11 Do you see that?

12 A. I do.

13 Q. You were -- your testimony was that the other side
14 didn't produce anything negative about the Allstate/Sterling
15 relationship. Correct?

16 A. I think what I'm talking about is that -- I mean, the
17 other side made a lot of noise, as I said yesterday, about
18 the competition. There wasn't anything from consumers about
19 quality or anything else about Sterling.

20 Q. And you expected there to be some hard, credible
21 evidence about quality. Right?

22 A. Well, I mean, I think if -- Senator Carona had said
23 that he was going to provide hard, credible evidence about
24 negative impact on consumers, or quality, I don't remember
25 the exact words.

Page 37

1 Q. And that was your expectation, that it was the
2 proponents' responsibility to bring hard, credible evidence
3 forward about quality. Right?

4 A. I mean, I'm just telling you what Senator Carona
5 said.

6 Q. And you expected Senator Carona or someone else to show
7 some hard, credible evidence about fraud -- about quality
8 issues. Right?

9 A. I think that when you're proposing legislation,
10 especially legislation that has such a tremendous impact on
11 a company in an industry, that you have some -- that you
12 should be showing some harm or something out there that
13 needs to be fixed.

14 Q. Did Allstate have any hard, credible evidence about
15 quality issues with Sterling? That you were aware of?

16 A. I don't know what you're talking about.

17 MR. YOXALL: Let's pull up Defendant's Exhibit
18 100.

19 BY MR. YOXALL:

20 Q. This is a May 21, 2003 e-mail from Jeff Brask to Chuck
21 Paul and Cathy Lazaroff. Do you see that?

22 A. I see that.

23 Q. And this is May 21 of 2003. Right?

24 A. Right.

25 Q. This is still during the legislative process, but kind

19 (Pages 36 to 37)

Page 38

1 of near the end. Correct?

2 A. A week before the end.

3 Q. The second paragraph, Mr. Brask in the second sentence
4 says, "We also have hard evidence of quality issues."

5 Do you see that?

6 A. I see that.

7 Q. Do you know who David Woodcock is?

8 A. I don't.

9 MR. YOXALL: Let's flip over to the next page.
10 Highlight the top, please.

11 BY MR. YOXALL:

12 Q. These are Sterling quotes and Woodcock observations
13 that he provided to Mr. Brask in May of 2003. Were you
14 aware that -- did you have any idea that Mr. Woodcock looked
15 at the Houston stores?

16 A. I said I don't know who he is.

17 MR. YOXALL: Let's go to the fourth bullet point,
18 highlight that.

19 BY MR. YOXALL:

20 Q. These are Sterling quotes and Woodcock observations,
21 "They are hiring people that don't know what they are doing,
22 and it effects my paycheck."

23 Do you see that?

24 A. I see that.

25 Q. The next bullet point says, "The team suffers for

Page 39

1 reworks equally, not just the person that did the poor

2 quality. This can actually lower the quality of the overall
3 team."

4 Do you see that?

5 A. I see that.

6 Q. Let's go down to the bottom of the page, under Sterling
7 process.

8 As I understand one of Allstate's positions, Ms.

9 Norton, in this lawsuit, that the Sterling process in the
10 automotive world is the greatest thing since sliced bread,
11 it's just better than anybody else, is that -- is that your
12 position, too?

13 A. I think I leave the position to the people -- I mean, I
14 know it's a good process. I think I would leave the
15 technical things to the folks that have a more technical
16 job.

17 Q. The first bullet point says, with respect to the
18 Sterling process, "I'm afraid -- I'm afraid to say much
19 more, I would get fired for talking about this."

20 Do you see that?

21 A. I see that.

22 Q. The second bullet point says, "We can't get the good
23 techs to work for us."

24 Finally, the third bullet point says, "They, Sterling,
25 make a lot of promises, but it's not working."

20 (Pages 38 to 39)

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

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Page 40

1 A. I don't know what this document is. I don't know the
2 context in which it was written.

3 Q. Right. No one from Allstate gave you this document
4 during the legislative process relating to hard, credible
5 quality issues at Sterling?

6 A. Again, I don't know that you can take this one document
7 and say there are hard quality -- credible quality issues.
8 You got to know who wrote it, in what context they wrote it,
9 who the intended audience is for it. And certainly I
10 wouldn't expect to have a document like this sent to me the
11 last week of the Legislative Session.

12 Q. You don't think these -- this will be a relevant
13 document to quality issues that legislators in Austin might
14 want to know about when they're considering whether it's
15 good for Allstate to own Sterling?

16 A. I think I want to give legislators information that I
17 know something about.

18 I also think that -- you know, with an internal
19 document I don't know for what use it was produced.

20 I guess that's it.

21 Q. Ms. Norton, do you think the legislators would have had
22 any interest in quality issues, say at the -- Houston -- or
23 Texas -- or Dallas stores?

24 A. I think if there were negative quality issues we would
25 have consumers complaining, we would have other body shops,

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1 competitors, saying it's bad quality, I'm having to fix
2 these cars, these consumers are complaining because they
3 have to do it.

4 We have no motive to do poor quality repairs.
5 Regardless of what we do or what somebody else does, we're
6 going to end up restoring that vehicle to its pre-accident
7 condition. We have every incentive to do it right the first
8 time.

9 If we have some quality issues along the way, as I
10 would expect with any new business -- we bought a lot of old
11 body shops, we put in new shops. This is not a very old
12 enterprise. I wouldn't expect everything to go smoothly.
13 And I don't think you can take one document and say because
14 somebody pointed out some quality things here and there that
15 it is a rampant problem, that it's not something that people
16 weren't working on and that it rises to the level of me
17 providing it to legislators in this context.

18 MR. YOXALL: I'll object as nonresponsive, Your
19 Honor.

20 THE COURT: Sustained.

21 MR. YOXALL: Let's pull up Defendant's Exhibit
22 146.

23 BY MR. YOXALL:

24 Q. So, Ms. Norton, if Allstate just had one document, it's
25 your position they shouldn't have to show that to you to --

21 (Pages 40 to 41)

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1 to raise any quality issues with legislators, right?

2 A. I think there are times that you would show one
3 document and times you wouldn't. I mean, I think it's a
4 very subjective thing. You've got to look at the context,
5 the document, and the purpose for which it was done and the
6 purpose --

7 THE COURT: You're going to put it in the best
8 light that you can for Allstate, because you're employed by
9 them, correct?

10 THE WITNESS: Yes.

11 THE COURT: You're not going to go to the
12 legislature and say this is a terrible thing, don't vote for
13 this. Right?

14 THE WITNESS: Right.

15 THE COURT: I mean, you wouldn't do it.
16 If there was a bunch of negative what would you do?
17 If you had gotten a bunch of negative information about
18 Sterling, how would you handle it? That happens with
19 lobbyists sometimes I guess, so how would you handle it?

20 THE WITNESS: I think if there was a bunch of
21 negative information -- now, tell me --

22 THE COURT: Well, the quality was just terrible.
23 You had gotten information that the quality at Sterling was
24 terrible. I don't know that it's there. This is a
25 hypothetical.

Page 43

1 How would you handle negative information with regard
2 to giving it to the legislature?

3 Would you just buck up, swallow hard and carry the ball
4 in there and -- or not show 'em that?

5 THE WITNESS: You know, I guess I think -- that's
6 a tough question, because I'm trying to figure out.

7 THE COURT: It is a tough question. That's why I
8 want to get to it as quick as I can.

9 MR. YOXALL: I think the judge is saying I'm
10 taking too long.

11 THE COURT: I don't care about who wins, I care
12 about getting the answer.

13 THE WITNESS: I'm not going to lie to the
14 legislature and I'm not going to give them any false
15 information.

16 Depending on what information was out there, you know,
17 I mean, external, if asked, I would provide information.
18 I'm just trying to figure out what the information -- I
19 don't think any of this is relevant information that even if
20 I had had I would have given.

21 But I think if there was a rampant problem we would
22 have a lot of discussions within the company. And I
23 certainly think there's a level or a type of document where
24 I would have provided it, even if it was really negative on
25 the company.

22 (Pages 42 to 43)

Page 44

1 THE COURT: Do you know of any documents that
2 Allstate has that you've seen, or any -- that -- that show
3 quality problems to the point that you feel bad about what
4 you said --

5 THE WITNESS: Not at all. We kept saying bring us
6 consumers, bring us information.

7 I have -- I feel very, very good about the Sterling
8 situation. I mean, I don't know if you've seen the shops or
9 if you've seen -- there's -- it -- it's a first class
10 operation.

11 THE COURT: Okay. I didn't ask that.

12 THE WITNESS: Okay.

13 THE COURT: I'm asking what have you seen that
14 Allstate has that was problematic.

15 THE WITNESS: I've seen nothing problematic on
16 this at all. I'm sure there were some blips in the -- you
17 know, along the way, but I haven't seen any documents
18 that -- that indicate that there's poor quality or that
19 there's been any harm to consumers.

20 THE COURT: Other than these documents he's
21 showing you?

22 THE WITNESS: Right. Which I had not seen.

23 THE COURT: And you had not seen. And you're not
24 sure whether you would have showed these to the legislators
25 or not?

Page 45

1 THE WITNESS: Yeah. I don't know if these were
2 one person's -- you don't know what the motive of the
3 purpose was, the purpose of the documents, is it to try to
4 inspire people to do better. I don't know what the purpose
5 of that was.

6 But I don't think anything in here indicates -- I
7 didn't get to read all the documents. Maybe if I read them
8 all I can respond better. But I don't think there's
9 anything in here that indicates there's a massive quality
10 problem --

11 THE COURT: Go ahead, Mr. Yoxall.

12 THE WITNESS: -- at Sterling.

13 BY MR. YOXALL:

14 Q. Let me spend a moment on this Exhibit 146. This is in
15 August of 2002, PCCSO strategy snapshot.

16 A. Yes.

17 Q. Under quality, PCCSO is saying repair quality not at
18 PRO standards in 50 percent of the stores. You see that?

19 A. I see that.

20 Q. And this was a document never provided to you by
21 anybody back at Allstate?

22 A. That's right. I don't know though if this is on the

23 shops that we acquired in Houston and they're trying to
24 bring those up to a PRO -- I mean, I don't know what they're
25 specifically referencing when they talk about quality.

23 (Pages 44 to 45)

Page 46

1 Q. That's a -- that's a good point, Ms. Norton.

2 You've got the legacy stores and the new stores.

3 Right?

4 A. Right.

5 Q. Did you ever tell any of the legislators about the
6 difference between the legacy stores and the new stores?

7 A. What do you mean by difference?

8 Q. Allstate contends that the legacy stores aren't quite
9 as good as the new stores. Did anybody in Austin from your
10 side of the table tell the legislators that?

11 A. We didn't talk a lot about the different -- I mean, we
12 talked about -- people were interested in where the stores
13 were and we talked about the fact that the -- when -- in
14 Houston when we bought Sterling we acquired some legacy
15 stores and that in the expansion when we went to Dallas we
16 were putting in new stores.

17 Q. My question is nobody from the Allstate -- Allstate's
18 side of the table ever told any staff members or
19 legislators, or testified in hearings, that the legacy
20 stores were not as good as the new stores. Right?

21 A. No. I mean, I don't know -- just because they're not
22 as good as the new stores doesn't mean they're bad.

23 THE COURT: I'm going to object as nonresponsive
24 again. I'm just asking her if --

25 THE COURT: Sustained. Just answer the question.

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1 BY MR. YOXALL:

2 Q. Anybody ever say that the -- did you ever hear anybody
3 tell legislators, staff members, or testify, that the legacy
4 stores were worse or different than the Dallas stores or any
5 of the new stores?

6 A. I don't think so.

7 MR. YOXALL: Very quickly go to page 3 of
8 Defendant's Exhibit 146. Page 3. Highlight the Houston
9 store. There you go.

10 BY MR. YOXALL:

11 Q. I just want to clarify that no one from Allstate told
12 you that PCCSO had failed five out of the seven Houston
13 stores and failed the overall Houston market in August of
14 2002. Nobody from Allstate told you that. Right?

15 A. No, I don't know the context of any pass/fail.

16 Q. And you -- and you never -- nobody from Allstate ever
17 told any -- any legislators -- any of the Houston
18 legislators in particular, that the stores in Houston had
19 failed the PCCSO analysis. Right?

20 A. I don't know what the PCCSO analysis is. I don't know
21 what the pass/fail standard is. No. I mean --

22 Q. Yes or no, did anybody ever tell anybody in Austin
23 about the Houston stores failing?

24 A. No.

25 Q. With respect to the fraud issue, which I was getting to

24 (Pages 46 to 47)

Page 48

1 a little while ago, at page 132 of the transcript, Judge
2 Kinkeade asked you, but you didn't keep any internal
3 statistics on it either, Allstate did not, and he's talking
4 about fraud. Do you see that?

5 A. Right.

6 Q. He goes on to say, "Allstate doesn't have any internal
7 statistics on fraud in Texas in the auto and body shop
8 business was, do they?"

9 And your answer was:

10 "A. I'm not sure what the exact fraud numbers we
11 have from our dealings in Texas -- I don't know that it
12 would be -- I guess in looking at the California numbers
13 they were kind of statewide, you know, industrywide, so I'm
14 not really sure --"

15 That was your testimony?

16 A. Yes.

17 MR. YOXALL: Let's put up Defendant's Exhibit
18 Number 11.

19 BY MR YOXALL:

20 Q. Now, Ms. Norton, you're familiar with what's called
21 the NICB?

22 A. Vaguely.

23 Q. Do you know that your own expert relied on talking to
24 the NICB in this lawsuit, Dr. Zion?

25 A. I didn't know that.

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1 MR. YOXALL: Let's highlight the top of the
2 e-mail.

3 BY MR. YOXALL:

4 Q. This is an e-mail from Brian Pinkerton dated February
5 21, 2003, to a number of people, including yourself, John
6 Edelen, people from Hill & Knowlton, you see that?

7 A. I do.

8 Q. Also Mr. Sullivan got this e-mail as well, right?

9 A. He did.

10 Q. And the subject line is Texas auto repair fraud.

11 Right?

12 The subject line at the top?

13 A. Yes, it is.

14 Q. Ms. Norton, Allstate had a relationship with Hill &
15 Knowlton, the PR firm, prior to the Texas legislative
16 process, right?

17 A. Yes.

18 Q. And Hill & Knowlton, the PR firm, was involved in this
19 entire process. Right?

20 A. In Texas?

21 Q. Yes.

22 A. Yes.

23 Q. Now, Mr. Pinkerton says, FYI, here are the fraud
24 numbers from the NICB. Unfortunately, the numbers are not
25 very compelling. There is no California bar-like agency."

25 (Pages 48 to 49)

Page 50

1 Right?

2 A. Yes.

3 Q. Now, who was Mr. -- who was Brian Pinkerton?

4 A. Brian Pinkerton is an Allstate employee who works in

5 corporate relations.

6 Q. So he's in the same area with Mr. Vainisi?

7 A. No. Mr. Vainisi is more in the governmental affairs

8 area. Corporate relations deals more with media, public

9 affairs aspects.

10 Q. So he's kind of a PR guy?

11 A. Um-hum.

12 Q. In any event, he's highlighting the fraud numbers. As

13 you go down, he was forwarding an e-mail from Gigi Westerman

14 from November of 2002, so before the legislative process got

15 started. Right?

16 Do you see the dates?

17 A. Yes, I do.

18 Q. Now, Gigi Westerman, I believe she's also in the

19 corporate relations department, correct?

20 A. She is.

21 Q. So for some reason Mr. Pinkerton had asked Ms.

22 Westerman to gather numbers on Texas auto repair fraud.

23 Right?

24 A. It looks that way.

25 Q. And Ms. Westerman says, "I got those Texas auto fraud

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1 numbers I was waiting for from the NICB, and I'm afraid they

2 weren't very helpful. Carol Anderson at the NICB in Texas

3 pulled from their database any questionable auto repair

4 claims that were referred to the SIU for investigation. And

5 here are the numbers."

6 Do you see that?

7 A. I do.

8 Q. Now, the SIU department, that's part of Allstate.

9 Correct?

10 A. Special Investigative Unit.

11 Q. Right.

12 A. Yes. I don't know -- I'm assuming -- I don't know what

13 they're really talking about here. Hold on.

14 Q. Ms. Norton, why would Ms. Westerman and Mr. Pinkerton

15 be pulling Texas fraud auto repair numbers in November of

16 2002, do you know?

17 A. I do not know.

18 Q. But there's references in here to California. Right?

19 A. I imagine Brian worked on California issues. Brian's

20 in home office, he works on issues all over the country.

21 Q. Now, these numbers were pulled because of the

22 anticipated Texas legislation, correct?

23 A. It could be. It wasn't at my direction. It could have

24 been corporate relations.

25 Q. That would make sense, wouldn't it, given the time?

26 (Pages 50 to 51)

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1 A. Right.

2 Q. Now, Ms. Westerman goes on to say, "Obviously these
3 aren't very dramatic numbers and Carol doesn't think this
4 data really reflects the problem, but she couldn't think of
5 any more way to get more comprehensive numbers."

6 Do you see that?

7 A. Um-hum.

8 Q. Now, Ms. Norton, you never provided this document to
9 anybody at the Texas Legislature when you were discussing
10 the fraud that you say is rampant in Texas. Correct?

11 A. That's right. I think that tells you why I didn't, is
12 that you have someone from NICB saying that it's -- doesn't
13 really reflect the problem. So why would we provide
14 information on fraud statistics that don't show the
15 problem?

16 And like I said, we didn't have statistics like they
17 had in California that would really show all levels of fraud
18 in auto repair.

19 Q. And Judge Kinkeade asked you yesterday if you had any
20 statistics, and you said no. Correct?

21 A. I don't know what statistics the company might have.

22 Q. Well, you don't consider those numbers right there
23 statistics from the NICB, I guess?

24 A. I mean, they're NICB numbers.

25 Q. In any event -- if you would answer my question: You

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1 didn't provide this e-mail to anybody in Austin, whether
2 staff members or legislators. Right?

3 A. You wouldn't -- this -- I don't think anybody on any
4 side would ever provide an e-mail to the legislator --
5 legislature.

6 Q. Ms. Norton, at your deposition you testified you didn't
7 give this e-mail to anybody in Austin?

8 A. I did not give this e-mail to anybody in Austin.

9 Q. And you didn't provide this information to anybody in
10 Austin?

11 A. I did not.

12 Q. Ms. Austin -- Ms. Austin -- Ms. Norton, there was also
13 testimony about the cost effectiveness of the Sterling
14 repairs during -- during the hearings. Right?

15 A. There was.

16 MR. YOXALL: Let's pull up Defendant's Exhibit
17 29.

18 BY MR. YOXALL:

19 Q. This is Allstate/Sterling review, update with George
20 Ruebenson, April 29 of 2003. Do you see that?

21 A. Yes.

22 Q. And this is during the legislative process, April 29,
23 2003?

24 A. Yeah.

25 Q. Let's go to page 6. I take it no one provided this

27 (Pages 52 to 53)

Page 54

1 document to you?

2 A. I don't think so. If they had sent it I probably

3 wouldn't have been able to read it anyway.

4 MR. YOXALL: Okay. If you could highlight the

5 first -- the findings, in the middle.

6 BY MR. YOXALL:

7 Q. In this report Mr. Ruebenson is being told that the

8 Paris database suggests Sterling pricing is 15 percent

9 higher than PRO. Anybody make you aware of that in Austin?

10 A. No.

11 Q. It also says further down that the results suggest

12 average Sterling pricing was 15 to 25 percent higher than

13 PRO. Do you see that?

14 A. I see that.

15 Q. So with respect to the cost effectiveness of the

16 Sterling repairs, nobody from Allstate provided you this

17 information during the legislative process?

18 A. No.

19 Q. Now, Ms. Norton, you were the -- the chief lobbyist in

20 Austin, right?

21 A. Yes.

22 Q. For Allstate?

23 A. Yes.

24 Q. And you hired some outside lobbyists?

25 A. I did.

Page 55

1 Q. You hired Rusty Kelley and Carol McGarah?

2 A. Yes.

3 Q. Rusty Kelley has a few people that work for him and as

4 you told Judge Kinkeade yesterday, he was making a pretty

5 good reputation for himself, wasn't he?

6 A. I hope so, since I hired him.

7 Q. That's what your people in Northbrook would expect you

8 to do?

9 A. Yes.

10 Q. And Allstate has done its own share of lobbying in

11 Austin over the last few years, right?

12 A. Excuse me?

13 Q. And Allstate has done its own share of lobbying in

14 Austin over the last few years, right?

15 A. I'm the first person they have had in Austin doing

16 that, but yes.

17 Q. You also retained Craig Pohlen and Robert Culley -- or

18 Robert Culley, excuse me?

19 A. I did.

20 Q. And you also retained Todd Smith?

21 A. I did.

22 Q. So you had three different sets of lobbyists, right?

23 A. I did.

24 Q. And Allstate, as you testified earlier, is a member of

25 the affordable collision -- the Texas Coalition for

28 (Pages 54 to 55)

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1 Affordable Insurance. Correct?

2 A. Yes.

3 Q. And, Ms. Norton, there was an extensive lobbying effort

4 that was going on. There was a grass roots effort. There

5 were letters. There were meetings. Allstate was doing all

6 those things that normally occur during the lobbying

7 process. Right?

8 A. Yes.

9 Q. You testified yesterday that you were ambushed at that

10 meeting. Right?

11 A. Yes.

12 Q. Allstate is a big company. Correct?

13 A. We are.

14 Q. And you've lobbied in Austin for a lot of years.

15 Right?

16 A. Yes.

17 Q. And you had a lot of people on your side of the table,

18 didn't you?

19 A. I guess -- during the Legislative Session, yes. At the

20 time of that specific meeting, no.

21 Q. And there were a lot of meetings in Austin during this

22 process. Right?

23 A. There were several meetings, yes.

24 Q. And, Ms. Norton, we discussed in your deposition some

25 of your past lobbying experiences. And you've shown up at

Page 57

1 meetings before where the other side didn't expect you to be

2 there, right?

3 A. You know, I don't know that I could say that for

4 certain. It could happen.

5 Q. You testified in your deposition that it could happen

6 and you may have done that, right?

7 A. Yeah, I said I thought it could happen.

8 Q. And Allstate had Sterling employees sending draft

9 letters to -- to the Texas Legislature talking about special

10 interests, right?

11 A. Yes.

12 Q. And Allstate had drafted those letters?

13 A. I think some -- we -- Allstate -- we were asked by our

14 employees, who were very worried about losing their jobs.

15 There's like 350 employees with really good jobs, and it was

16 a very scary time to them. We did provide some talking

17 points for them. A lot of them sent in -- some of them sent

18 in letters that were a little bit different.

19 MR. YOXALL: For example, pull up PX 84,

20 Plaintiff's Exhibit 784.

21 BY MR. YOXALL:

22 Q. Down in the second to last paragraph, "Big government

23 should not support special interest laws that deny citizens

24 from earning an honest living."

25 These were the kind of letters that Allstate had

29 (Pages 56 to 57)

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1 drafted and Sterling employees were sending in?

2 A. The Sterling employees did send these letters in. They
3 are not that different from the letters that the body shops
4 sent in.

5 Q. Exactly right. This was a lobbying effort, Ms. Norton,
6 and both sides were lobbying this thing real hard, right?

7 A. Yes.

8 Q. And, as you testified, there were about two months
9 worth of meetings, a lot of meetings over this issue.

10 Correct?

11 A. Yes.

12 Q. And House Bill 1131 passed overwhelmingly in the
13 House. Right?

14 A. It did.

15 Q. And at that point in time your primary goal was to
16 avoid divestiture. Correct?

17 A. I think at all times my goal would be to avoid any
18 kind of legislation that would impact us.

19 Q. Your primary goal at that point in time was to defeat
20 legislation that would require divestiture. Right?

21 A. Yeah. To defeat the legislation, period.

22 Q. And it would have been a large benefit to Allstate to
23 avoid divestiture. Correct?

24 A. Not having to divest our 14 stores would be a benefit,
25 yes.

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1 Q. Okay. And you had people from Allstate come down and
2 attend those meetings, correct? Mr. Edelen?

3 A. On occasion I had some people come in for specific
4 meetings.

5 Q. Mr. Edelen was there?

6 A. Yes. He came down.

7 Q. Mr. Thompson was there?

8 A. He did, yes.

9 Q. And there were meetings that occurred with just the
10 Allstate side and different members of the Legislature,
11 right?

12 A. Yes.

13 Q. And then there were joint meetings, right?

14 A. Yes.

15 Q. And there were discussions of the grandfather clause.
16 Correct?

17 A. At some of the meetings there were discussions of the
18 grandfather clause, yes.

19 Q. After the Dewhurst meeting that you referenced in
20 your -- in your -- in your testimony yesterday, after that
21 point in time every draft of the bill had the grandfather
22 clause and the code of conduct contained in those drafts.

23 Correct?

24 A. That's probably true.

25 Q. And with respect to that Dewhurst meeting, Ms. Norton,

30 (Pages 58 to 59)

Page 60

1 you testified that Lieutenant Governor Dewhurst came out and
2 made a statement about the Bill. And that would have been
3 about April 9th, right?

4 A. I think that's right.

5 Q. And then there was a -- there was a meeting in his
6 chambers about April 16th or 17th. Right?

7 A. State that one more time.

8 Q. There was a meeting in Lieutenant Governor chambers --
9 Lieutenant Governor Dewhurst's chambers, where Senator
10 Carona was in attendance. Right?

11 A. On what date? I thought you were --

12 Q. About April 16th or 17th?

13 A. Okay. Probably, yeah.

14 Q. Were you in attendance at that very first meeting after
15 Lieutenant Governor Dewhurst's public statement?

16 A. You know, I'm not -- I think I probably would have
17 been, if Allstate was included in the meeting.

18 Q. You referenced your -- those notes yesterday about the
19 April 22 meeting, right? Yesterday?

20 They're the notes about the grandfather clause?

21 A. That somebody from the other side had made?

22 Q. Right.

23 A. Yeah.

24 Q. That was an April 22 meeting. Correct?

25 A. I think that's right.

Page 61

1 Q. And you recall that meeting?

2 A. I guess I'm trying to see -- there were meetings on
3 different days in April, I don't -- I don't know that I'm
4 right now able to tell you which meeting. If you could help
5 me out.

6 Q. My question is you're not sure if you were at the very
7 first Lieutenant Governor Dewhurst meeting in his chambers
8 on or about April 16th or 17th?

9 A. I think I was at every meeting to which Allstate was
10 invited. I don't know the specific date of the meetings.
11 If you want to help me out there.

12 Q. There was a meeting April 16th in Lieutenant Governor
13 Dewhurst's chambers?

14 A. Okay. Then I think I was there.

15 Q. Okay. And you obtained a legal opinion from a UT law
16 professor regarding grandfathering, true?

17 A. I did.

18 Q. And that opinion suggested that grandfathering would be
19 constitutional. Right?

20 A. That -- I requested that opinion from this law
21 professor at the request of the Lieutenant Governor's
22 office. It was about equal protection.

23 Q. It related to grandfathering, correct?

24 A. It related to grandfathering in the limited context of
25 whether it violated the equal protection.

31 (Pages 60 to 61)

Page 62

1 Q. Correct? But it was with respect to the grandfathering
2 clause that was now in the drafts of the bill, whether that
3 was constitutional. Right?

4 A. You know, I don't know if it was -- I don't know that
5 we ever provided her with any specific language. It may
6 have been more just the concept of grandfathering, whether
7 that would have somehow violated equal protection.

8 Q. Any event, over the course of those two months there
9 were informal meetings with legislators, right?

10 A. There were.

11 Q. There were telephone calls to legislators?

12 A. Yes.

13 Q. Mr. Thompson met with the members of the Senate
14 Business and Commerce Committee meeting --

15 A. Right.

16 Q. Mr. Edelen had meetings with legislators?

17 A. Yes.

18 Q. And there was exchange of draft bills?

19 A. Yes.

20 Q. Right?

21 MR. YOXALL: Let's put up Defendant's Exhibit
22 340.

23 BY MR. YOXALL:

24 Q. This is a redline version -- an Allstate redline
25 version of one of the draft bills, correct?

Page 63

1 A. Yes.

2 Q. And at the very bottom, if we could highlight the
3 day -- now down by confidential -- this was a document
4 produced by Allstate, so it's labeled confidential.

5 It was a 5/8/2003 Allstate proposal redline of
6 dealer/body shop 5/03 substitute. Right?

7 A. Right.

8 THE COURT: Let's go over to the third page.

9 Is this 340? I couldn't read it.

10 MR. YOXALL: Yes, Your Honor. It's Defendant's
11 Exhibit 340.

12 THE COURT: Okay.

13 BY MR. YOXALL:

14 Q. Now, in the columns there's some comments, and those
15 are from Allstate. Right?

16 A. Yes.

17 Q. And then the text of the -- of the -- of the Bill is
18 redlined, there's comments made. Some things are stricken
19 out, some things are left. Right?

20 A. Right.

21 MR. YOXALL: Let's highlight the first one -- no,
22 the first side comment on the right.

23 BY MR. YOXALL:

24 Q. This comment is from Allstate saying PURA language was
25 added to define better behavior?

32 (Pages 62 to 63)

Page 64

1 A. Yes.

2 Q. The reference to the PURA reference is from the first
3 Dewhurst meeting where the concept of this code of conduct
4 based upon the public utilities regulatory act code of
5 conduct was discussed. Right?

6 A. Yes.

7 Q. And there was a discussion over this bill about relying
8 upon a grandfather clause and a code of conduct. Right?

9 A. No. That's not true.

10 Q. There was no discussion of the PURA statute?

11 A. Bruce Gibson, who is the Lieutenant Governor's chief of
12 staff said y'all go see if you can't work something out on
13 this bill. Bruce had been a -- an officer and a lobbyist
14 for Reliant Energy.

15 And he said, you know, I know we've had some dealings
16 in the electrical industry before we were -- in reference to
17 PURA -- we had problems with the other side because they
18 kept coming back saying that the Lieutenant Governor had
19 ordered us to have a PURA like code of conduct.

20 We went back to the Lieutenant Governor's office.

21 He said, no, I just threw that out, I saw one industry
22 able to resolve things with that.

23 So it was more of something that we could look at as
24 some possibilities, but it was never -- we were never told
25 to have grandfathering, we were never told to have the PURA

Page 65

1 code of conduct.

2 Q. And so that's what -- your recollection of what Mr.
3 Gibson said at that first meeting?

4 A. Yes, it is.

5 Q. Okay. But in any event, the drafts after that point
6 had grandfathering in this proposed code of conduct in the
7 various drafts that were exchanged back and forth?

8 A. Yeah, I think there may have been a draft from me that
9 tried to get back to addressing the steering problem that
10 would have had none of that in there.

11 Q. Okay. Let's go over and look at one other thing. Go
12 over two pages.

13 Now, the code of conduct is contained at section
14 2306.006 of the statute. Right?

15 That's the prohibition part of the statute?

16 A. Right.

17 Q. And that's the code of conduct that has been raised in
18 this -- that's been discussed in this lawsuit?

19 A. Right.

20 Q. And if we could just go to the regular screen, as this
21 document reflects, Allstate was making comments and giving
22 critiques and suggesting language and striking things out
23 throughout the code of conduct. Right?

24 A. Yes.

25 Q. Let's go to the -- just the very next page.

33 (Pages 64 to 65)

Page 66

1 So Allstate was accepting some language and striking
2 others, right?

3 A. I think for purposes of the negotiations we were
4 striking things, we were adding language, yes.

5 Q. Okay. In any event, the final version of HB 1131
6 contained many of the changes that Allstate identified,
7 critiqued, provided, and sought. Isn't that right?

8 A. Could you repeat that one more time?

9 Q. The final version of HB 1131 contained many of the
10 changes that Allstate identified, critiqued, provided, and
11 sought?

12 A. You know, it's hard to say it that succinctly. They
13 took out some of the stuff we objected to. They added some
14 of the language that we offered as critiques.

15 Q. Do you remember giving your deposition back in June?

16 THE COURT: All right. Let me stop you.

17 Let's take a 20 minute break.

18 THE SECURITY OFFICER: All rise.

19 (Recess taken.)

20 THE SECURITY OFFICER: All rise.

21 Please be seated.

22 MR. YOXALL: May I proceed, Your Honor?

23 THE COURT: Yes, sir.

24 (CROSS-EXAMINATION)

25 (Continued)

Page 67

1 BY MR. YOXALL:

2 Q. Ms. Norton, I think the question I was asking you was
3 the final version of House Bill 1131 contained many of the
4 changes that Allstate identified, critiqued, provided and
5 sought. Is that right?

6 A. Yeah. I think I said that the final version did have
7 many of the -- some language that we had offered, some of
8 the critiques that we had had, yes.

9 Q. Let's see what you said during your deposition.

10 "A. The final version of House Bill 1131 contained
11 many of the changes that Allstate identified, critiqued,
12 provided and sought. I don't think there are any problems
13 with that."

14 Is that your testimony back in June?

15 MR. SMITH: "Any problems with that," I didn't
16 hear you read those two words.

17 MR. YOXALL: "I don't think there are any problems
18 with that."

19 THE WITNESS: That's from my deposition back in
20 June.

21 BY MR. YOXALL:

22 Q. Ms. Norton, during the legislative process, Allstate,
23 through the meetings, joint or separate, through telephone
24 calls, through conversations in the Capitol, Allstate had
25 every opportunity and Sterling had every opportunity to tell

34 (Pages 66 to 67)

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1 the legislators their side of the story about how good
 2 Allstate and Sterling and the whole relationship is. Right?
 3 A. Allstate had the -- had the opportunity the tell our
 4 side of the story.
 5 Q. Now, Ms. Norton, did Allstate bring Dr. Zion,
 6 Allstate's I think car/fraud expert, down to Austin to
 7 testify?
 8 A. We didn't. I think, as I said earlier, that had not
 9 been an issue. I don't know, why we would bring him down
 10 for -- for that?
 11 Q. The issue of fraud wasn't an issue in the auto body
 12 repair industry?
 13 A. I think we provided testimony on it. No one ever asked
 14 for any more -- any information. I think it's a pretty
 15 given that this is an industry, like the fourth, you know,
 16 highest complaint ratio. It was just a given. There were
 17 no questions about it.
 18 I certainly wouldn't bring -- it's like using a, you
 19 know, steamroller to kill a flea. You're not going to bring
 20 experts down if nobody is questioning it. It would be a
 21 waste of resources and time.
 22 Q. So, Ms. Norton, Allstate's position is if the
 23 Legislature doesn't ask we don't provide, right?
 24 A. We provide helpful information. The proponents of this
 25 bill did not offer anything to the Legislature on -- we

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1 addressed things. We said there was fraud. We provided --
 2 if anybody had asked for information, I would have provided
 3 it.
 4 Q. And that's my question.
 5 The legislators had to ask for Allstate --
 6 A. No, they didn't.
 7 MR. YOXALL: If I could finish my question, Your
 8 Honor.
 9 THE COURT: Yes.
 10 BY MR. YOXALL:
 11 Q. The Legislature had to ask other staff members, or
 12 whoever, for Allstate to provide some of the information --
 13 A. Absolutely not.
 14 Q. If I could finish my question.
 15 To provide some of the information on fraud, pricing,
 16 quality of repairs, and conflict of interest, the
 17 information that Allstate had, the Legislature had to ask.
 18 A. Absolutely not.
 19 We provided a great deal of relevant information to the
 20 Legislature. I would have loved to be able to provide
 21 statistics on fraud.
 22 As I said, unfortunately in Texas the auto repair
 23 industry is not regulated. There are not statistics out
 24 there to provide. You're saying I should go dig up some
 25 fraud experts and bring them in for a legislative hearing,

35 (Pages 68 to 69)

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1 the total of which was two and a half hours in both houses?

2 I mean, they weren't interested in hearing what we had
3 to say.

4 MR. YOXALL: I'll object to the nonresponsive,
5 Your Honor.

6 THE COURT: Sustained.

7 BY MR. YOXALL:

8 Q. Dr. Zion didn't testify in Austin, did he?

9 A. He did not.

10 Q. Dr. Harrington, who is here in the courtroom, Allstate
11 didn't bring him down to Austin to testify either, did they?

12 A. We did not.

13 Q. Did you bring any experts down to Austin to testify?

14 A. I did not. Experts don't usually testify at the
15 Legislature.

16 Q. Right. That's exactly right.

17 Now, Ms. Norton, Allstate continued to lobby the
18 legislators, Lieutenant Governor Dewhurst, and even Governor
19 Perry to veto the bill until the very last day, right?

20 A. Yes, we did.

21 MR. YOXALL: Let's pull up Defendant's Exhibit
22 30 -- 13. If we could switch over, Eric. I'm sorry.

23 BY MR. YOXALL:

24 Q. Ms. Norton, after Governor Perry didn't -- did not veto
25 the bill, did you have any expectation that Allstate might

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1 bring litigation over House Bill 1131?

2 A. I mean, I guess I knew when they ended up filing it.

3 No, I mean, I think after the legislation was initially
4 passed the company kind of moved forward going into the
5 implementation mode, because we had to make some pretty
6 significant changes.

7 Q. So you don't know one way or another whether Allstate
8 was considering litigation after the bill was passed and not
9 vetoed?

10 A. I was not involved -- no, I didn't know that.

11 MR. YOXALL: Okay. Let's go down to the chain.
12 There's an e-mail from John Edelen, if we could highlight
13 the very first part of the e-mail.

14 BY MR. YOXALL:

15 Q. This is February 17th of 2003. Mr. Edelen says, "A few
16 exhibits. Bottom line, I'm not sure we can challenge them
17 on the data entirely."

18 Do you see that?

19 A. I see that.

20 Q. And then let's go down to the very bottom of the
21 document.

22 Very last sentence, Mr. Edelen says, "Absent a
23 compelling interest, this needs to be challenged on
24 constitutional grounds, as we have discussed. Any way to
25 fashion an interstate commerce argument just for good

36 (Pages 70 to 71)

Page 72

1 measure?"

2 Do you see that?

3 A. I see that.

4 Q. Do you recall getting that e-mail?

5 A. I don't think I got that e-mail.

6 MR. YOXALL: If we could go back up to the top.

7 Mr. Edelen's e-mail.

8 Under the top part, you see Jo Betsy Norton?

9 A. I see that.

10 I don't recall reading that e-mail from John.

11 Q. Let's pull up Defendant's Exhibit 24.

12 MR. YOXALL: Let's highlight the top of it,

13 please.

14 BY MR. YOXALL:

15 Q. This is June 25, 2003, from Cathy Lazaroff, who is Vice

16 President of PCCSO, she says the Texas Governor signed the

17 Sterling Bill into law.

18 Do you see that?

19 A. Yes, I see that.

20 MR. YOXALL: Go to the second paragraph, please.

21 BY MR. YOXALL:

22 Q. "The forced divestiture of existing Sterling stores in

23 observation, which was a key component of the original bill,

24 was stricken from the final legislation." Right?

25 A. Yes.

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1 Q. And the memo goes on, if we can go to the next

2 paragraph, "Adopted, the bill enables Sterling to continue

3 to operate its 15 stores in Houston, Dallas, and San

4 Antonio," that's what Ms. Lazaroff states, right?

5 A. That's what it says.

6 Q. And then in the next paragraph she says, "We will

7 continue efforts to ensure that Allstate and Sterling are

8 able to compete fairly in the Texas market."

9 Do you see that?

10 A. Yes, I see that.

11 Q. Did you receive this e-mail?

12 A. I would have -- it says the regional counsel were

13 copied, so I probably did receive it.

14 Q. Do you know if Ms. Lazaroff in her reference in that

15 paragraph was referencing future litigation over the

16 statute? Do you have any idea?

17 A. I have no idea.

18 THE COURT: Could you scroll back up. I was

19 reading something.

20 MR. YOXALL: Sorry, Your Honor.

21 THE COURT: All right. The third paragraph.

22 Okay. Go ahead.

23 BY MR. YOXALL:

24 Q. Ms. Norton, in the middle of that third paragraph

25 Ms. Lazaroff says, "The bill imposes restrictions on insurer

37 (Pages 72 to 73)

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1 investment and auto collision repair facilities that remains
 2 a source of concern." Right?
 3 A. Yes, that what's it says.
 4 Q. And that was the fundamental problem, this bill
 5 prohibited insurance companies from investing in body shops,
 6 right?
 7 A. Say that one more time.
 8 Q. The fundamental concern from Allstate's perspective was
 9 this bill imposed restrictions on insurer investment in
 10 automobile collision centers.
 11 A. I think that would be true with the initial bill,
 12 because it was the divestiture. I would say the final bill
 13 there were concerns beyond that because it restricted our
 14 ability, the way in which we would interact with the
 15 Sterling stores and with other repair facilities.
 16 Q. In any event, it restricted insurance company
 17 investment, right?
 18 A. The final bill does restrict insurance company
 19 investment.
 20 Q. It didn't restrict other auto body chains from outside
 21 of Texas, it didn't restrict them from coming into Texas and
 22 opening their chains, if they weren't insurance owned,
 23 right?
 24 A. You know, I don't know if there are any such entities.
 25 Q. If there are, it doesn't restrict 'em, right?

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1 A. It doesn't appear to restrict 'em, no.
 2 Q. Now, Ms. Norton, earlier you testified that you did
 3 take notes during all these meetings that occurred from
 4 February through May. Right?
 5 A. Yes.
 6 Q. And these meetings were important to you and Allstate?
 7 A. Yes.
 8 Q. And there were significant negotiations that took place
 9 in those meetings. Right?
 10 A. Yes.
 11 Q. You didn't keep any of those handwritten notes after
 12 this legislation was over with, did you?
 13 A. No. As I told you I have a very small office. I don't
 14 keep a lot of paper.
 15 Typically, the notes from my papers I would type up,
 16 there usually are scribbles on the side. I would type up,
 17 send 'em an e-mail, kind like the ones you saw to Brian.
 18 I was not anticipating any litigation. I turned over a
 19 ton of documents because I do so much on my computer.
 20 So, I mean, it was just in the normal course of my
 21 business.
 22 I had about a ton of stuff from Senate Bill 14 as well.
 23 Q. In any event, after this legislation, which was the
 24 first legislation of its kind that passed in the United
 25 States -- right?

38 (Pages 74 to 75)

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Page 76

1 A. Yes.

2 Q. You did not keep your notes from any of those meetings?

3 A. I mean, I have them -- you've seen them. They're in my
4 word documents and stuff, where I typed up my notes, because
5 they were basically scribbles, so I could -- everybody was
6 very interested in what I had to say about it and I'm going
7 to send them scribbled notes on the side of papers.

8 MR. YOXALL: I'll object as nonresponsive.
9 Eric, if you could --

10 THE COURT: Overruled.

11 MR. YOXALL: If you could go to the ELMO, please.

12 BY MR. YOXALL:

13 Q. Just show you what you said during your deposition:

14 "Q. So just to be clear, you didn't keep any
15 handwritten notes that you made during the 2003 session
16 relating to Senate Bill 435 or House Bill 1131?

17 "A. I did not."

18 That was your answer then, right?

19 A. I think that's what I just said to you.

20 Q. Let me show you the statute, which is now the
21 Occupations Code, at 2306.001.

22 Ms. Norton, the definition of "insurer" means "any
23 insurer authorized by the Texas Department of Insurance to
24 write motor vehicle insurance in the state, including a
25 county mutual insurance company, a Lloyd's plan."

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1 Do you see that definition?

2 A. I do.

3 Q. And that's the definition that's in the statute?

4 A. I have no reason to believe that that's not the statute
5 that you were showing.

6 Q. Ms. Norton, under House Bill 1131, no insurance company
7 can own a body shop, whether they're in Texas or out of
8 Texas, other than those that are specifically addressed in
9 House Bill 1131. Right?

10 A. That's right.

11 MR. YOXALL: Pass, Your Honor.

12 THE COURT: Ms. Goldstein.

13 MS. GOLDSTEIN: Brief redirect, Your Honor.

14 (REDIRECT EXAMINATION)

15 BY MS. GOLDSTEIN:

16 Q. Ms. Norton, in your meetings at the Capital, did you
17 receive information from the body shops or their lobbyists
18 about poor repairs at local shops?

19 A. At local Sterling shops?

20 Q. No. Local non-Sterling local body shops?

21 A. No, I did not.

22 Q. Did anyone give you information throughout the process
23 that insurer ownership causes more problem repairs than the
24 local shops?

25 A. No, I did not.

39 (Pages 76 to 77)

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1 Q. Did you, or anyone from Allstate, ever agree to the
2 enactment of HB 1131?

3 A. We did not.

4 MR. YOXALL: One question, Your Honor.

5 THE COURT: All right.

6 (RECROSS-EXAMINATION)

7 BY MR. YOXALL:

8 Q. Ms. Norton, the quality of repairs at the other body
9 shops was not an issue. The issue raised by the other body
10 shops was the quality of repairs at Sterling shops.

11 Correct?

12 A. Repeat it.

13 Q. The quality of repairs that were at issue during the
14 Texas legislation -- during the Legislative Session was the
15 quality of repair at the Sterling shops, that was the issue
16 raised by the other side, right?

17 A. Right. I think we have said they didn't raise the
18 specific quality issues.

19 Q. But they raised the quality of repair issues at
20 Sterling shops, correct?

21 A. Indirectly.

22 Q. They raised the quality of repair issues for Sterling
23 shops, correct?

24 A. Well, what I'm saying, there was no testimony on
25 quality of repairs. We were in meetings with some of the

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1 proponents, the auto dealers and the body shops, they made
2 some broad reference to quality of repairs.

3 So I'm kind of torn on how to answer that question

4 because I do not think that the quality of repair issue was

5 brought up to the legislature. I think it was brought up in

6 meetings between the parties and there was never any

7 substantiation of any of the statements that they made.

8 So -- I mean --

9 Q. The only people that had quality -- had information on
10 the quality of repairs were the people back at Allstate in
11 Northbrook, right?

12 You didn't have that information, correct?

13 A. I didn't -- I did not have specific information on
14 quality of repairs.

15 MR. YOXALL: No further questions, Your Honor.

16 THE COURT: I notice that former County Judge, and
17 I believe he was a State Senator, Cryer, testified.

18 THE WITNESS: She did.

19 THE COURT: Why did USAA testify on y'all's -- I
20 don't know, your side?

21 THE WITNESS: Well, I don't know. I think they
22 were concerned -- I'm trying to remember her testimony
23 specifically.

24 THE COURT: Well, she did testify in favor of --
25 well, of trying to stop the bill.

40 (Pages 78 to 79)

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1 THE WITNESS: Right. I think part of where she
2 was coming from in the Senate hearing, I haven't looked at
3 her testimony recently, was really more kind of the unfair
4 advantage that it gave to Allstate over other insurers,
5 since there was that grandfather provision where we would
6 get to keep a certain number of stores.

7 But USAA, if they wanted to get into the business, they
8 wouldn't have the opportunity.

9 THE COURT: So she really wasn't in favor of this
10 at all but she sure didn't want Allstate to have an
11 advantage over USAA?

12 THE WITNESS: Okay. I'll have to look back at her
13 testimony. She may have been in favor -- that was one thing
14 she raised. I would have to go back and look at her
15 testimony specifically.

16 THE COURT: I'll just have to look at it.

17 THE WITNESS: She had one other concern, I guess
18 I'm trying to be helpful. The way the bill -- the language
19 came out of the bill that came out of the Senate, ended up
20 somehow impacting just even shops like USAA, it ended up
21 impacting their dealings with PRO shops, so she ended up,
22 through her lobby efforts, had some minor changes made to
23 the statute in Senate Bill 14, because it was like the last
24 bill that was passed.

25 She was -- from her perspective it was more I think of

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1 an unintended consequence that the wording actually reached
2 out and would have affected them slightly.

3 Okay. And then I notice somebody from AAA instead.

4 Do you remember anything --

5 A. Anne O'Ryan. I didn't really know her before the
6 session.

7 THE COURT: Were they in favor of the bill,
8 against the bill or what?

9 THE WITNESS: Against.

10 AAA has -- I don't know the specific interest, but some
11 sort of a financial interest or stake in Caliber. It's a
12 little different than our setup.

13 THE COURT: Okay. Okay.

14 THE WITNESS: That's why she testified.

15 THE COURT: I understand now.

16 So when the -- you weren't happy when House Bill 1131
17 was enacted into law, yes or no?

18 THE WITNESS: I was not happy. No.

19 THE COURT: I made that a double negative, didn't
20 I?

21 You were not happy, correct?

22 THE WITNESS: I was not happy.

23 THE COURT: Okay. And Allstate, despite their
24 efforts in getting changes made, they still weren't
25 satisfied; is that your position or not?

41 (Pages 80 to 81)

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1 THE WITNESS: Yeah. I would say -- no, we were
 2 not -- we were still not happy. I think we felt that the
 3 final provisions kind of had this -- while it wasn't total
 4 divestiture, the -- the heavy requirements and restrictions
 5 and the code of conduct kind of ended up in this de facto
 6 divestiture, that you couldn't operate the company -- even
 7 the ones that were left, you couldn't operate those shops in
 8 a way that -- that would make any business sense. It kind
 9 of took away any advantage of having -- even though we were
 10 left with some of the shops, there were such severe
 11 restrictions placed on how Allstate could interact with them
 12 that it took away any real benefit of ownership.

13 THE COURT: Any more questions?

14 MR. YOXALL: Based on your questions, Your Honor,
 15 if I can find the document I may have one quick question.

16 THE COURT: Okay. How about you, Ms. Goldstein.

17 MS. GOLDSTEIN: No, Your Honor.

18 MR. YOXALL: No further questions, Your Honor.

19 THE COURT: All right. Is this witness excused?

20 MR. YOXALL: As far as we're concerned.

21 MS. GOLDSTEIN: Yes.

22 THE COURT: All right. You're excused.

23 All right. Okay. I think we're ready for our seventh
 24 witness.

25 MR. SMITH: Your Honor, this is our seventh and

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1 from our case our last witness, which is Dr. Harrington and
 2 Colin Kass is going to handle that examination of
 3 Dr. Harrington, although obviously we've submitted for the
 4 court's review the deposition excerpts by video of
 5 Mr. Mattax and Mr. Reyes, which are an essential part of our
 6 case.

7 THE COURT: Right. Okay.

8 (Witness sworn.)

9 THE COURT: All right. Please take a seat, sir.

10 MR. KASS: Your Honor, may I approach?

11 THE COURT: Yes, sir.

12 I've got to ask you this: Do you say economics or
 13 economics?

14 THE WITNESS: Economics.

15 THE COURT: Okay. I give up then.

16 Even in the south?

17 THE WITNESS: Not in the south.

18 THE COURT: Okay. Okay. That makes me feel
 19 better.

20 Okay.

21 SCOTT EDWARD HARRINGTON,

22 having been duly sworn testified as follows:

23 (DIRECT EXAMINATION)

24 BY MR. KASS:

25 Q. Dr. Harrington, can you please introduce yourself to

42 (Pages 82 to 83)

Page 84

1 the court.

2 A. My name is Scott Edward Harrington.

3 I am a professor of healthcare systems and insurance
4 and risk management at the Wharton School of business at the
5 University of Pennsylvania.

6 Q. How long have you held that position?

7 A. I've held that position for about a month.

8 Q. And what was your position prior to your starting at
9 Wharton?

10 A. Prior to that, beginning in 1988, I was a professor of
11 insurance and finance at the Moore School of Business at the
12 University of South Carolina.

13 Q. Can you please tell the court what you believe
14 qualifies yourself to provide expert economic testimony in
15 this case.

16 A. Let me touch on my academic background.

17 I received an BA in economics from the University of
18 Illinois summa cum laude in 1975.

19 I then got a master's degree in finance and a Ph.D.
20 degree in finance from the same institution in 1976 and
21 1979.

22 I joined the Wharton faculty as a lecturer in their
23 insurance department in 1978.

24 I became an assistant professor in 1979.

25 I was promoted and tenured in 1985.

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1 And then moved to my position at the University of
2 South Carolina.

3 During my 26 year academic career I've researched
4 extensively and published widely on the economics of
5 insurance markets and insurance regulation, particularly
6 with respect to property casualty insurance markets where
7 I've done a lot of work on insurance company behavior,
8 competition, insurance regulation, and similar issues.

9 I've also taught a course almost every year during my
10 26-year career on property casualty insurance where I
11 consider the basic economics of the business, insurance
12 company underwriting, pricing, distribution, claims
13 management, and regulation.

14 I include material on how direct writing insurers like
15 Allstate operate, the incentives they face, and in my
16 material on claims management I talk extensively about
17 incentives for quality provision of claim services.

18 Q. And have you testified before on issues relating to
19 economics of insurance markets and in particular claims
20 processing?

21 A. I've testified in a variety of forums on the economics,
22 insurance, and insurance regulation, including competition
23 in insurance markets, insurance availability, insurance
24 affordability problems, and the causes of those problems.

25 I've done so in judicial, legislative, and regulatory

43 (Pages 84 to 85)

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1 forums.

2 I've also testified before the United States Congress.

3 I have not testified specifically on insurance company
4 claims management practices.

5 Q. But do you have experience with regard to the economic
6 incentives of insurance claims handling?

7 A. Yes.

8 Q. Okay. And can you please describe that for the court?

9 A. Well, as a part of my work in becoming an expert on the
10 economics of insurance and insurance markets.

11 I've paid very close attention to the structure and
12 conduct of the industry and how it relates to economic
13 theory. And in particular I've studied over the years the
14 literature on the provision of quality and thought about how
15 that relates to insurance markets.

16 And as I mentioned, I also -- I also teach about claims
17 strategy and claims policy for insurance companies address
18 the types of things that influence the choice of quality.

19 MR. KASS: At this time, Your Honor, I would like
20 to tender Dr. Scott Harrington as an expert in the field of
21 economics.

22 MR. POWELL: Your Honor, we do object, and we
23 would like to, if we might, do a short voir dire of the
24 witness.

25 THE COURT: Okay.

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1 (VOIR DIRE EXAMINATION)

2 BY MR. POWELL:

3 Q. Dr. Harrington, your advanced degrees are in finance,
4 in economics; is that correct?

5 A. My undergraduate degree is in economics. My advanced
6 degrees are in finance.

7 Q. And you are a professor in -- in South Carolina you
8 were a professor in the finance department?

9 A. I was a professor in the finance department, yes.

10 Q. You're not an expert on the legislative process in
11 Texas or elsewhere. Is that correct?

12 A. That's correct.

13 Q. You've not written or given any academic papers or
14 given any testimony on the automobile body repair industry
15 before, have you?

16 A. That is correct.

17 Q. For this testimony that you're about to give, you
18 didn't do any of the kinds of things you normally would do
19 as an academic, such as large scale data collection, data
20 analysis, quantitative assessments, mathematical modeling or
21 any of that?

22 MR. KASS: Your Honor, this is beyond the scope
23 of voir dire, so I object.

24 THE COURT: I'll let him go a little further.

25 BY MR. POWELL:

44 (Pages 86 to 87)

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1 Q. Is that correct, sir?

2 THE COURT: Overruled.

3 THE WITNESS: No, I can't -- you gave a bunch of
4 specific examples, but the types of things that I normally
5 do as an academic include looking at a state of some facts
6 in a particular situation and drawing inferences about what
7 the economics of a particular problem are, what those
8 problems might be -- might be, whether competition
9 effectively manages the problems, and so on.

10 I mean, basic economics, the application of economics,
11 involves a lot of logic, a lot of application of theory to a
12 particular set of facts, and by no means requires large
13 scale data analysis or the other things that you mentioned.

14 BY MR. POWELL:

15 Q. Well, you testified in your deposition that basically
16 what you did was follow your economic intuition to reach the
17 results in this case, did you not?

18 A. I could easily have said that, but when I say follow
19 the economic intuition, that's not just some loosey-goosey
20 thing where you say I think that might be the case. That
21 reflects many years of having observed economic behavior,
22 understood and studied economic theory and thought about the
23 fundamental incentives that face various players and the
24 constraints that they face.

25 So when I say economic intuition it's a way in academia

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1 to say we're not going to focus on quantifications and a lot
2 of details, we're going to go right to the heart of the
3 matter.

4 Q. You have not done any effort -- made any effort to
5 quantify what you would perceive to be the benefits of
6 Allstate's acquisition of Sterling?

7 A. It depends on the meaning of "quantify." In terms of
8 actually trying to come up with numbers to indicate in
9 financial impact, I have not done that, but in terms of
10 quantification, looking at the various incentives that are
11 faced and weighing the likely magnitude of those incentives
12 I think is a form of conclusion.

13 Q. Your conclusion is going to be that they are
14 potentially enormous. Is that correct?

15 A. As stated in my report, I think the potential
16 advantages from insurer ownership of collision repair
17 services are enormous.

18 Q. And you can't add anything to the word "enormous," can
19 you?

20 A. As far as -- excuse me.

21 Q. As far as quantification, definization, enormous is
22 your conclusion?

23 A. No, that's incorrect.

24 My report -- my report, and if I'm allowed the
25 opportunity to provide testimony, I will explain in a

45 (Pages 88 to 89)

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1 certain degree of detail the basis for the idea that the --
2 the benefits here could be enormous.

3 Q. Could be enormous, that's your conclusion.

4 MR. KASS: Your Honor, I renew my objection. Now
5 we're getting into the substance of his opinions.

6 THE COURT: Well, I think you're mixed at this
7 point. Some of it is still voir dire and some of it you
8 just can't resist cross-examining.

9 MR. POWELL: I've always had a problem with that
10 line, Your Honor.

11 THE COURT: I'm going to give you a couple more
12 questions, then I'm going to cut you off.

13 MR. POWELL: All right, sir.

14 Thank you.

15 THE COURT: Overrule your objection.

16 BY MR. POWELL:

17 Q. Even though you are a professor of finance, at the
18 time we took your deposition you hadn't examined any
19 financial statements of Sterling, had you, whether at the
20 macro level or the micro level.

21 A. I had read all sorts of documents related to the
22 initiative and the acquisition of Sterling. I had not
23 looked at particular financial statements of Sterling.

24 MR. POWELL: Your Honor, based on the witness'
25 testimony we would object under federal rule of evidence

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1 702. We would object to him being -- his -- his opinions
2 being received here because there's no showing that his
3 education or prior scholarship qualifies him to state the
4 opinions he's being asked to state.

5 I think Your Honor will see that many of the opinions
6 pertain to legal matters. He's not qualified to give
7 opinions on legal matters.

8 We don't think his testimony will be based on
9 sufficient facts or data and we don't think that his
10 testimony will be the product of reliable principles and
11 methods, so we would object to the court receiving
12 Dr. Harrington's opinions.

13 THE COURT: Well, I'm going to listen to him
14 testify and then I'll rule on that after I hear him
15 testify.

16 MR. POWELL: Thank you, Your Honor.

17 THE COURT: Okay.

18 (DIRECT EXAMINATION)

19 (Continued)

20 BY MR. KASS:

21 Q. Dr. Harrington, before we get to the work that you
22 performed, we've already talked a little bit about it but
23 we'll get into the substance of what you've done, can you
24 please explain -- did you reach some conclusions with regard
25 to the economic impact of insurer ownership and the economic

46 (Pages 90 to 91)

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1 impact of HB 1131?

2 A. Yes, I did.

3 Q. If you could turn to PDX 701 in your binder.

4 Could you please tell me what that -- what this
5 demonstrative is?

6 A. It represents a summary of the opinions that I reached
7 based on my analysis.

8 Q. Is this a fair and accurate summary of your opinions?

9 A. Yes.

10 MR. KASS: I'd like to put PDX 701 on the screen.

11 BY MR. KASS:

12 Q. Can you please explain to the court what your first
13 opinion is?

14 A. Yes. By shifting business from out-of-state collision
15 repair service firms, in this case Allstate/Sterling, to
16 local body shops, HB 1131 disproportionately impacts
17 out-of-state providers.

18 I reached that conclusion based on an analysis of the
19 Allstate/Sterling planning documents and a variety of other
20 evidence.

21 Q. What's your second opinion?

22 A. My second opinion is that by denying Allstate and
23 Sterling meaningful access to the collision repair market in
24 the State of Texas, it substantially injures the market.

25 And, in addition, there are cross-border effects that

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1 reduce the value of the initiative beyond the borders of
2 Texas.

3 Q. Your third opinion?

4 A. My third opinion is that insurer ownership poses no
5 threat of unfair competition, in the sense that that's
6 normally -- that term is normally used in economics.

7 Q. And your fourth opinion?

8 A. And my fourth opinion is that there are no substantial
9 risks that consumers will be hurt by insurer ownership.

10 Q. Before we discuss each of these in some detail, did you
11 prepare an expert report setting forth your opinions?

12 A. Yes.

13 Q. And if you could turn to PX 559 in your binder.

14 A. 559?

15 Q. Yes.

16 A. I don't appear to have 559 in my binder.

17 Q. Okay. Apologize. We'll get back to it. But it is
18 your expert report. I'll move the expert report once we get
19 a copy back.

20 Let's discuss a little bit about the work that you did
21 in this case.

22 Could you describe the work that you performed in
23 reaching your conclusions?

24 A. Yes.

25 I analyzed an extensive volume of documents. A lot of

47 (Pages 92 to 93)

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1 the documents pertained to the Allstate/Sterling initiative
2 and what went on in terms of analyzing the initiative and
3 executing the initiative.

4 In addition to that, I interviewed a number of people.
5 I interviewed Mr. Robert Thompson of Sterling, who has
6 testified here.

7 I interviewed Mr. William Daly of Allstate, who is now
8 director of operations of Sterling who has testified at this
9 trial.

10 I interviewed Sharon Mazanec, who has testified, and I
11 interviewed Dr. Kenneth Zion, who has also testified.

12 In addition to interviews I visited two Sterling
13 greenfield shops in the Dallas/Fort Worth area.

14 I also reviewed the expert report of Dr. House and
15 Dr. House's deposition.

16 MR. KASS: Your Honor, may I approach with the
17 expert report of Dr. Harrington?

18 THE COURT: Yeah.

19 MR. KASS: Here's a copy of the report.

20 THE COURT: Thank you.

21 MR. KASS: Your Honor, since Dr. Harrington is
22 available for cross-examination, I move for the admission of
23 his expert report into evidence.

24 MR. POWELL: Your Honor, our objections are
25 hearsay, and also based on Rule 702, the same objection that

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1 we made to his live testimony, so we have two objections to
2 the receipt into evidence of his expert -- so-called expert
3 report.

4 THE COURT: Overrule your hearsay objection, and I
5 will continue to listen to him a little longer before I rule
6 on your 702.

7 So I am going to -- I overrule both your objections
8 with regard to this document. This document then is
9 admitted into evidence at this point. I'm still considering
10 whether I will admit any or all of this for purposes of my
11 consideration, but I am admitting it for the simple purpose
12 at this point of determining -- of listening and deciding
13 the 702 issue.

14 Okay?

15 MR. KASS: Thank you, Your Honor.

16 BY MR. KASS:

17 Q. Dr. Harrington, did you review Dr. House's expert
18 report in this case?

19 A. Yes.

20 Q. Did you review his deposition?

21 A. Yes.

22 Q. Are you familiar with Dr. House's opinions in this
23 case?

24 A. Yes, I am.

25 Q. I would like to focus on the areas of agreement and

48 (Pages 94 to 95)

Page 96

1 disagreement that you have with Dr. House.

2 If you could turn in your binder to PDX 702, can you
3 please describe this document for the court?

4 A. Yes. This is just a summary performed at my request of
5 the areas in which I agree with Dr. House.

6 MR. KASS: Can we put on the screen PDX 702?

7 BY MR. KASS:

8 Q. Can you explain to the court --

9 THE COURT: Excuse me?

10 MR. POWELL: I object to their excerpting little
11 bits and pieces from Dr. House's report and putting it
12 before the court.

13 If they're going to talk about Dr. House's testimony
14 they need to offer Dr. House's testimony into the record.

15 It is not proper for them to attempt to do it in this
16 way.

17 THE COURT: Overruled. I'll let you offer the
18 rest of it at your opportunity. And since I'm the only one
19 here it certainly won't affect me adversely. I'll look at
20 all of it.

21 MR. KASS: Thank you, Your Honor.

22 BY MR. KASS:

23 Q. Can you please explain for the court the areas of
24 agreement that you have with Dr. House?

25 A. Yes.

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1 When vertical integration takes place it sometimes or
2 often benefits consumers, and that's going to be the case
3 here.

4 I agree the consumer can't always immediately detect
5 the differences in the quality of repairs. And that's
6 relevant to whether or not you're likely to have much fraud
7 or waste in the industry. So I agree with that.

8 I agree that higher capacity utilization can affect the
9 efficiency of auto body repair, and that's a central part of
10 the Allstate/Sterling initiative.

11 And I agree that absent HB 1131, Sterling's capacity
12 would increase in its existing stores and that would help
13 achieve efficiencies.

14 I also agree that HB 1131 causes sales that would have
15 gone to Sterling to go to local body shops, noninterstate
16 body shops.

17 I agree that interstate consolidators are relatively
18 rare, making it unlikely that they would be able to promptly
19 replace lost sales for Sterling.

20 And I agree that greenfield expansion is more likely to
21 affect the market share of local firms, greenfield expansion
22 such as that done by Allstate and Sterling in Texas, than
23 would be acquiring existing shops or so-called brownfield
24 expansions.

25 And last on this slide, I believe that investment in

49 (Pages 96 to 97)

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1 reputation represents a powerful countervailing force
2 against incentives to cheat, and it's particularly relevant
3 in this case.

4 Q. Are there areas in which you disagree with Dr. House?

5 A. Yes.

6 Q. And if you could turn to PDX 703 in your binder.

7 Does this set forth your areas of disagreement?

8 A. Yes, it does.

9 MR. KASS: Okay. If we could put PDX 703 on the
10 screen.

11 BY MR. KASS:

12 Q. Could you please walk the court through your areas of
13 disagreement, with the court?

14 A. I disagree it's appropriate to determine whether you
15 might have something that would be efficient just because it
16 has been tried at a particular moment.

17 So I disagree that it's appropriate to determine that
18 there aren't possible economies of scale in collision repair
19 just because we haven't seen that on any wide scale basis
20 yes.

21 I disagree that the problems of fraud and waste can be
22 effectively managed by competition in the collision repair
23 market by itself.

24 And I disagree that vertical integration,
25 insurer-ownership of collision repair facilities will yield

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1 significant incentives to reduce quality.

2 And then fourth, because "the Texas legislation does
3 extend prohibitions to other 49 states but places no
4 unreasonable economic burden on interstate commerce," I
5 disagree with that.

6 The -- the HB 1131 prohibition --

7 THE COURT: Wait a minute.

8 I'm not sure you read it right. I think you left the
9 word "not" out.

10 THE WITNESS: Okay. I'm sorry.

11 I disagree with the conclusion that the Texas
12 legislation does not extend prohibitions to the other 49
13 states, it therefore places no unreasonable economic burden
14 on interstate commerce.

15 Instead, it does shift business from interstate firms
16 to local body shops.

17 BY MR. KASS:

18 Q. I'd like to discuss each of your four opinions that we
19 saw earlier.

20 MR. KASS: If we could put up 704 again. 701.

21 BY MR. KASS:

22 Q. Okay. Your first opinion, shifting business from
23 out-of-state collision repair services firms to local body
24 shops causes HB 1131 to disproportionately impact
25 out-of-state providers.

50 (Pages 98 to 99)

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1 I'd like to walk the court through your analysis that
2 you employed to reach this conclusion.

3 If you could turn in your binder to PDX 705 through
4 708.

5 Could you please describe what those demonstratives are
6 designed to show?

7 A. Yes.

8 In determining whether or not HB 1131 has a
9 disproportionate impact on out-of-state providers versus
10 local providers, you really need to ask four questions. And
11 these exhibits illustrate those four questions.

12 MR. KASS: If we could put up PDX 705 on the
13 screen.

14 BY MR. KASS:

15 Q. Could you please walk the court through the first of
16 the court questions?

17 A. Yes. The first issue relates to the facial neutrality
18 of the statute. But you have to ask the question: Does HB
19 1131 adversely impact any local providers.

20 In this case the relevant issue is does it adversely
21 affect any local insurance companies, does it adversely
22 affect any local body shops.

23 Q. What's the answer?

24 A. Well, there's no evidence that any of the business
25 plans or anything was happening which would imply that any

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1 local insurance companies in Texas were likely planning to
2 undertake this type of initiative or that there were local
3 body shops that were anticipating affiliation with insurers
4 through ownership.

5 Q. And what's your -- what's the second step in your
6 analysis?

7 A. Okay. The second step is to ask does HB 1131 reduce
8 sales to interstate firms by denying them access to local
9 markets.

10 Q. And how does that apply to this case?

11 A. Well, in this case, as -- as the graphic shows, with
12 the fence around Texas, the provisions of HB 1131, the
13 prohibition on expansion and the limitations on the
14 operating -- operation of the existing shops of Sterling, or
15 any owned insurer are-owned shop, do reduce sales by
16 interstate firms.

17 Q. And what's your third step in the analysis?

18 A. Well, then you have to ask the question: Where are
19 those lost sales, where is the production in sales if you
20 look at Sterling now versus what would have been the case
21 without HB 1131, where do they go.

22 And the answer is that the Texas collision repair
23 market is predominantly characterized by local in-state body
24 shops, so that the lost sales will primarily go to those
25 firms.

51 (Pages 100 to 101)

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1 Q. And what's the fourth step in the analysis?

2 A. Really just extends the third -- the third issue and
3 relates to the second question which you asked, can those
4 lost sales be promptly replaced by rapid expansion of
5 interstate firms in the State of Texas.

6 Q. And what's the answer?

7 A. The answer there is that given the history of
8 interstate collision repair services and the behavior of
9 consolidators and the existing marketplace, there is little
10 or no likelihood of such rapid expansion and no evidence of
11 it.

12 Q. Dr. Harrington, why is it economically speaking that
13 you believe that Sterling -- allowing Sterling to compete --
14 or, I'm sorry, banning Sterling and denying them access to
15 the market protects the local body shops?

16 A. The Allstate/Sterling initiative in particular and
17 insurer ownership in general address two fundamental
18 problems that have characterized the collision repair
19 market.

20 Q. What are those two fundamental problems?

21 A. The two problems first are that many or most shops are
22 characterized by relatively small size. They are unable to
23 achieve substantial scale economies and they don't utilize
24 substantial division of labor.

25 The second problem is one of incentive misalignment

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1 where the incentives of the shop owner may not always be
2 aligned with those of the customer or with the customer's
3 insurer.

4 Q. Let's focus first on the first problem, the problem of
5 inefficiency in the market.

6 Dr. House says that the market is competitive and that
7 the competition will drive out any efficiencies --
8 inefficiencies.

9 Why is it that you say that the market is inefficient?

10 A. I'm not saying that the market is completely
11 insufficient, but I am saying based on the documents I have
12 read and various publications I have read, we know the
13 market is characterized by lots of small shops, as well as a
14 few larger shops, that don't have the volume that would
15 allow spreading a lot of the costs, the fixed costs, the
16 overhead costs, the costs of investment in new and state of
17 the art equipment, over a relatively large volume of cars.

18 Q. I would like to show you a portion of Dr. House's
19 expert report.

20 MR. KASS: And if we could put up on the screen
21 PD -- PX 562. Turn to page 3, and paragraph 10.

22 BY MR. KASS:

23 Q. Dr. House says, "The fact that there are many small
24 auto repair shops throughout Texas is strong evidence that
25 large shops do not offer market advantages."

52 (Pages 102 to 103)

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1 Isn't he right?

2 A. With all -- all due respect, I don't think he's right
3 in this particular instance.

4 Now, as a general rule, in competitive markets without
5 substantial imperfections, I think it is appropriate to
6 infer that the status quo tends to be characterized by
7 efficiency, but in this case we've got a market that
8 historically has been plagued by limited scale of operations
9 which drive up average cost and by the problem of incentive
10 misalignment which leads to waste and fraud. So in this
11 particular instance I don't think you can make that
12 conclusion.

13 And in addition, very importantly, we have innovation
14 which is being undertaken to address some of the problems in
15 the industry.

16 Q. Okay. Are there examples of this innovation that has
17 led to increased efficiency in the past, other markets?

18 A. Yes, there are.

19 I mean, if you go back to say around 1970, and if you
20 looked at many retail markets, they would be characterized
21 by predominantly small shops. It was before the time of the
22 substantial expansion of Wal-Marts and Home Depots and
23 Office Maxes and a variety of other retail establishments
24 that have achieved substantial economies by large
25 establishments in different localities, as well as by

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1 network effects. So you couldn't at that time look at the
2 marketplace and say there aren't economies of scale in those
3 markets just because you didn't see large facilities at that
4 point.

5 Q. Well, if the issue is volume, in terms of building
6 scale, you build scale, you have a shop of large volume, why
7 can't a shop just attract higher volume by lowering its
8 prices?

9 A. Well, Mr. Thompson testified about this.

10 The fact of the matter is that most collision repairs
11 are paid for by insurers. This reduces the incentive of the
12 customer, the auto owner, to shop for any type of shop based
13 on price, so it reduces the price elasticity of demand.

14 What shop owners tend to do is base their references on
15 convenience and location, and often they will go to a shop
16 based on recommendations.

17 THE COURT: Is this the same as it is in
18 healthcare?

19 That you pick a hospital to do your procedure based on
20 convenience and you don't care about price because you're
21 not paying for it?

22 THE WITNESS: I think it would be very similar.
23 You would reflect convenience and you would also reflect
24 recommendations, such as the recommendation of the
25 physician.

53 (Pages 104 to 105)

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1 And you're not likely to look around closely to see if
2 there are differences in the average cost per day at
3 particular hospitals in a neighborhood, if you are heavily
4 insured.

5 THE COURT: Okay. Okay. Would it make a
6 difference if your car was severely damaged?

7 Would that make a difference in anything you're saying
8 versus fender-bender?

9 Does that have any affect on this at all?

10 THE WITNESS: I don't think that makes any
11 difference.

12 THE COURT: Here's the reason I'm asking that.

13 If I'm having brain surgery I'm going to go wherever it
14 takes. If I have to go to Europe, I probably wouldn't do
15 that, but I'll find that. My car is really severely
16 damaged, would I seek out quality? No. Or not? No. I
17 don't care. I guess I would seek out quality.

18 THE WITNESS: You would seek out quality.

19 THE COURT: I wouldn't worry about price.

20 THE WITNESS: You wouldn't worry about price,
21 because by in large once you exceed your deductible your
22 insurer is going to pay for the cost of your repair.

23 There could be certain examples, if you have an exotic
24 automobile --

25 THE COURT: Right I was going to say Ferarri.

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1 THE WITNESS: You're going to do due diligence and
2 find a place that does Ferarris.

3 THE COURT: But if we're talking about Buick,
4 assuming it's a Buick, or it's a main line car from a major
5 manufacturer, in the middle price range, it's going to fit
6 what you're going to tell me, right?

7 THE WITNESS: Yes.

8 THE COURT: All right.

9 BY MR. KASS:

10 Q. I'd like to focus what on the recommendation is.

11 How does the collision repair services market, the
12 recommendations made by insureds in that market differ from
13 the selection of healthcare providers in the let's say HMO
14 market?

15 A. Well, there are fundamental distinctions.

16 The ownership of collision repair centers offers some
17 of the types of efficiencies that managed care in the
18 healthcare sector or HMOs were purported to offer, but one
19 fundamental distinction central to this initiative is
20 choice, that Allstate's customers get to go where they
21 want.

22 It's not like they are limited to any group of
23 preferred providers. They're not limited to some physician
24 that has to serve as a gate keeper. They have choice.

25 And it goes beyond that. They have another choice that

54 (Pages 106 to 107)

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1 is broader and more flexible than in the healthcare market,
 2 and that is, they have the choice of whom they buy their
 3 insurance from in a very competitive market with lots of
 4 options, whereas a lot of health carriers is linked to one's
 5 employment relationship where there might be limited choices
 6 but in order to really act on it if you're unhappy you would
 7 have to change your job.

8 THE COURT: Well, you left something out.

9 What -- you said choice, but also doesn't the
 10 guarantee -- isn't that an incentive here?

11 There is no guarantee if I go to my HMO that they're
 12 going to really do a good job and my hernia won't break open
 13 again on the surgery they do. Here you get a guarantee.
 14 Doesn't that make a difference?

15 Doesn't Sterling offer a guarantee?

16 No.

17 THE WITNESS: I think -- I think guarantees are
 18 important.

19 THE COURT: But it's not a market -- it's not a
 20 big deal in your analysis?

21 THE WITNESS: It's -- it's important.

22 Many shops, many PRO shops offer guarantees. There are
 23 advantages of the Allstate/Sterling guarantee.

24 THE COURT: Okay. So many offer guarantees. So
 25 that's probably not a big differentiator in this market,

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1 right?

2 THE WITNESS: There are -- there are
 3 characteristics of the Allstate/Sterling guarantee that are
 4 attractive, but there are many guarantees that are
 5 potentially attractive.

6 THE COURT: But those alone aren't enough to
 7 probably make me go one place or the other?

8 THE WITNESS: Yeah. I wouldn't be able to speak
 9 for the representative consumer, but there would be people
 10 that might qualify a guarantee from Allstate/Sterling more
 11 if they think it covers parts and it covers all labor and
 12 Allstate stands behind it instead of a local shop. There
 13 could be advantages.

14 THE COURT: But you didn't mention it earlier.

15 The reason I brought that up is you didn't mention it,
 16 the guarantee.

17 THE WITNESS: No. When -- I had planned to
 18 mention it when I discussed incentives for providing
 19 quality, in response to questions.

20 THE COURT: If I had just been patient you would
 21 have gotten there?

22 THE WITNESS: Yes.

23 THE COURT: Okay. Sorry.

24 BY MR. KASS:

25 Q. Well, while we're on the topic of recommendations, why

55 (Pages 108 to 109)

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1 can't Allstate simply pick a large body shop or some local
2 body shop or interstate consolidator and recommend them,
3 generate economies of scale that way?

4 MR. POWELL: Your Honor, I'm going to object.

5 How does he know these things?

6 That just calls upon speculation why Allstate can or
7 can't do something.

8 THE COURT: I'll let him answer it. Overruled.

9 THE WITNESS: Well, for one, if you just look at
10 local shops, there aren't that many large local shops that
11 has the type of capacity that Allstate has been building in
12 its greenfield facilities.

13 If you take interstate firms or consolidators in
14 general, also there are issues associated with getting the
15 economies of the network that Allstate would get by having
16 groups of shops that closely matched to its own customer
17 base and its own customer density.

18 And just going out to existing shops doesn't give
19 Allstate the same opportunity to produce state-of-the-art
20 facilities, to produce consistent quality and processes that
21 have motivated the initiative.

22 BY MR. KASS:

23 Q. I would like to now turn to the second fundamental
24 problem in the industry that you raised, which is the issue
25 of misaligned incentives.

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1 Now, does the issue of misaligned incentives relate to
2 whether HB 1131 shifts business from interstate firms,
3 Sterling in particular, to local body shops?

4 A. It's important.

5 Vertical integration in this case has the potential to
6 reduce waste and fraud associated with misalignment of
7 incentives. It's central. It's the reason some insurers,
8 those with sufficient customer density, and the desire to do
9 so, would choose to vertically integrate in order to better
10 manage the problems of waste and fraud.

11 And it's also important to understanding why there are
12 advantages to insurer ownership compared to, say, having
13 Wal-Mart enter the collision repair business on a multistate
14 business or having existing consolidators or interstate
15 firms without any association with an insurance company
16 enter the market or expand.

17 Q. Well, if we turn to Dr. House's report, page 6,
18 paragraph 21, what he says is fraud can -- cannot be
19 eliminated but it is effectively managed.

20 Do you agree with Dr. House?

21 A. In this instance, in this particular market, I'm not
22 sure what he means by "effectively managed," but in normal
23 circumstances you say you have a market, you have
24 competition, there are going to be incentives to reduce the
25 cost of fraud and in that sense you might say you are having

56 (Pages 110 to 111)

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1 some management of fraud.

2 But in this particular instance we know that regardless
3 of the meaning of effectively managed, that fraud and waste
4 are in fact significant.

5 And, in addition, one of the motivations for the
6 Allstate/Sterling initiative in particular, and insurer
7 ownership in general, is to get a better handle on this
8 problem.

9 Q. What are the economic characteristics of markets
10 generally that exhibit sub-optimal quality or are prone to
11 waste and fraud?

12 A. The problems arise when it's difficult or costly for a
13 consumer of a good or a service to assess or judge the
14 quality of the product, and in many cases with markets where
15 there's a lack of repeat purchases, so that the consumer is
16 not using the product all the time -- so that if they got a
17 bad deal they would quickly go to another provider and drive
18 the first provider out of business.

19 Q. Turning to -- in your book to PDX --

20 THE COURT: Wait a minute. Wait. Wait. Wait. I
21 want to make sure I understand.

22 You're saying that collision repair is not one of those
23 businesses where the consumer walking won't effectively
24 control -- because they don't? What's going on here?

25 Is that what you're talking about?

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1 Did I miss your point? Help me with that.

2 THE WITNESS: I'm saying that consumers have a
3 difficult time judging the quality of repairs, and, in
4 addition, judging whether the procedures and the charges for
5 those repairs are appropriate -- would be appropriate.

6 THE COURT: Why?

7 I don't -- why is that any different than anything
8 else?

9 Help me -- that's what I thought you said, and I want
10 to make sure I understand that, and I'm not -- I'm not -- I
11 just really don't understand. I don't -- I don't get that.

12 Why is that any different than anything else?

13 I mean what makes this different?

14 THE WITNESS: Well, I think what makes it
15 different --

16 THE COURT: Here's my point: I'm driving my car
17 after it has been fixed at Sterling and it pulls to the
18 left. Or not Sterling. Anywhere. And I call the guy and
19 go, look, it still pulls to the left. I've still got that
20 squeak back in the right. The window has air coming in it.
21 There's a knock in the engine. The fender sticks up, it
22 shouldn't do that. The paint doesn't match.

23 I mean, it seems to me -- and you see, just from a
24 nonexpert, like this person who has had a number of cars
25 repaired over his lifetime, many of which I caused, it seems

57 (Pages 112 to 113)

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1 to me I did know what was going on. And I just -- am I
2 missing it?

3 Why would I not know?

4 It seems to -- I'm not that savvy a guy. I'm not a car
5 guy, but I know enough to know it's not right.

6 THE WITNESS: In many cases you may know it's not
7 right and you may find it relatively quickly. For a lot of
8 cosmetic things you look at the car you go, yeah, it's not
9 right. Or two days later driving down the road, something
10 clanging, that's not right.

11 But other things, you mentioned, Your Honor, well, what
12 about the paint, did they use the right thickness of paint
13 and things like that that would be more difficult to detect.

14 Or we heard testimony from Dr. Zion about how there
15 might be some structural problem underneath the vehicle that
16 because of the pressures and the haste and the incentives of
17 the local body shop maybe they tried -- they just tried to
18 patch it up and mask it and it's not observable to a person
19 like you or me.

20 THE COURT: Okay. But in your analysis you really
21 feel like that this particular industry is one where the
22 consumer is less prepared to know than in many other areas?

23 This happens to be one where there is more hidden than
24 less? Or not?

25 Am I misinterpreting --

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1 THE WITNESS: Well, it's one of the industries
2 that has that. There are other industries where consumers
3 clearly have a difficult time assessing quality, and
4 sometimes we have quality regulation because of that.
5 Sometimes we have rating services that rate a firm's
6 facility.

7 But it is one where there is a lack of -- often a lack
8 of repeat business. I'm not saying that word of mouth and
9 reputation don't matter, but if you've got customers that
10 mainly go to a shop every ten years, that amplifies this
11 problem, because the provider, in this case the collision
12 repairer, may know that he's never going to see or she's
13 never going to see this particular person again.

14 THE COURT: Okay. So it's a combination of not
15 going there very often and some percentage in your mind of
16 hidden things that won't show later on, like your example of
17 paint and my example of paint.

18 THE WITNESS: Yes.

19 THE COURT: Okay. Those are the sort of things,
20 okay, that help me understand.

21 Sorry. I didn't mean to interrupt you.

22 But I understand your position.

23 BY MR. KASS:

24 Q. Dr. Harrington, just on that one point, we talked about
25 quality being a factor in waste and fraud, but is there

58 (Pages 114 to 115)

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1 another area of waste and fraud that the consumer may not be
2 as interested in because it is not paying the bills but the
3 insurance company may be?

4 MR. POWELL: Objection. Beyond the scope of any
5 conceivable expertise of a finance professor.

6 THE COURT: Are you sure?

7 Any conceivable?

8 MR. POWELL: Any conceivable, Your Honor.

9 THE COURT: Okay. Overruled.

10 THE WITNESS: Well, yes. I mean, it's well-known
11 in the vast literature on the economics of insurance and the
12 economics of financial markets that you have issues arise
13 when someone who is getting a service isn't paying for the
14 service. And if you're paying for only a small part of the
15 service, it changes your incentives to monitor what's being
16 done and what the prices are that are being charged.

17 THE COURT: They don't have enough skin in the
18 game?

19 THE WITNESS: Not enough skin in the game.

20 BY MR. KASS:

21 Q. Turning in your book to PDX 709. Could you please
22 explain for the court what this --

23 THE COURT: I want to stop you.

24 MR. KASS: Sure.

25 THE COURT: And I know this is going to be a

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1 little bit speculation, but let's assume there is no
2 insurance involved in this industry. Like if it was
3 healthcare it's plastic surgery. No insurance. Nobody
4 covers insurance for plastic surgery except reconstruction
5 from cancer. Let's assume it's not something like that.

6 If there's no insurance in this and it's just consumers
7 and it's just going to the body shop, and they can do all
8 sort of repairs, does that change this dynamic?

9 I mean, would -- would people do something different
10 based upon that?

11 I'm assuming they would.

12 THE WITNESS: I think they would have -- they
13 would have significantly more incentive up-front to ask
14 questions and evaluate what's going to be done and what it's
15 going to cost and they -- they would have I believe more
16 incentive to kind of shop around or get ideas of what the
17 reputations for quality would be. They might be asking a
18 lot more questions of friends and neighbors and those
19 things.

20 THE COURT: Really?

21 Okay. So it's this whole dynamic of having insurance
22 that's really affecting what's going on here, isn't it?

23 Having the insurance company in this affects what's
24 going on in a big way?

25 THE WITNESS: Yes. That's central.

59 (Pages 116 to 117)

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1 THE COURT: Okay. I mean, I know it's obvious,
2 but I wanted to talk about it a little bit. All right?

3 THE WITNESS: All right.

4 THE COURT: And I may want to talk about it a
5 little more, because obviously consumers would be real
6 concerned about cost and they would be concerned about
7 quality and that would be a big deal. Right?

8 THE WITNESS: Yes.

9 THE COURT: I guess my question is going to be now
10 that -- that is -- and that's a good thing for consumers to
11 be concerned about those two things. Correct?

12 THE WITNESS: Yes.

13 THE COURT: If Sterling and Allstate are allowed
14 to go on and do business the way they want to do it, will it
15 help consumers come to those conclusions in the way that
16 it's an economic benefit, that it's a benefit for them and a
17 benefit for -- for the industry?

18 Is that -- do you see what I'm saying?

19 If they're allowed to go on and do it the way they want
20 to do it, are these consumers going to align themselves in
21 that way more?

22 Are they going to be more sensitive to what's going on
23 about price and quality, or not?

24 THE WITNESS: I believe that they will. If the
25 strategy goes on, what's going to happen is Allstate and

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1 Sterling are going to have more and more shops. Those shops
2 will have a reputation, because Allstate has so many
3 customers, and a certain percentage of the customers will go
4 to those shops, and there will be more information out there
5 about what's going on in collision repair and that there may
6 be options or choices that in the current fragmented market
7 consumers might not have any idea about, I guess, what I'm
8 suggesting, some response to your question.

9 THE COURT: Okay.

10 Go ahead and finish your thought.

11 THE WITNESS: Well, in response to your question
12 I'm suggesting that a new model that develops a substantial
13 reputation might just help inform consumers that there are
14 options out there, that this historical market where you've
15 got primarily local shops, that there are new games in town
16 and thus that they might want to consider a little more what
17 they do, where they go.

18 THE COURT: Are you sure it's not going to be just
19 driven by the incentives of the insurance industry?

20 I guess you can't say you're sure, but you're giving me
21 an expert opinion.

22 THE WITNESS: The -- take the Allstate/Sterling
23 strategy. They recommend Sterling when they are allowed to
24 do so. Some people are going to act on those
25 recommendations. A lot of people are not going to act on

60 (Pages 118 to 119)

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1 their recommendation. They will have their favorite local
2 shop. They will have the one that they used before. They
3 will have the one that their uncle owned or friends and
4 neighbors. They might want to go to a dealer, or so on.

5 The market test is going to be the percentage of
6 Allstate's customers that go to Sterling, if they are
7 satisfied customers, then that is going to change -- that is
8 going to change things and help Allstate's brand and
9 Sterling's brand. If they're not satisfied, then you're
10 going to get the opposite results.

11 THE COURT: Okay. It's like when I go in and I
12 buy a new car and the finance guy says do you want to buy
13 credit life insurance. And I always say no, because I know
14 it's -- it's higher priced insurance. And I -- it seems to
15 me that this could turn out like that.

16 I mean, there's still going to be a market for that,
17 but there may be people that just say, no, I don't want to
18 go to Sterling, I want to go over here to the -- to the
19 other -- to my independent insurance agent, in my example.

20 THE WITNESS: Sure. And there's -- there's a
21 distinction, too, that if you have a consumer goes in,
22 they're not -- they just want to get their car fixed and
23 they hear the recommendation, go, fine, I'll do that, it's
24 not analogous to buying credit life insurance, where you're
25 buying something you may not have needed or you're paying

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1 more than you would have to pay if you access it a different
2 way.

3 Allstate and Sterling have the obligation to fix your
4 car and pay for it above your deductible. So then we're
5 back to the quality issue that we already discussed, is are
6 they then going to underprovide quality, and I don't think
7 that's the case.

8 THE COURT: Okay. I didn't mean to get so far off
9 on that but go ahead.

10 BY MR. KASS:

11 Q. You brought us back to where we were, Allstate being a
12 customer of collision repair services, in some sense, what
13 are the options for them to if they're not happy with the
14 level of quality or they believe there's too much fraud or
15 waste in the market?

16 And to do this can you look at PDX 709 in your book.

17 MR. KASS: And can we put that on the screen?

18 BY MR. KASS:

19 Q. And can you walk the court through your discussion?

20 A. Well, in general, and as in this case, there are three
21 types of outcomes that can arise, three types of strategies,
22 so to speak, if you have problems of sub-optimal quality or
23 waste and fraud.

24 And one -- one market type solution, that firms will
25 develop a reputation for providing high quality. They will

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1 develop a brand name. And that's very important to this
2 whole strategy.

3 Companies like Allstate have made enormous investments
4 over the years in building a book of business and building a
5 brand. And the lifeblood of those businesses is their
6 ability to have large volumes of customers and spread the
7 fixed costs of their operations. And they're very, very
8 concerned with repeat business. They're very concerned with
9 renewals. It affects their ability to compete and the
10 prices that they charge for their products.

11 So those types of incentives, from reputation, brand
12 name, the desire to keep your customers, are important and
13 can offset any incentive to underprovide quality.

14 And, in fact, the economics literature emphasizes these
15 types of incentive issues.

16 The second possibility is if you can't -- if you can't
17 develop -- if you can't develop or find quality in a market,
18 you can vertically integrate into the market. You can
19 basically do something yourself.

20 And the third type of thing --

21 THE COURT: Wait. Wait. Wait. Explain that to
22 me. I'm not sure what that means.

23 THE WITNESS: In Allstate's case they're a
24 customer of collision repair services. Actually, I was
25 bleeding into vertical integration in my prior remarks.

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1 But if they are a customer -- they are a big customer
2 of collision repair services and over the years they have
3 decided they're not getting the type of consistent quality
4 experience for their customer base that they really wanted
5 to achieve, and they have decided that it didn't appear that
6 the market was really moving in a direction that would make
7 that happen, if the market is not providing something, you
8 can do it yourself, you can vertically integrate and provide
9 the collision repair through your own facilities.

10 THE COURT: Okay.

11 THE WITNESS: The last sort of outcome is that you
12 don't have reputations develop for -- for providing strong
13 quality. You don't have strong quality on average. You
14 don't have vertical integration, but you just have the
15 market plod along with sub-optimal quality and waste and
16 fraud.

17 BY MR. KASS:

18 Q. Dr. House has commented on one of the things that you
19 can do if the market fails to deliver quality, and I would
20 like to display an excerpt from his deposition. It's page
21 339, lines 1 through 12.

22 "Q. Even if all of those other conditions do not
23 exist, if the customer wants a higher-quality product and
24 the competitive marketplace does not deliver that product,
25 then one solution would be for the customer to produce that

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1 product himself?

2 "A. Well, that's a rather simple hypothetical. What
3 you have assumed is that the competitive market will not
4 produce high quality. How do you get high quality? You
5 produce it yourself. I would agree with that. If the
6 competitive market cannot produce that, yes, you produce it
7 yourself."

8 How does Dr. House's general opinion apply
9 specifically to the collision repair services market here?

10 A. Well, it applies in the context of the
11 Allstate/Sterling initiative.

12 A lot of the evidence about the strategy indicates that
13 Allstate was unhappy with the consistency and quality of
14 collision repair services that it was getting and it decided
15 to attempt -- in the markets where it has sufficient
16 customer base to make this possible, it has decided to
17 attempt to do it itself.

18 Q. Dr. Harrington, you've heard the term "Rome wasn't
19 built in a day," does your opinion that HB 1131 protects
20 locally-owned body shops depend on Allstate and Sterling
21 fully aligning incentives and enhancing efficiency
22 overnight?

23 MR. POWELL: Objection, leading.

24 THE COURT: Sustained.

25 BY MR. KASS:

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1 Q. Okay. Dr. Harrington, what would be the impact on
2 local body shops if Allstate and Sterling do not fully align
3 incentives and address inefficiency overnight?

4 A. We've heard a lot of testimony about issues associated
5 with the Sterling operation immediately following the
6 acquisition when other insurance companies removed Sterling
7 from their direct repair programs. There has been testimony
8 about issues with legacy shops at Sterling.

9 But what we do know is that prior to HB 1131, that
10 Sterling was growing. It was growing in Texas. They built
11 a number of greenfield shops. Those shops were capturing
12 market share.

13 And even if all the efficiencies, potential in theory,
14 from insurer ownership aren't realized, it's clear that
15 Sterling was increasing its market presence and that it
16 would be taking business from local shops.

17 THE COURT: Okay. Let's break for lunch.

18 Y'all be back at 1:20.

19 THE SECURITY OFFICER: All rise.

20 (Recess taken.)

21 THE SECURITY OFFICER: All rise.

22 THE COURT: Okay.

23 THE SECURITY OFFICER: Be seated, please.

24 THE COURT: We're ready. Okay.

25 (DIRECT EXAMINATION)

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1 (Continued)

2 BY MR. KASS:

3 Q. Dr. Harrington, before the break we were talking about
4 the impact that insurer ownership has on local body shops,
5 and I'd like you to comment on a comment made by Dr. House
6 during his deposition, and it's at page 216, line 4, through
7 217, line 5.

8 (Videotape playing.)

9 "Q. Because what I'm interested in is the number of
10 sales going to interstate providers as a whole. And I want
11 to know whether the proportion of sales going to interstate
12 providers as a whole is higher or lower as a result of HB
13 1131.

14 "A. Well, it's -- to me it's a silly question. It's a
15 question of: Do sales at Sterling decrease with that
16 statute? Yes.

17 "Q. And so you --

18 "A. Now, where do those sales go? They go in the
19 industry. The industry is made up of interstate firms and
20 mom and pop shops. They go to both.

21 "Q. But as you say, interstate firms are relatively
22 rare?

23 "A. Interstate firms are relatively rare.

24 "Q. And you would expect most of the sales that would
25 otherwise go to Sterling are going to go to the local body

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1 shops?

2 "A. I don't know that, but it's a silly answer."

3 Now, in your mind as an economist what is the
4 implication of Dr. House's admission that HB 1131 would
5 reduce sales to Sterling and that interstate firms are
6 relatively rare?

7 A. The conclusion is that most of the lost sales for
8 Sterling will go to intrastate, that is, local shops.

9 Q. Couldn't interstate firms expand to fill the void left
10 by Sterling?

11 A. In theory they could, but there's a lot of evidence
12 that suggests that that won't happen or at least it won't
13 happen rapidly.

14 Q. What -- what type of evidence are you talking about?

15 A. The number of interstate firms in the collision market
16 is -- is relatively small, and, in addition to that, their
17 growth and expansion, there's been a lot of documents that
18 Allstate considered, a lot of analysis Allstate considered,
19 wasn't in many cases very rapid, it wasn't matching
20 Allstate's customer density and it wasn't providing the
21 types of new shops in most cases that Allstate desired.

22 Q. Well, I'd like to expand -- expound a little bit on the
23 differences in shops between what the consolidators were
24 doing when they acquire facilities and Sterling with their
25 new greenfield facilities.

64 (Pages 126 to 127)

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1 If you could turn to PDX 710, what is this slide?

2 A. 710?

3 Q. Yes.

4 A. Sorry. This slide is a slide that's prepared to
5 illustrate the different modes of operation by interstate
6 firms, whether it be insurer ownership or consolidation.

7 MR. KASS: Could we put up 710 on the screen?

8 BY MR. KASS:

9 Q. If you would, Dr. Harrington, would you explain the
10 differences between the consolidated model of expansion and
11 the Sterling greenfield expansion?

12 A. Yes. The panel on the left starts out with the notion
13 that you've got a market in Texas that's characterized by a
14 variety of shops and ignore for the moment that there are
15 any interstate shops, if they are, they're there but there's
16 no Sterling.

17 In that case we've more or less got the status quo and
18 the issue of business shifting is irrelevant.

19 The important part here is the next two panels.

20 The middle panel shows the nature of operational of
21 most consolidators, interstate firms, and even intrastate
22 firms that consolidate collision repair facilities.

23 The example here shows Boyd but it's just illustrative.

24 What generally happens with consolidators is that when
25 they expand in the new markets they acquire existing shops,

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1 and that means that there's no net increase in market
2 capacity solely from that acquisition. You've got the same
3 number of facilities after as you did before.

4 Also, there's no strong reason to think there are going
5 to be any sudden changes in market share between the shops
6 that were there before and the shop that's now been bought,
7 a so-called brownfield shop, by the consolidator.

8 And moreover, it's fundamental, that when this
9 acquisition of existing shops takes place, the purchase
10 price is going to be determined, it's going to be
11 negotiated, and it's going to reflect the present value of
12 the future profits that would be expected by that existing
13 shop.

14 So the consolidator in essence is paying for that
15 stream of operations and that stream of operating profits,
16 which would stay then in the local market.

17 So, in the sense of no changes in market share and that
18 the profits in fact stay, there's really no business
19 shifting.

20 Q. And how does that contrast with the greenfield approach
21 by Sterling?

22 A. The greenfield market is fundamentally different. As
23 illustrated on the slide, we've got the large Sterling
24 shop. When a greenfield shop is created, a 15, 16,000
25 square feet shop that wasn't there before, it immediately

65 (Pages 128 to 129)

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1 adds, upon its opening, increased capacity to the
 2 marketplace. And the business -- since the number of cars
 3 that are wrecked and need to be repaired for most intents
 4 and purposes will be exactly the same, the immediate impact
 5 as the new greenfield facility attracts business is that you
 6 have a market share shift, a shift in market share from the
 7 surrounding shops to the greenfield shop.

8 And in this environment the profits are going to go to
 9 the best competitor and who gets -- who gets the most market
 10 based on the interaction between consumers, insurers, and
 11 the players in the marketplace. Also it impacts choice.

12 I think the diagram, it's different but it makes it
 13 clear, now we've got the large shop, the insurer-owned shop,
 14 which has added capacity and provided an alternative.

15 Q. I would like to now just turn to the economics of the
 16 collision repair services market.

17 Just generally speaking, what is the difference between
 18 a services market and a goods market?

19 A. Particularly relate is in this case it's a physical
 20 services market. To provide automobile collision repair you
 21 obviously have to be there. You have to be in the local
 22 market. You can't produce automobile collision repair
 23 services out of state and then resell them in the state.
 24 It's inherently -- the actual sales has to take place
 25 within -- within the environment where the vehicles are

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1 being wrecked and repaired, whereas in goods markets it's
 2 very common that the manufacturer of the goods will sell
 3 goods in other states, but it doesn't do so directly, it can
 4 do so through a variety of other ways, like wholesalers or
 5 independent dealers. So you can access goods markets
 6 typically without actually being there and having the
 7 manufacturer sell directly in that market.

8 Q. Now, the Ford and Exxon cases in which the state relies
 9 in its market are both franchise markets of are there unique
 10 incentives associated with franchise markets that are not
 11 present in nonfranchise markets, like the collision repair
 12 services market?

13 A. Yes. Franchise markets do present special
 14 considerations. The franchisee is entitled to conduct
 15 operations, market, and do things under the brand name or
 16 the umbrella of the franchisor. Franchisees often make
 17 significant investments in time, energy, and money in
 18 developing relationships, customer relationships in a
 19 particular market, and a lot of the benefit for that accrues
 20 to the manufacturer.

21 That type of situation where you've got a contract
 22 between the franchisor and the franchisee raises some
 23 possibility that the franchisor under certain conditions
 24 might take action subsequent to the investments of the
 25 franchisee that could do things that would erode the value

66 (Pages 130 to 131)

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1 of the franchise to that franchisee.

2 Q. If you could turn in your binder to PDX 711 and just
3 explain for what -- what that is.

4 A. This is an exhibit that illustrates some of the
5 distinctions between goods markets and franchise markets, as
6 it applies to the court decisions that have dealt with some
7 of the issues about prohibiting the interstate flow of goods
8 or services.

9 MR. KASS: Okay. If we could put up PDX 711 on
10 the screen.

11 BY MR. KASS:

12 Q. Could you please explain what the difference is between
13 the franchise goods market at issue in the Ford case and the
14 collision repair services market at issue here, from an
15 economic perspective.

16 MR. POWELL: Objection, Your Honor. We're now
17 having the witness explain Supreme Court opinions.

18 MR. KASS: Your Honor, Dr. Harrington is just
19 discussing what the economic differences are between the
20 type of market at issue in those cases and the type of
21 market at issue here. He's giving economic opinion.

22 THE COURT: Overruled.

23 THE WITNESS: Okay. If you look at -- at the
24 left-hand panel, just taking Ford as an example, Ford can
25 sell cars in the State of Texas or other states in a variety

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1 of ways. If Ford were prohibited from directly marketing
2 cars in the State of Texas, as it was under the Ford case,
3 or in, other state, it would still fundamentally have access
4 to the automobile market in the state. It would be able to
5 access the market through independent dealers, for example,
6 or perhaps through her mechanisms other than direct sale.

7 So by prohibiting a goods supplier from directly
8 selling within a state, it does not foreclose access to the
9 market. It does not deny access to the market to those
10 goods.

11 BY MR. KASS:

12 Q. And this is what you were talking about when you said
13 there's a difference between a goods market generally and a
14 services market?

15 A. Yes.

16 Q. Okay. Now, can you explain what the difference is with
17 regard to access in the Sterling scenario?

18 A. Well, in the Sterling -- in the Sterling case with
19 insurer ownership of collision repair shops -- and, again,
20 you've got the illustration of the fence around Texas, but
21 if you deny or restrict access to a services market, there
22 isn't the ability, as there is with goods, to still access
23 the market. If you can't provide collision repair services
24 or you're greatly constrained in your ability to provide
25 those services, you're more or less out of the game, and

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1 that's in direct contrast to with typical goods situation.

2 Q. Okay. And what about with regard to prompt
3 replacement?

4 What are the differences between the Ford cars market
5 and the Allstate collision repair services market?

6 A. Well, in the -- in the event if for some reason the
7 prohibition on a car manufacturer, such as Ford, from
8 selling vehicles directly, were in fact to reduce the number
9 of Ford's that would flow into and be sold in the State of
10 Texas, then you would expect that fairly quickly, promptly,
11 that other car manufacturers, mainly interstate car
12 manufacturers, would replace that supply. It's not that
13 significantly fewer cars would be purchased in the State of
14 Texas, there would be replacement by other providers.

15 Now, if you contrast that to the --

16 Q. Could you hold on one second? We're having technical
17 difficulty here.

18 Okay. It's back on the screen.

19 A. Okay. Sorry.

20 Q. Okay. So can you contrast that with the Sterling
21 repair services market with regard to prompt replacement?

22 A. Yes. In the case of Sterling, if Sterling's market
23 share is reduced, if it's prohibited from expanding or in
24 the extreme case if you couldn't own a shop at all, you
25 couldn't build the greenfield shops, the lost market player

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1 is going to be promptly replaced by interstate firms. It
2 will be promptly replaced in the local market. There may be
3 some increased waiting time and so on, but the replacement
4 from out-of-state profiteers is not going to be prompt. It
5 may be very slow or it may not take place at all.

6 Q. And what's the difference with regard to the
7 franchisor/nonfranchise aspect of these two markets?

8 A. Well, in the Ford case and the related cases involving
9 goods, they involve franchisees, where there were
10 dealerships that were franchises.

11 In general, for the reasons I mentioned, with a
12 franchisor-franchisee relationship there is some
13 opportunity, under certain conditions, for the franchisor to
14 behave opportunistically, behave unfairly in a sense, and in
15 this case there's not a franchise market.

16 Allstate has PRO shops but it doesn't have the ability
17 to -- it's not the same relationship, by any means, as a
18 franchise relationship is.

19 Q. Why do you say their -- it's a different relationship
20 between the Ford dealership and the PRO shops?

21 A. Well, the Ford dealership operates under the brand name
22 Ford, and a lot of what the Ford dealership does benefits
23 Ford, and vice versa.

24 The franchisor Ford also has a major impact on the
25 terms of trade in the cars that go to Ford, whereas, in the

68 (Pages 134 to 135)

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1 insurance case, the collision repair case, there is no
2 franchise. PRO shops got operate under the brand name of
3 Allstate or Sterling.

4 When they invest in good relationships with their
5 customers, that doesn't provide any direct benefit to
6 Allstate or Sterling, other than the fact that they may have
7 some satisfied customers.

8 MR. KASS: If we could put on the screen PDX 712.

9 BY MR. KASS:

10 Q. What is this document designed to show?

11 This is a document that was used I believe in the
12 opening as well?

13 A. Well, this is another case involving the flow of goods
14 across state lines. And in the Exxon case, Exxon was
15 prohibited from directly selling gas in the state of
16 Maryland through its own dealerships, but Exxon was able to
17 use independent dealers to distribute its products and had
18 access to the market despite the prohibition of being able
19 to do it in a company owned shop.

20 So it's basically the same situation.

21 Q. Same situation as what?

22 A. As the Ford case that I just described.

23 Q. Okay. If we could go to PDX 713, does this summarize
24 the differences between the Exxon line of cases and the --
25 and the issues here, from an economic perspective?

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1 A. Yes.

2 In the one case you've got the flow of goods, where the
3 issues were how could the manufacturer access the market,
4 access wasn't forbidden, it was just the mode of access that
5 was forbidden. And in that sense the access to the
6 out-of-state firm was not denied. There wasn't any major
7 shift of sales from the out-of-state firm to in-state
8 competitors because the gasoline was still going to flow in,
9 for example, from Exxon from out-of-state. And if there was
10 any reduction in the amount of gasoline in that case or the
11 amount of cars in the other case, it would be expected to be
12 promptly replaced by other interstate providers, and none of
13 those things are true here.

14 And last, those cases did involve franchisee rights,
15 which create some special issues.

16 Q. Dr. Harrington, turning now to your second opinion, if
17 we could put up PDX 701.

18 Could you please explain for the court what your second
19 opinion is?

20 A. Yes. The second opinion is directly related to the
21 first.

22 HB 1131 -- HB 1131 denies meaningful access to the
23 Texas market for Allstate and Sterling. It denies
24 meaningful access to the collision repair services market
25 and substantial injures that market. It does it directly,

69 (Pages 136 to 137)

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1 but it also does it by affecting the ability of Allstate to
 2 develop this network for the -- for the benefit of large
 3 numbers of customers in Texas and in other states, and it
 4 also has an impact by possibly influencing similar
 5 legislation in other states that could kill the entire
 6 initiative.

7 Q. What do you mean that by -- when you say "HB 1131
 8 denies meaningful access to the Texas collision repair
 9 services market"?

10 A. Allstate's business plan was to build more greenfield
 11 shops and to have more shops in the metropolitan regions in
 12 Texas where it had a sufficient customer base to achieve the
 13 economies of scale by building these larger shops and
 14 investing in state of the art equipment. It can't do that
 15 under HB 1131. The existing shops were grandfathered, but
 16 it can't build the new shops.

17 And we heard testimony from Sharon Mazanec about some
 18 of the implications of that.

19 In addition, HB 1131 hamstrings, in many respects, the
 20 ability of Allstate and Sterling to coordinate in ways that
 21 will help the project be successful and help align
 22 incentives and achieve economies of scale by getting
 23 sufficient volume at the existing Sterling shops.

24 Q. Yesterday Mr. Daly was asked on cross-examination
 25 whether he was assuming whether HB 1131 would cause Sterling

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1 to -- Allstate to divest Sterling in Texas in reaching his
 2 conclusions.

3 When you say "Allstate and Sterling substantially
 4 injures the market by denying them meaningful access," are
 5 you assuming that Allstate will have to divest its stores in
 6 Sterling -- in Texas?

7 A. No. The relevant issue here is to ask the question
 8 without HB 1131 how would the network have grown, how many
 9 shops would there have been, what would their capacities
 10 have been.

11 And HB 1131 certainly has choked off the number of
 12 shops, and there's substantial evidence, as we've heard
 13 testimony on, that it's reduced the volume at the existing
 14 shops.

15 So the market share is definitely lower than it would
 16 have been absent HB 1131.

17 Q. I would now like to put upon the screen PX 9, which is
 18 part of the legislative transcript from the hearing in the
 19 Senate Business and Commerce Committee.

20 If we could turn to page -- to page 11, line 14.

21 This is Senator Carona speaking and he says, I think
 22 the most significant thing we've tried to do here is just
 23 make sure that we don't let those actual shops owned by the
 24 insurance companies have any kind of competitive advantage
 25 in the region.

70 (Pages 138 to 139)

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1 Do you think eliminating a firm's competitive
2 advantage and ensuring a level playing field good for the
3 national economy?

4 A. Not by any means as a general rule. Our economy works
5 on the premise of competition, encouraging firms to be
6 efficient and encouraging innovation. And firms on average
7 that innovate in ways that make customers better off capture
8 market share from other firms, and, in addition, by the very
9 process, inject additional competition into the market,
10 which encourages other firms to also become efficient or
11 adapt similar -- similar methods and procedures.

12 Q. I'd like to now put on the screen PX 1, a copy of the
13 law at issue here.

14 Have you seen -- have you read HB 1131?

15 A. Yes.

16 Q. I don't want to go through every provision, but I would
17 like to point out a few and understand what the economic
18 impact of some of those provisions are.

19 If we could turn to Section 2306.006, Subsection 2,
20 states, An insurer may not share information with its tied
21 repair facilities unless it also gives that same information
22 to the DRP or PRO shops.

23 How does that impact Sterling's access to the market?

24 A. Well, it would certainly be expected that Allstate and
25 Sterling would coordinate and exchange all sorts of

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1 information in order to make the processes work, develop
2 better processes and get a consistent quality offering to
3 their customers.

4 What this basically says is you either can't do it or
5 you do do it, you have to give it to everybody else. So it
6 more or less says Allstate is required to allow free-writing
7 by the other shops.

8 Q. Section 4 says an insurer may not provide its tied
9 repair facilities with a recommendation, referral,
10 description, advantages or access to its policyholders that
11 it does not make available to other DRP facilities.

12 How does this impact Allstate's and Sterling's access
13 to the Texas collision repair services market?

14 A. This provision impacts it most directly, because what
15 it's saying is if Allstate builds facilities or acquires
16 facilities and tries to provide a better customer offering
17 and achieve scale economies and align incentives, that it
18 can't recommend to its customers that it has this option.
19 It has to basically withhold information from its customers.

20 And that goes right to the heart of its ability to
21 achieve capacity utilization on economies of scale at these
22 shops. It definitely -- if it were in fact this were the
23 rule and it were being enforced and no injunction or
24 anything, this would choke off Sterling's ability to grow
25 and achieve efficient capacity utilization.

71 (Pages 140 to 141)

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1 Q. Doesn't this provision just prevent steering?

2 A. I don't think it has anything to do with steering in
3 terms of its effects.

4 Allstate by law and by policy is required to tell Texas
5 insurance consumers that if they have a collision and
6 they're an Allstate policyholder that they have choice.

7 What this does is it allows Allstate, after investing
8 all the money it's been investing to try to do something
9 different in the business, it allows them to tell the
10 consumers that they have this option. This will -- whether
11 this is successful in part will depend on how well Allstate
12 delivers on the promise and whether consumers, the
13 relatively small portion perhaps that may act on that
14 recommendation, are satisfied with the experiences that they
15 have.

16 Q. There are other provisions I'd like to go through, but
17 I'll just do this one last one.

18 And it says -- Subsection 7 says an insurer may not
19 subsidize the business activities or operating expenses of a
20 tied repair facility.

21 Economically speaking, what is the impact on this
22 provision of Sterling's ability to compete?

23 A. Well, if I regard "subsidize" as having its generally
24 accepted meaning, it implies that Allstate cannot invest any
25 significant amounts of money in the shops that help their

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1 activities. It can't invest money to work on their
2 processes. It can't provide assistance financially in those
3 sorts of ways.

4 And as a result, it will impede Allstate and Sterling's
5 ability to achieve the efficiencies that they had hoped to
6 get when the strategy was initiated.

7 Now, this is particularly relevant here because
8 Sterling is owned by Allstate. And we heard Mr. Thompson
9 say that one of the problems Sterling was facing, and other
10 consolidators have faced, but one of the problems that
11 Sterling was facing when it was in the process of
12 becoming -- before it became acquired by Allstate, was that
13 it had a lot of good ideas and it wanted to build more shops
14 but it was having trouble raising capital.

15 Now Sterling is owned by Allstate, its ability to raise
16 capital on its own is probably diminished since it was an
17 independent entity and it needs to rely on investments and
18 capital by Allstate.

19 Q. Aren't Sterling's problems, the ones that they're
20 having, just a function of the fact that other insurers have
21 taken Sterling off their DRP programs?

22 A. No. There's no doubt, based on the evidence and the
23 testimony, that after the acquisition was announced there
24 was a shock to the existing Sterling network. The volume
25 fell off dramatically and that created lots of issues and

72 (Pages 142 to 143)

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1 problems associated with what are you going to do, how are
2 you going to keep the employees working on cars, all those
3 things.

4 There's no doubt that that happened. There's also no
5 doubt that as months went by Allstate was building new
6 greenfield facilities, they were opening new facilities.

7 Sharon Mazanec has testified about the volume that
8 they had in the shops in the Dallas area. And they were
9 growing, despite that initial shock.

10 Q. I would now like to put on the screen an excerpt from
11 the transcript that we -- from Monday's hearing and the
12 court asked a question:

13 Why can't Allstate go ahead with its failed plan?

14 And Powell's response is we think, you know, in 49
15 states they can. In 49 states they can.

16 Why can't Allstate simply invest the money that they
17 were going to invest in Texas in other states.

18 A. The planning documents and just the underlying
19 economics of this indicate that Texas is a very important
20 part of the overall piece.

21 This strategy -- from what we know now has its most
22 chances of really adding value in various metropolitan
23 regions across the country with fairly dense populations
24 that will achieve efficiencies in the collision repair
25 services.

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1 Texas is a major part of that overall market. By
2 chopping off Texas you also reduce the overall size -- you
3 reduce the overall size of the network. You reduce
4 significantly the ability to spread various types of fixed
5 costs associated with the strategy among more shops and
6 among -- and among more cars. So it's very important.

7 And then the other issue is that realistically, as a
8 practical matter, the success of HB 1131 in Texas, if it
9 does in fact deny Allstate and Sterling meaningful access to
10 the market if it is upheld, there is a nontrivial
11 probability that this could happen in other places.

12 MR. POWELL: I am go going to object a professor
13 of finance predicting what other state legislators in other
14 states, given their own public policies and laws, might or
15 might not do. He has testified that he is no expert in
16 state legislative processes.

17 MR. KASS: Your Honor, Dr. Harrington is not
18 testifying about whether other states will pass legislation
19 but what the impact of the risk that other states may do so
20 will have on the initiative.

21 THE COURT: Overruled.

22 BY MR. KASS:

23 Q. Dr. Harrington, what will the impact be in terms of the
24 incentives that Allstate faces, given the risk of potential
25 legislation elsewhere?

73 (Pages 144 to 145)

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1 A. Well, this -- this is more or less where you can bring
2 in sort of a standard financial analysis to ask this
3 question.

4 What really goes on is Allstate has to evaluate the
5 future cash flows from these initiative compared to what
6 it's going to cost to get it going and it has to consider
7 the probability that it will actually realize those cash
8 flows.

9 The possibility of these type of actions in additional
10 states affects the probability of Allstate achieving the
11 efficiencies and obtaining the cash flows from the
12 initiative, and it is boilerplate finance and economics that
13 as that probability goes up of not being able to do this in
14 various states with large populations, that the net present
15 value as we like to call it of the initiative will become
16 negative, at which point you would expect it will be
17 terminated.

18 Q. Dr. Harrington, I would now like to turn to your third
19 opinion, which is that the Allstate and Sterling initiative
20 does not pose a risk of unfair competition.

21 Do you have a disagreement with Dr. House on this
22 point?

23 A. I don't believe that I do. I don't believe, based on
24 my reading of his report, Dr. House's report, and his
25 deposition testimony, that he concluded that insurer

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1 ownership would reduce competition in collision repair.

2 Q. I would like to play a short clip from Dr. House's
3 deposition. It's page 14, line 16, through page 15, line
4 1:

5 (Videotape playing.)

6 "Q. And you didn't reach a conclusion that insurer
7 ownership of collision repair markets would tend to
8 substantially lessen competition in the collision repair
9 market?

10 "A. I have not constructed an opinion on that
11 particular issue to date."

12 Now, Dr. Harrington, have you constructed an opinion on
13 whether insurer ownership would substantially lessen
14 competition in the collision repair services market?

15 A. Yes.

16 Q. Okay. Could you please explain your opinion for the
17 court?

18 A. The automobile insurance market is highly competitive.
19 Economists that have looked at this market virtually
20 universally agree it's got a very competitive structure in
21 terms of number of players in concentration, ease of entry
22 and the standard benchmarks.

23 The market for collision repair services is also
24 competitively structured. When you think of unfair
25 competition the issue usually is, is there reason to think

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1 that firms are going to do things that significantly
2 increase their market pour and try to monopolize the market.

3 At the market shares in the competitive conditions in
4 these markets, that is no realistic concern in this case.

5 There is no evidence of anti-competitive behavior in the
6 form of exclusions or foreclosure of access to markets.

7 Q. Well, given that customers have a choice, as you've
8 testified earlier, what is the likely impact on quality and
9 price in the collision repair services market as a result of
10 Allstate's and Sterling's initiative?

11 A. There's every reason to expect, given Allstate's
12 alleged goals and its major investment in this project, that
13 it is creating a new source of competition if this is
14 allowed to go forward. And that if it provides high quality
15 services to its customers and is able to achieve various
16 efficiencies it will win on two dimensions: It will have an
17 attractive collision repair network; and it also will become
18 a better competitive force in the insurance market. It will
19 have some comparative advantage there.

20 In most cases the expectation is that it would enhance
21 competition and encourage competitive responses both within
22 the collision repair market and the insurance market
23 overall.

24 Q. And ways your basis for this conclusion?

25 A. Well, the basis is, as I've described, there are very

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1 strong reasons to think that insurer ownership does provide
2 a method of significantly reducing the two major problems
3 that have affected collision repair, and the rest of it is
4 pretty much just boilerplate economics.

5 If you do something well, you do something better,
6 you're going to capture profits. That's one of the motives
7 for doing it, at least for some period of time, but the very
8 process injects additional competition in the market, which
9 can change the behavior of others.

10 Q. And did you review any documents in reaching your
11 conclusions?

12 A. I reviewed a large number of documents that related to
13 things, like market shares and collision repair, and the
14 potential economies and incentive alignments, as well as
15 linking that to the underlying economics.

16 Q. And have you reviewed the expert report and deposition
17 of Chris Zora?

18 A. I have scanned the deposition of Mr. Zora, read parts
19 of it carefully and scanned others.

20 Q. And did any of that influence your opinions?

21 I know it was after you submitted your report, but
22 was -- did any of what Dr. Zora -- or Mr. Zora testified to,
23 did that have any confirmatory affect on reaching your
24 conclusion about unfair competition?

25 A. Well, Mr. Zora did make some comments that implied

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1 when Sterling came into the market doing things and offering
 2 various types of customer services that some of the other
 3 shops responded in terms of pricing to some extent or in
 4 terms of the service they were providing.

5 Q. I'd like to play a short videotape from Mr. Zora
 6 deposition, page 142, line 12, to 143, line 1:

7 (Videotape playing.)

8 "Q. When Sterling enters a market, you're aware of
 9 the fact that surrounding local body shops?

10 "A. True.

11 "Q. And when Sterling enters a market, you are aware
 12 of the fact that surrounding local body shops have had to
 13 increase their consumer coverings, true?

14 "A. Yes. They have had to increase their incentives
 15 to do business with them."

16 What does this suggest about the existence of unfair
 17 competition?

18 A. This is the normal byproduct of innovation and
 19 competition. When there is innovation firms come in and do
 20 things differently that have some competitive advantage of
 21 the other firms tend to respond.

22 Q. Well, can't vertical integration sometimes have
 23 anti-competitive affects?

24 A. Yes.

25 Q. And do you believe they have anti-competitive affects

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1 here?

2 A. No.

3 Q. Why not?

4 A. Normally when we think of vertical integration running
 5 the risk of being anti-competitive, the concern is that it
 6 will allow an extension of monopoly power.

7 And as I previously said, the whole idea of significant
 8 market power or monopoly type power here is a nonstarter
 9 because of the structures of the insurance market and the
 10 collision repair market.

11 Q. During yesterday's cross-examination of Mr. Daly he
 12 argued that local body shops compete to get on the DRP
 13 programs for Allstate and that because of the Sterling
 14 initiative there will be less of that competition.

15 What is your response to this argument?

16 A. The Allstate/Sterling initiative, if allowed -- if
 17 allowed to grow, is not going to eliminate Allstate's demand
 18 for PRO shops. Allstate is for the foreseeable future going
 19 to need lots of shops.

20 Just as an example, even if it was able to build out
 21 300 Sterling stores around the country, in major
 22 metropolitan areas, it would still have a need for other
 23 shops, and the evidence is that the percentage of consumers
 24 that might follow a recommendation and go to a Sterling
 25 shop, maybe it's 10, maybe it's 20, maybe it's 30, but there

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1 are going to be a lot of Allstate customers that are going
2 to be availing themselves of other options, and that other
3 option will include PRO.

4 Q. Are there any other reasons why the competition to get
5 on the PRO program will not diminish? Or the impact from
6 the Sterling initiative will not diminish as a result of
7 insurer ownership?

8 A. Other body shops because a lot of Allstate's customers
9 will be going to other shops they're going to have strong
10 incentives to try to get and retain a position on Allstate's
11 PRO shop list.

12 And if -- if you look at it a little differently, say
13 competing to get on the list or have a -- have a place
14 and -- and be in a favored position because of something
15 which you've done, what's going on here is Allstate has
16 decided that it can provide another option, and the other
17 option may be better able to meet its objectives of having
18 consistent high quality experience for its customers than
19 the traditional system of PRO, and I think that form of
20 competition is good, as I've indicated.

21 THE COURT: Is there a chance, professor, that
22 consumers will be turned off and they're just not going to
23 trust Allstate, I mean, that this could be a failure not for
24 the reasons you've talked about, consumers are just not
25 going to do it, they don't trust them, they're coming in

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1 with a bias against them or something like that.

2 THE WITNESS: There was testimony in some exhibits
3 earlier related to some focus groups that said some people
4 in those focus groups, as I recall were inherently
5 distrustful of this notion.

6 And what you would expect then if they were Allstate
7 customers and they were inferred of an affiliation with
8 Allstate, they will say what else.

9 That's very important, because it's one reason that the
10 predicted or expected or anticipated share of customers
11 going to Sterling is, you know, well under a hundred
12 percent.

13 People are going to go elsewhere for a number of
14 reasons. Over time those consumer prejudices, and I don't
15 mean that pejoratively, might change.

16 But they could change, either way: If Allstate doesn't
17 deliver, they said I went to Sterling, it was a terrible
18 experience, people will have heard of Sterling, everybody's
19 heard of Allstate, and there will be damage, and you would
20 expect even fewer people to go to Sterling in the future and
21 you would expect Allstate to lose some renewal business in
22 the ability to write new policies.

23 But, yeah, based on that evidence, that doesn't
24 surprise me, some consumers are inherently anti-insurer
25 and -- and would have suspicions. Over time those

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1 suspicions may diminish if Allstate provides a high quality
2 product.

3 THE COURT: Does it -- any of your answers to any
4 of the questions by counsel, does it concern you that this
5 is the first -- that this is the first time anybody has
6 tried to do this vertical integration in this particular
7 industry? Or are you comforted by some analogous situation
8 that you haven't told me about?

9 THE WITNESS: That's -- that's an excellent
10 question. Of course, it gives me time to think to say that.

11 Your Honor, when I first became familiar with the --
12 the economics of this case, and what was going on, what went
13 through my mind was that's a new idea that seems to get at
14 the heart of the problems.

15 So it's never been done. And as a result, it
16 definitely is risky. We don't know whether it's going to
17 work. But the basic idea seems to be very sound, in terms
18 of being able to get bigger shops, with bigger throughput,
19 bigger capacity utilization, and change the incentive
20 structure away from maybe trying to get a higher bill
21 regardless of what you actually do to the car for some shops
22 some of the time, to a system where Allstate by managing the
23 employees and the management of its affiliate is able to
24 instill a lot of incentive.

25 THE COURT: Okay. But it doesn't concern you

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1 that maybe there's some economic analysis that you might
2 miss because there's no -- no analogy that you might be able
3 to make?

4 That's my concern.

5 Does that make sense?

6 THE WITNESS: I think if I think more about it
7 there are -- there clearly are risks. And ignoring the
8 legislative risks, but there are economic risks.

9 It is -- it is new -- new turf here. And as a result
10 the issue you brought up about how many consumers will
11 really want to go, is there some -- is there going to be
12 some bias or prejudice and are the scale economies really
13 going to be there to the extent that are anticipated and
14 that logically would suggest would -- would will be there.

15 It's uncertain, an uncertain venture, but it's
16 certainly -- the economics suggest it's certainly worth a
17 shot.

18 THE COURT: Okay.

19 BY MR. KASS:

20 Q. Well, Dr. Harrington, are there examples where vertical
21 integration has been a benefit to consumers?

22 A. Yes.

23 Q. Okay. Can you provide some examples?

24 A. I'd -- I'd like -- I'd like to provide one example in
25 particular.

78 (Pages 154 to 155)

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1 One of the major developments in the latter half of the
2 Twentieth Century was the vertical integration of insurers
3 into the distribution of insurance. And it produced great
4 expense efficiencies, economies of scale, economies of
5 scope, and consumers that can be served and are happy to
6 deal with an exclusive agent representing an insurer.

7 You know, it's been very good for consumers to have
8 that type of vertical integration.

9 Q. Dr. Harrington, the state and intervenors argue that HB
10 1131 is reasonable because it is based on the regulations
11 and the public utilities field. And then they also point to
12 the Department of Justice transportation regulations
13 governing airliner reservations.

14 And if we could pull up the intervenors' brief, page 9.

15 Here the intervenors argue that intervenors are aware
16 of no challenges to PURA attempting to undo the state's
17 regulation -- deregulation of Texas public utilities.

18 And in the airline industry, the United States
19 Department of Transportation imposed a code of conduct upon
20 airlines that own computer systems used by travel agents.
21 Doesn't this suggest that HB 1131's code of conduct would
22 not have an adverse impact on competition?

23 A. No. These -- these regulations aren't comparable in
24 purpose or affect. They're not applying in the same context
25 at all.

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1 First, there's no issue here about business shifting
2 from -- from interstate providers of a good or service to
3 local providers of a good or service. These statutes don't
4 have anything -- don't have anything to do with that.

5 The PURA regulations apply to local firms, public
6 utilities, primarily local firms, the -- which traditionally
7 have been local firms.

8 The United States Department of Transportation
9 regulations apply to a national market and they apply to the
10 utilization of what really is an essential facility, the
11 reservation systems in the national market.

12 Another -- another distinguishing issue is that in both
13 of these markets there's limited choice. Utilities, public
14 utilities have traditionally been regarded as natural
15 monopolies. You've gotten certain types of services from
16 the utility, without competition or choice as a consumer.

17 The airline reservation systems were essential
18 facilities that might be developed by one or two insurers,
19 but the other insurers really needed to have access to those
20 things, but it wasn't a competitive environment.

21 In this case insurance markets and collision repair
22 markets are structured for competition and consumers have
23 choice to pick an insurer and to pick a repairer.

24 Q. Dr. Harrington, I'd now like to turn to your fourth
25 opinion.

79 (Pages 156 to 157)

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1 If we could put up PDX 701 again.

2 Could you please explain what your fourth opinion is
3 for the court?

4 A. My fourth opinion is that insurer ownership does not
5 present any substantial risk to consumers that they're going
6 to be harmed through the insurer-ownership process.

7 Q. What do you base that opinion on?

8 A. Well, as I said a couple of times, the automobile
9 insurance market is highly competitive. Allstate competes
10 vigorously with a whole variety of players. And they
11 compete on the basis of being able to provide a good price
12 and to meet consumers' expectations when it comes to the
13 time of having a claim. So there's lots of competition
14 there.

15 And it's very important here, because if Allstate
16 frustrates its consumers' expectations when they have a
17 wreck and they have their cars repaired, there's a direct
18 market penalty to Allstate. It impedes its ability to get
19 new customers because of the word-of-mouth affects and it
20 increases the likelihood that it loses a valuable existing
21 customer relationship.

22 In addition, Allstate's spending a lot of money to
23 build Sterling and invest in a Sterling brand, and fit
24 frustrates consumer examinations, the value of that demand
25 will certainly diminish and Allstate gets hit two ways, its

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1 collision repair chain value goes down and it also hurts the
2 value of its primary franchise.

3 Q. Well, don't businesses generally have an incentive to
4 cut corners? Don't all businesses have that incentive?

5 A. I think if you take the big picture, what many, most
6 businesses do, and we teach this, is that they try to
7 maximize the long-run value of the corporation. And that in
8 many or most cases, and really most cases, means the way
9 they do that is by providing things that consumers want and
10 need and are willing to pay for. And in many cases that
11 means providing very high quality, as is illustrated in a
12 lot of markets.

13 Q. Like what types of markets?

14 A. Well, you just take the motor vehicle markets. There's
15 demand for various types of quality motor vehicles, and we
16 see a wide variety of quality in motor vehicles.

17 Q. Any other examples where you have where there's an
18 incentive not to cut corners but to provide high quality?

19 A. There -- there -- there are so many.

20 But say, I'll just go to insurance markets.

21 Insurance markets, by in large, firms are very
22 sensitive to their financial ratings that they get from
23 various rating agencies which indicate how financially
24 strong they are. And the reason is, is that they know there
25 may be some customers that they will drive away or lose if

80 (Pages 158 to 159)

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1 they don't remain financially strong.

2 Q. Well, can't Allstate make more money by cutting corners
3 than by providing high quality repairs?

4 A. I've even -- as I've reviewed materials for this case
5 I've seen no evidence that cutting quality, a systematic
6 policy of cutting quality, would actually increase

7 Allstate's profits, given a variety of factors, including
8 very important the reputation issue and the desire to keep
9 your customers that I described earlier.

10 And some of the other things are there is the
11 guarantee, so that if you don't provide the quality and it
12 is discovered and it comes back you've got to rework the
13 vehicle.

14 That provides some incentive. But more broadly, and
15 the type of thing I teach when I talk about incentives to
16 provide claims service would be the threat of litigation if
17 you don't provide adequate quality, and also a variety of
18 regulations that may result in some sanction if you don't
19 meet the expectations of your customers.

20 Q. Well, the state and intervenors argue that it's
21 difficult to monitor the quality of repairs in some
22 instances. Doesn't that give an insurer the ability to
23 profitably cut corners?

24 A. Well, if you -- if you had the hypothetical where they
25 could do stuff that consumers would never find out about,

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1 that they would be completely clueless about, so that there
2 was no market penalty whatsoever, no injury to the consumer
3 that was ever discovered, yeah, in that hypothetical,
4 theoretical world, you might say, well, maybe -- maybe there
5 would be some incentive to cut corners, but that's not --
6 that's not the world we're in.

7 You've got the brand name, reputation, customer
8 loyalty, customer renewal influences that I described.

9 But moreover, if you systematically provide low
10 quality, or maybe, to take Dr. Zion's testimony, he
11 testified at length about how you might have some
12 structural -- structural component that's not fixed
13 correctly that actually increases the risk that the occupant
14 of the vehicle be harmed. Well, litigation is a potent
15 threat, a potent deterrent to engaging in that type of
16 activity and it's particularly potent for corporations like
17 Allstate.

18 And it's particularly potent to them for two reasons,
19 and ones not so obvious, but it's very important.

20 For one reason Allstate, has an enormous value, it has
21 very deep pockets. So if it does things in large numbers of
22 people, or even small numbers of peoples were hurt, or maybe
23 they were just harmed on a very minor basis but many people
24 were harmed and found out about it and filed class actions,
25 Allstate has enormous resources open to litigation.

81 (Pages 160 to 161)

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1 But secondly, and less obviously, a bigger firm, a
2 firm that does collision repairs is more likely to get
3 caught.

4 If you take Dr. Zion's example, if there's one -- one
5 in a thousand or one in 500 or one in 10,000 chance that
6 you've done an improper repair and the consumer will be
7 hurt, for a relatively small body shop there's a good chance
8 the accident will never happen and they will never get
9 caught.

10 But for a corporation like Allstate that may end up
11 doing thousands and thousands of repairs, the more you do
12 that, it becomes inevitable that you will get caught,
13 because someone will be injured and the litigation will
14 result.

15 Q. Dr. Harrington, I'd like to conclude this examination
16 where we began.

17 If we could pull up PDX 703.

18 Can you please explain what your areas of disagreement
19 are with Dr. House and why he is wrong.

20 A. I disagree with Dr. House that the Allstate/Sterling
21 initiative really doesn't make any economic sense. And I've
22 described the reasons I think it means -- it makes economic
23 sense.

24 But, among others, it makes no sense -- if that were
25 true, it would make no sense for Allstate to be spending

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1 tens of millions of dollars on this initiative if it didn't
2 have some reasonable prospect of success and thus being
3 economically sensible.

4 And if this made no sense, if this initiative made no
5 sense, I don't think you would see all the effort being
6 expended by various parties, including local body shops, to
7 try to kill the initiative.

8 The -- the second point of disagreement is that fraud
9 is not being effectively managed currently in the sense that
10 we think it's only a small problem. There's substantial
11 evidence that waste and fraud are meaningful problems. And
12 basic economics suggests that insurer ownership will provide
13 substantial incentives for the reduction in waste and fraud.

14 My third source of disagreement, as I have explained in
15 detail, is that insurer ownership does not provide
16 significant incentives -- it's not going to yield strong
17 incentives to reduce fault and to the contrary for the
18 reasons I described we might expect quality will be just as
19 good or better.

20 And last and perhaps most important, HB 1131 has
21 interstate affects. And if you apply the business shifting
22 test with integrity, you have to include that it shifts
23 business from interstate providers to local firms. And it
24 does that without providing any real benefits to consumers,
25 but instead it deprives those consumers of a new choice in

82 (Pages 162 to 163)

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1 collision repair.

2 MR. KASS: Thank you, Dr. Harrington.

3 I pass the witness.

4 MR. POWELL: Your Honor, before I cross-examine
5 the witness, I would renew our objection under Rule 702.

6 All you have heard is essentially argument from the
7 witness stand dressed up as some opinion after an
8 economist. There is no analysis. There's no effort to do
9 anything rigorous. There's no effort to subject any of this
10 to any sort of peer group testing. It is simply argument
11 from the witness stand. It is not helpful to Your Honor.

12 The arguments can be made by the lawyers.

13 I have a feeling that if -- if Mr. Kass had sat down up
14 there and the professor had stood up up here, it would be
15 just about the same. So we would move to strike it.

16 THE COURT: All right. Overrule your objection.

17 Dr. Harrington is admitted as an expert on -- in the
18 field of economics.

19 (CROSS-EXAMINATION)

20 BY MR. POWELL:

21 Q. Let me ask you, Dr. Harrington, I wanted to ask you a
22 few things about some of the charts that you have talked
23 about here.

24 MR. POWELL: And could I have the ELMO up,
25 please?

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1 BY MR. POWELL:

2 Q. I'm first going to look at PDX 706.

3 This is one of your charts, right, sir?

4 A. Yes.

5 Q. I actually think this chart is -- is fairly
6 descriptive, because what you're showing as being denied
7 access to the Texas market by this big long fence that goes
8 all around Texas, is an overlap, an overlay of Allstate and
9 Sterling, correct?

10 A. Yes.

11 Q. If you took a big black marker and you cut that overlay
12 right there, and you didn't have Sterling overlaid on
13 Allstate or Allstate overlaid on Sterling, there is nothing
14 about HB 1131 that would keep Sterling from coming into the
15 market, is there, sir?

16 A. I -- I'm pausing because there's an issue of by the
17 wording in the statute, the actual what it says, versus the
18 economics of whether or not Sterling would have entered the
19 Texas market and be able to expand as much as it would with
20 Allstate's support. I think there's a distinction there.

21 Q. Okay. And that's the distinction you drew in your
22 deposition.

23 You said you could not say that the Sterling business,
24 without Allstate, would not have been successful. Could
25 you?

83 (Pages 164 to 165)

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1 A. I don't remember exactly what I said in my deposition,
2 but what I can say is that the Sterling operation clearly
3 was designed to rely on the financing of Allstate and the --
4 the money to build out greenfield shops and to be able to
5 expand throughout the region and achieve efficiencies. And
6 that's the reason that they were acquired, as Mr. Thompson
7 testified.

8 Q. Okay. That's not my question.

9 My question -- let's go back to my first question and
10 see if I can get an answer to it.

11 If you broke that bond between Sterling and Allstate -
12 and you've testified you've read the legislation and you've
13 given your opinions on it - there's nothing in the world to
14 keep Sterling from moving into the Texas market in whatever
15 size it can afford to do so, is there?

16 A. Well, what in the world is there to prevent that is the
17 underlying economics. And the issue here is does the
18 statute prevent Sterling from achieving a certain scope of
19 operation and efficiencies because it's owned by an
20 insurance company and it's an interstate entity; and the
21 answer is yes.

22 MR. POWELL: Motion to strike as nonresponsive,
23 Your Honor.

24 THE COURT: Overruled.

25 BY MR. POWELL:

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1 Q. Let's go back to what you said.

2 Is in fact there anything in the statute that you know
3 of, based on your study, that would keep Sterling from
4 coming into the Texas market if it can get the financing to
5 do so from somewhere?

6 A. In the statute itself, no.

7 Q. Okay. And there is certainly nothing to keep Allstate
8 out of the Texas market, is there?

9 A. In terms of it being an insurance company?

10 Q. Right.

11 A. No.

12 Q. In fact, it's here in a big way, is it not?

13 A. Yes.

14 Q. In fact, you heard the testimony from Ms. Norton this
15 morning that one of its subsidiaries, Allstate County, is
16 located out here in Irving, did you not?

17 A. Yes.

18 Q. And do you know that that entity, that Texas-based
19 insurance entity, writes about half of the automobile
20 insurance in the State of Texas?

21 A. Allstate has several affiliates writing automobile
22 insurance in the State of Texas. And I don't know the
23 specifics, but I know it writes a lot of insurance through
24 its affiliates in the State of Texas.

25 Q. All right. So that company, Allstate County Mutual

84 (Pages 166 to 167)

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1 Insurance Company, is a Texas-based company and it is
2 precluded from owning Sterling, is it not?
3 A. Yes.
4 Q. And if we went down here to San Antonio and he looked
5 to that USAA, and let's just say that, for example, USAA
6 decided to buy Service King and overlay, just like up here
7 in Oklahoma where you've got Sterling and Allstate
8 overlapped, that would also be prohibited, would it not, the
9 USAA/Service King combination by the statute you're
10 complaining of?
11 A. In terms of the wording of the statute, as I understand
12 it, that would be prohibited.
13 Q. So there's really not any barrier, as I understand it,
14 as I understand this fence that you've drawn around Texas,
15 to out of state collision repair companies coming into
16 Texas, is there?
17 No legal barrier.
18 A. There is an economic barrier that's created by the
19 statute. So whether we call that a legal barrier or an
20 economic barrier, there is a barrier to access by interstate
21 firms because the primary mode of access, or a major mode of
22 access that we would expect is going to be through
23 insurer-owned shops.
24 Q. How many of those are there, insurer-owned chains of
25 body shops?

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1 A. Right now there is -- is one that is wholly owned.
2 Q. All right. So all of the rest of the body shops in the
3 world are not owned by insurance companies. Is that your
4 testimony?
5 A. There are some body shops where insurance companies
6 have an ownership interest, a minority interest.
7 Q. That's Caliber, right?
8 A. Yes.
9 Q. That's all over Texas, is it not?
10 A. Yes.
11 Q. And putting aside Sterling and putting aside Caliber,
12 all of the rest of the body shops in the world, or in the
13 United States anyway, are owned not by insurance companies?
14 As far as you know.
15 A. Yes.
16 Q. And they're all free to come to Texas, are they not?
17 If they want to.
18 A. I think I understand what you're saying, is they're
19 free in the sense is there a law that says you cannot do
20 this?
21 Q. Right.
22 A. All right. That would be true.
23 Q. And if they can get the money, to come to Texas, if
24 they like to come to Texas because they think there's a good
25 market here, there is nothing about HB 1131 that keeps any

85 (Pages 168 to 169)

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1 of those automobile body shops from moving into Texas. Is
2 that right?

3 A. I can't agree entirely with that, because one of the
4 issues that has confronted consolidators and interstate
5 firms, is how do they get the money. And one of the source
6 of support, or money, or being able to achieve economies is
7 insurance companies.

8 So as a practical matter, are the opportunities for
9 expansion of interstate collision repair centers reduced by
10 chopping off a potential source of capital and support, and
11 the answer would be, yeah, yeah, their ability to come in is
12 reduced. It doesn't mean, oh, yeah, you can come in, but it
13 increases the costs of coming in because you're changing the
14 opportunities for coming in.

15 Q. Well, I mean, there are banks who could loan money.
16 You could go to the public market and raise money, you could
17 get money have venture capitalists. You might have family
18 money. You might be able to save your money, and use this
19 capital to come to Texas.

20 There are all sorts of sources of capital in the
21 marketplace, are there not?

22 That's what you really study, isn't it?

23 A. Yes.

24 Q. And also in order to make these investments desirable
25 there's the need to be able to get enough volume and if

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1 possible to operate efficiently, not only through volume but
2 through incentive alignment. Right?

3 A. And insurance ownership addresses both of those
4 issues. It can help provide volume.

5 You know, the banks aren't going to help provide you
6 any cars. Other sources of capital aren't going to provide
7 you with the volume. Yeah, they can provide you with money.

8 Q. And that's your argument in favor of vertical
9 integration between the insurance companies and the body
10 shops, because the insurance companies have a source of
11 cars. Right?

12 A. That's a part of the argument, is that insurance
13 companies by building quality -- quality facilities and
14 recommending those shops may be able to achieve the type of
15 volume that makes it efficient to build larger shops with
16 state-of-the-art equipment and achieve better capacity
17 utilization.

18 Q. You've agreed with me that there are -- the economic
19 literature anyway does identify potential dangers, potential
20 cons, harms of vertical integration, have you not?

21 A. Yes.

22 Q. So vertical integration, one of the things that some
23 economists think about vertical immigration is it produces
24 interbrand competition in the lower level market, right?

25 A. That's -- that's one opinion that it sometimes could do

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1 that.

2 Q. Yeah. And another potential harm is that it extends

3 power that the acquiring firm has from the upper market into

4 the lower market. It can extend market power from one

5 market into another?

6 A. Yes. And that's definitely not applicable here.

7 Q. Well, but I'm not asking you to apply it here yet.

8 I'll get to that.

9 A. All right. Let me -- can I answer?

10 Yes. Now, there's debate and work done on the precise

11 conditions where vertical integration by a firm with market

12 power actually can extend the market power and a lot -- a

13 lot of people think that it's not very likely that it will

14 happen, but that is an issue.

15 Q. Some people think it will happen?

16 A. Under certain conditions.

17 Q. What are the other dangers of vertical integration?

18 A. The major source of dangers would be a vertical

19 integration could be used to increase the ability of a firm

20 to raise its prices and limit competition.

21 Q. And engage in limiting competition in the lower level

22 market.

23 A. That's one --

24 Q. Correct?

25 A. That's one issue. But, of course, it's debated the

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1 conditions under which vertical integration might limit

2 competition as opposed to enhancing it.

3 Q. There's a big debate about all this --

4 A. Yes.

5 Q. -- in the economic literature, is there not, sir?

6 A. Yes.

7 Q. And I suppose another concern would be that if a firm

8 up here in the higher market does business with a number of

9 firms in the lower market but then firms into the lower

10 market and acquires one of those firms, that it could

11 provide information to its subsidiary that it gets from

12 other firms in that market. Kind of an -- an unlawful

13 competition or an unfair competition because -- because of a

14 control of information. That would be possible, wouldn't

15 it?

16 A. That -- that I think can arise in some circumstances.

17 Q. That's another issue that some people worry about when

18 they hear about vertical integration?

19 A. Yes.

20 Q. Right?

21 A. But it depends -- but it depends a lot on the structure

22 of the market and basically how competitive the market is

23 and whether that firm has any real advantage with the

24 information to begin with.

25 Q. It requires a -- a --

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1 A. Whether the information is otherwise available in the
 2 marketplace or is truly a source of information that the
 3 other players can't get, whether it's proprietary and so on.
 4 Q. You need to know a lot of those things, don't you, to
 5 know whether there's going to be that problem?
 6 A. Well, I think you can -- I think you can look at the
 7 issue and say -- draw some -- draw some inferences about how
 8 important that particular type of information is and how
 9 advantageous that particular type of information would be.
 10 Q. And that -- and that's just part of the literature
 11 debate or the debate among economists about whether vertical
 12 integration can be positive or whether it can be negative,
 13 whether the costs of vertical integration might outweigh the
 14 benefits of vertical integration, in certain circumstances?
 15 A. That's true.
 16 Q. And what you have done here is you've looked at this
 17 situation and you've concluded that the benefits of vertical
 18 integration outweigh the costs?
 19 A. What I have concluded is that if you look at the
 20 collision repair market and you look at the insurance
 21 market, there are very strong reasons to think that the
 22 benefits could be substantial or, in fact as I said in my
 23 report, enormous.
 24 And if you look in particular about the types of harms
 25 that could be done by this activity, they appear to be

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1 minimal.
 2 So, yes, in that sense I definitely conclude that the
 3 benefits here outweigh the costs.
 4 Q. So that's what -- that's your conclusion -- that's your
 5 opinion?
 6 A. That is my opinion.
 7 Q. You've stacked up the benefits over here and you've
 8 stacked up what you perceive to be the cost and you think
 9 benefits are greater than the costs?
 10 A. Yes. But I would caveat that in the sense that the
 11 benefits are probabalistic, as are the costs for that
 12 matter. And as I noted, there's risks here.
 13 And ultimately, if the initiative is allowed to
 14 proceed, without interference, which restricts the ability
 15 of an interstate competitor to come into an area and build
 16 greenfield shops and attract market from local providers, if
 17 it is allowed to pass that market test, then ultimately
 18 we'll have a much greater idea as to the quantity of the
 19 benefits.
 20 Q. This is an experiment that you think should be allowed
 21 to go forward because you think the potential benefits
 22 outweigh the potential costs?
 23 A. Well, as a personal opinion --
 24 Q. That's right.
 25 A. -- my reaction is definitely that this experiment

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1 should be allowed to go forward, but that's not what my
2 testimony is.

3 My testimony is my expert opinion on whether or not HB
4 1131 shifts business from interstate firms to local
5 providers and whether or not fraud and waste are effectively
6 managed under the status quo in the collision repair
7 industry and whether or not insurer ownership creates
8 significant risk of harm to consumers and -- and the
9 other -- the things I've testified on.

10 Those aren't personal opinions. Those are my expert
11 opinions based on my understanding of insurance markets and
12 my understanding of economics in general.

13 Q. Describe for me the Texas Department of Insurance's
14 staffing for dealing with fraud in the insurance industry.

15 A. That's a very -- that's a very broad question. Excuse
16 me.

17 Q. Let me ask you this.

18 Did you consult with anyone in the Texas Insurance
19 Department about the issue of fraud?

20 A. I listed the Texas Insurance Department's web site. I
21 looked at things related to fraud on the web site.

22 Q. You made no evaluation of whether there's an efficient
23 way to deal with fraud in Texas or not, by virtue of
24 statutes that already exist, have you?

25 A. What I teach and what I'm familiar with is there are

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1 unfair Texas trade practices acts and there are insurance
2 department regulations. The Texas Insurance Department has
3 a procedure for compliance. There is a ability for
4 consumers to complain if they feel he have been mistreated
5 whether by an insurance company or as a result of any
6 relationship with the insurer, that the Texas Insurance
7 Department maintains complaint records on a very detailed
8 basis, that on their web site they warn consumers about
9 certain types of things that they should be aware of,
10 including the possibility of fraud in insurance markets and
11 fraud in collision repair.

12 Q. Have you done any empirical study of whether the Texas
13 Insurance Department is effective or not effective?

14 A. I wouldn't -- I wouldn't know how to define "effective"
15 under those -- do I -- have I done a study of whether the
16 resources that they spend are producing benefits that exceed
17 the cost of those resources? No.

18 Q. You -- you -- back to your PDX 706.

19 If -- you would have to agree with me that the only
20 thing this statute works against - and you think this is
21 bad, I understand you think this is bad - is the vertical
22 integration between insurance companies and auto body shop
23 shops. That's the only thing that's kept out of Texas,
24 right?

25 A. Well, what's kept out of Texas is insurer-supported and

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1 insurer-owned shops.

2 Q. Right. Now, one of the other charts that you put up
3 here, you have done a -- you have -- you have made an
4 assumption, it appears to me, that most of the other body
5 shops in Texas -- let me -- let me make sure I wanted
6 your -- your situation.

7 Your -- your distinction between -- your statement
8 about out-of-state providers, the people you put into that
9 category, are body shops that are owned by some -- that
10 are -- let me ask you this. Is it body shops that are
11 formed under the laws of some other state; is that an
12 interstate provider?

13 A. Yes.

14 Q. And is it body shops that might be formed under the
15 laws of Texas but happen to have their principal place of
16 business in Oklahoma?

17 Is that an interstate provider?

18 A. I haven't thought about.

19 Q. What's in your category of interstate providers, just
20 body shops that are incorporated in some other state?

21 A. That would be my major inference.

22 Q. So if a body shop is located in Texas and it's got 37
23 stores down here, but it's a Delaware corporation, then it
24 meets your definition of an "interstate provider"?

25 A. I haven't defined "interstate provider" in any legal --

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1 legal sense.

2 When I think of interstate provider I think of a
3 provider that markets goods and services across state
4 lines.

5 Q. Okay.

6 A. And it's not -- does not have its primary place of
7 business or domicile in the State of Texas. And it can be
8 an interstate provider if it's in Texas?

9 Q. I'm sorry?

10 A. It can be an interstate provider if it's in Texas, if
11 it operates in other states.

12 But my testimony is about, in part, about the market
13 share of interstate firms in the collision repair market.

14 Q. If --

15 A. And those are -- those are firms in the context of this
16 case that primarily -- have -- they are domiciled out of
17 state but are marketing services in Texas.

18 Q. And when you say they're "marketing services in Texas,"
19 you mean they are owned -- they have their domicile out of
20 Texas but they have a lot of -- of facilities here in the
21 state?

22 Is that what you're talking about?

23 A. I -- I'm not sure what the question is.

24 Q. I'm trying to find out --

25 A. Well, all right. On a basic level -- basic level, if

90 (Pages 178 to 179)

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1 you have a business that is operating in two states, it's
2 interstate.

3 If all its operations are in one state, it's
4 intrastate.

5 Q. So it's the operations, not where the domicile is?

6 A. I am not -- I am not making legal distinctions, other
7 than, for example, if there's a Texas domiciled insurance
8 company that is of some relevance because then the issue --
9 I would regard that, in a sense, as a company in Texas that
10 might be affected by the statute, even if they have
11 interstate operations, and you would have to ask would they
12 be affected by the statute.

13 Q. And one of those is USAA, right?

14 A. Yes.

15 Q. And you've testified that you think you would have to
16 look in order to determine whether there's an interstate
17 impact about the particular market plan of the out-of-state
18 company as to whether it had a market plan to come into
19 Texas?

20 A. No, I don't think that's what I testified.

21 I think I testified when you want to ask whether or not
22 HB 1131 disproportionately affects interstate firms and
23 increases the market share of local firms, you have to
24 consider what its affects are on local firms, and in
25 deriving my opinions I have not dealt with legal nuances or

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1 distinctions about what might be interstate or intrastate.

2 But I will regard, in that context I would say you
3 would want to consider the impact on a firm like USAA.

4 Q. Okay. Let's -- on your chart up here that you've got
5 PDX 706, you've got a Vandergriff, a Vandergriff body shop
6 up there, right?

7 A. Yes.

8 Q. Is that an interstate or an intrastate provider?

9 A. My understanding of Vandergriff is that it has multiple
10 facilities within the state.

11 Q. Just within Texas?

12 A. I'm not -- I don't know.

13 Q. Let's assume that Vandergriff has facilities in seven
14 states. Just assume that with me.

15 A. Yes.

16 Q. That would put it in the interstate category, right?

17 A. It would make it an interstate provider of those types
18 of services.

19 Q. Okay. So --

20 A. But in a sense, like the sense of USAA -- and I am not
21 expert, obviously, on Vandergriff. Mr. Vandergriff can tell
22 you exactly everything about his own business, but if the
23 primary operation is here, the history is here, the
24 beginning was here, it's the main base, I would consider it
25 to be in a sense a local -- a local business, even though it

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1 operates interstate.

2 Q. Oh, so if Sterling had begun in Texas and had begun to
3 grow in Texas, and then had expanded all over this country,
4 you would put it in the intrastate category still?

5 A. I -- I can't answer that, because I can't connect -- I
6 can't put the -- dot the "i"s, sir.

7 What I can do is tell you what my testimony is. And my
8 testimony is that the market share of interstate providers
9 of collision repair services is lower because of HB 1131,
10 because of what it has done to Sterling, the plans for new
11 shops, and the ability to grow. And there would be a
12 great -- a greater market presence of interstate firms
13 absent HB 1131 than with HB 1131.

14 Q. Well, actually your testimony is that HB 1131 has had
15 an impact on Sterling and Allstate's ownership of Sterling,
16 and that's about it, isn't it?

17 It's a one firm impact right now.

18 You haven't seen any other impact of HB 1131, except
19 this one example, have you?

20 A. Well, as I just -- just answered in response to a
21 previous question, if you ask the question broadly: Does
22 prohibiting insurer relationships and ownerships with
23 collision repair facilities affect other collision repair
24 facilities, even if they're not owned by a collision -- an
25 insurance company right now, the answer is it may affect

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1 their ability to obtain funds, it may affect the strategies
2 that they can pursue.

3 But right now, Sterling is -- the Allstate ownership of
4 Sterling, and they apart from the interests of the Caliber
5 situation, those are the games.

6 Q. Okay. Now, I'm really interested in your -- in your
7 attempting to divide the world between interstate and
8 intrastate. And it looks to me like right now you have put
9 virtually everybody in the category of intrastate, except
10 Sterling, and that's your only interstate entity?

11 A. Not -- that's not the intention.

12 I will describe the intention this way: There is
13 something like 4600 body shops in the State of Texas, give
14 or take. There are some that are part of interstate chains.
15 There are some that are part of dealerships. There are some
16 that are part of interstate chains that involve
17 dealerships. There may be some with their roots in Texas
18 that are interstate. There may be some like Service King
19 that are chains that are only in Texas. But the testimony
20 is Allstate/Sterling and insurer-owned companies will
21 definitely be interstate under the analysis, and by reducing
22 their market share, with 4600 shops, many of which, the vast
23 majority of which are locally owned, it follows that there's
24 going to be some transfer of that loss market share to the
25 local shops.

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1 Q. Now, it's down to there's going to be some transfer of
2 that to the local shops?

3 A. Well, I never said it would be a hundred percent.

4 Q. What study have you made of the domicile of the other
5 body shops that are within, say, a 25 mile radius of the
6 Sterling shops?

7 A. I haven't done any -- any study. I'm familiar with
8 Service King a little bit. I don't know where they're
9 domiciled. I know they have a lot of shops near the Dallas
10 shops.

11 Q. Okay. You've been -- you've been by a Service King
12 shop here, haven't you?

13 On your half a day trip --

14 A. I believe that when I visited the -- the Sterling shops
15 I drove by or was driven by, in route, at least one maybe
16 more, Service King shops.

17 Q. And it's -- it's a big bright yellow facility, you
18 know, that is sort of -- kind of like looks kind Sterling,
19 except it's different color. Is that right?

20 A. I don't recall.

21 Q. And -- and do you know that Service King is -- is the
22 company that probably has more body shops in the Dallas/Fort
23 Worth area than any other company?

24 A. My understanding is that Service King has multiple
25 shops. I don't know the number, and I know based on -- I

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1 think now recalling a conversation with Sharon Mazanec she
2 said they were big in the Dallas area.

3 Q. You've got them stuck way down here in Brownsville.
4 That's on the wrong end of the state. But as far as you
5 know there's up there really where Vandergriff is but
6 there's a lot of them, that's what Sharon Mazanec told you?

7 A. I don't remember -- I seem to remember a number of 15
8 to 20 or something like that, but I don't know about their
9 specific locations.

10 Q. You've got them in the intrastate category, correct?

11 A. Yes.

12 Q. If they opened a shop in Oklahoma City and one in
13 Albuquerque and one in Little Rock, would that make them an
14 interstate supplier?

15 A. That's -- that's -- I haven't thought about that.

16 In terms of the way I would think of a problem,
17 ignoring any legal nuances, yeah, if they start doing things
18 in other state then a layperson or anyone who thinks about
19 the economics would say, yeah, they're an interstate
20 provider.

21 Q. Okay. So if these things happen: If HB 1131 remains
22 in place, just like it is, but if Service King opens a shop
23 in -- let's don't -- let's don't even push 'em very far.
24 Let's just put them up in Ardmore, which is just right
25 across the line, then they expand, then your scenario of all

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1 of the work or most of the work or much of the work or some
2 of the work, or whatever the answer is, going to the
3 intrastate market would fall by the wayside, would it not?

4 A. No.

5 Q. If Caliber decided we're going to move in here with 25
6 shops in the Dallas/Fort Worth area and Service King did
7 that, put a shop up in Ardmore, would your analysis then
8 fall by the wayside?

9 A. No.

10 Q. If Vandergriff is in seven or eight or ten or 15 states
11 and they decided to open up two or three new body shops here
12 in Texas, would your analysis fall by the wayside?

13 A. I think one could speculate indefinitely about what
14 might could and would happen if firms expanded in multiple
15 states, but the evidence is that a lot -- a bulk of the
16 collision repair market in the State of Texas is basically
17 local. It's basically interstate.

18 Q. Where is that evidence?

19 What is that evidence?

20 A. Well, you have evidence on the numbers of shops. The
21 fact that Service King -- now, if Service King has gone into
22 another state, sometime in the recent past, I don't know
23 about that. But they definitely primarily are Texas, and I
24 was -- I thought they were exclusively Texas, but that's not
25 it. They are a Texas entity that could be locally protected

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1 bylaws that more or less say here's a new source of
2 competition, it's taking business away from local shops,
3 those with their roots in Texas, those with their primary
4 operations in Texas, those with their political alliances in
5 Texas, and the statute basically says we're going to keep
6 that from happening.

7 Q. Well, you think the statute -- let's assume Vandergriff
8 is a seven to ten state operation, do you think the statute
9 protects Vandergriff?

10 A. I would say that even if Vandergriff were -- and I have
11 no -- no idea whether they're a seven to ten state
12 operation --

13 Q. Assume with me that they are.

14 A. Let's just assume that their market share is divided
15 equally among seven states, then would the prohibition of
16 Sterling's growth and efficient operation, would it provide
17 benefits to them, yes, I would presume that it would.

18 Would that be shifting business from interstate firms
19 to local firms, that would be -- that would be very
20 arguable.

21 Q. So you think that HB 1131 might provide some protection
22 to interstate automobile body shops in the State of Texas
23 that are not owned by insurance companies?

24 A. I -- one would have to conclude that to the extent it
25 prevents a significant new source of competition, the market

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1 will be affected. But that's not my testimony.

2 Q. I know.

3 A. My testimony is the market is predominantly local in
4 nature, the primary affect is local. It's not that the
5 exclusive affect would be local.

6 Q. So -- so HB 1131 you would admit and you would agree
7 with me has the affect of protecting interstate operations
8 of body shops that are not insurance company owned?

9 A. No. What I would say is this, having thought about the
10 hypothetical: To the extent that this significant new
11 source of competition is foreclosed, chilled, prohibited in
12 the State of Texas, then there might be interstate firms
13 that would benefit from that in the Texas market, but it
14 would have nothing to do with the other markets, unless
15 other states started to do the same thing or, unless, as I
16 described, that the network economies are reduced, which in
17 fact would maybe even give them a leg up in other states.

18 Q. Okay. So your argument is it might benefit interstate
19 firms in other states, under your analysis of the
20 marketplace?

21 A. It's conceivable that choking off the new source of
22 competition could benefit firms in other states, but that's
23 not the issue.

24 The issue is does in this context -- and what I've
25 testified about is does HB 1131 shift -- does a reasoned

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1 analysis suggest that it would shift business from
2 interstate firms to local firms. And the answer to that is
3 yes, regardless of all this.

4 THE COURT: Stop.

5 Let's take a 20 minute break.

6 MR. POWELL: Thank you, Your Honor.

7 THE SECURITY OFFICER: All rise.

8 (Recess taken.)

9 THE SECURITY OFFICER: All rise.

10 THE COURT: Okay.

11 THE SECURITY OFFICER: Be seated, please.

12 THE COURT: Have you got water?

13 THE WITNESS: Yes.

14 MR. POWELL: Your Honor, we're going to pass the
15 witness.

16 THE COURT: I'm going to start calling breaks a
17 lot more often.

18 Thank you, sir.

19 Mr. Kass.

20 MR. KASS: Thank you, Your Honor.

21 (REDIRECT EXAMINATION)

22 BY MR. KASS:

23 Q. Dr. Harrington, I just have a couple of quick questions
24 for you.

25 There was a question about whether Allstate can access

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1 the local market. And in the collision repair market --
2 when you're looking at the collision repair services market,
3 can Allstate access that market?
4 A. No, not with the prohibitions I -- when I said that I
5 was referring to the insurance market.
6 Q. So if the relevant market in this case is the collision
7 repair services --
8 A. Yes.
9 Q. -- then it's just not true that Allstate has access to
10 that market?
11 A. No.
12 Q. Now, in Ford and Exxon, if the relevant market was the
13 car market, did Ford and Exxon -- well, Ford being cars and
14 Exxon being gas, did Ford have access to the car market?
15 A. Yes.
16 Q. Did Exxon have access to the gas market?
17 A. Yes.
18 MR. KASS: Okay. No further questions.
19 MR. POWELL: We have no questions, Your Honor.
20 THE COURT: Okay. You can step down.
21 Is this witness excused?
22 MR. KASS: Yes, Your Honor.
23 MR. POWELL: Yes, Your Honor.
24 THE COURT: Thank you, professor.
25 Do you go by professor or doctor?

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1 THE WITNESS: Scott.
2 THE COURT: Scott. Okay. Thank you.
3 You're excused.
4 MR. SMITH: Your Honor, as I've mentioned several
5 times, in addition to everything else that we put on, there
6 were the testimony of Mattax and Reyes and the -- I know
7 that we've got quite a bit of time -- is Senator Carona
8 going to be available --
9 MR. POWELL: Ready.
10 MR. SMITH: All right. Well, we rest our case.
11 THE COURT: All right. Off the record.
12 (Discussion off the record in open court.)
13 THE COURT: All right. Let's go back on the
14 record.
15 MR. POWELL: Your Honor, I'm speaking in this
16 motion -- or making this motion on behalf of the state
17 defendants and the intervenors --
18 MR. HOHENGARTEN: And we do adopt this motion,
19 Your Honor.
20 THE COURT: Do you want to hear what he says,
21 first?
22 MR. HOHENGARTEN: No. He gave me a good idea what
23 he was going to say.
24 THE COURT: All right. Okay.
25 MR. POWELL: He knows what I'm going to say, Your

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1 Honor. I'm making this motion under Federal Rule of Civil
2 Procedure 52(c), Charley, plaintiffs have now been fully
3 heard on their constitutional challenges to HB 1131 under
4 the Dormant Commerce clause, and we make the following
5 motion for judgment against plaintiffs, as allowed by Rule
6 52(c).

7 First, there is no evidence that this statute
8 discriminates against interstate commerce.

9 Number one, it does not discriminate on its face.

10 Number two, there is no evidence of any intent by the
11 Legislature to discriminate against interstate commerce.

12 The only evidence by the court is by the Legislature's
13 intent to prohibit insurance ownership of automobile body
14 repair shops.

15 And three, there's no evidence of any constitutional
16 impact on interstate commerce. There is no showing that HB
17 1131 deters in any way the flow of goods or services across
18 state lines.

19 The second point of our motion is that it is clear from
20 the evidence that HB 1131 is immune as a matter of law from
21 attack under the Dormant Commerce clause by virtue of the
22 McCarran-Ferguson Act at 15 USC, Section 1011 and 1012(a).

23 We call the court's attention to the Supreme Court case
24 of United States versus Fabe, F-A-B-E, 508 US 491, 1993,
25 which emphasizes that 15 USC Section 1012(a) deals with a

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1 broad category of state laws enacted for the purpose of
2 regulating the business of insurance.

3 There can be no question that HB 1131 was designed to
4 do exactly that, to prevent insurance companies from owning
5 automobile body repair shops, to protect policyholders from
6 practices that the Texas Legislature thought improper within
7 the relationship of the insurer and policyholder.

8 As the Supreme Court explained just last year, the
9 point of McCarran-Ferguson's legislative choice of leaving
10 insurance regulation generally to the states was to limit
11 commercial preemption under the commerce power, whether
12 dormant or exercised, and that's American Insurance
13 Association versus Garamandi, G-A-R-A-M-A-N-D-I, 123 Supreme
14 Court 2374 at page 2394, 2003.

15 So as another reason why the plaintiffs Dormant
16 Commerce Clause challenge to this statute has no merit
17 whatsoever, we would rely upon 15 USC 1011 and 1012(a).

18 So we would move the court to grant judgment in the
19 favor of the state at this point on behalf of both the state
20 and the intervenors.

21 THE COURT: Anything you want to add,
22 Mr. Hohengarten?

23 MR. HOHENGARTEN: No. Nothing, judge.

24 THE COURT: All right. I deny your motion at
25 this time. And I think you're ready to call your first

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1 witness.

2 MR. HOHENGARTEN: Judge, at this time we call
3 Senator John J. Carona.

4 THE COURT: Is this our eighth witness?

5 Do y'all remember how many witnesses --

6 MR. YOXALL: I believe that's correct, Your
7 Honor.

8 (Pause.)

9 MR. HOHENGARTEN: I know he's here. He's on the
10 floor.

11 THE COURT: No. It's okay.

12 Let me swear you in.

13 (Witness sworn.)

14 THE COURT: The microphone will be the only thing
15 that will really move. The chair spins but doesn't move
16 back and forth. So if you can hear your voice reverberate a
17 little bit, you will know you're okay.

18 You have a loud voice, I'm not really worried about it.

19 Do you have water down there?

20 THE WITNESS: Yes, sir.

21 THE COURT: Okay.

22 JOHN J. CARONA,
23 having been duly sworn testified as follows:

24 (DIRECT EXAMINATION)

25 BY MR. HOHENGARTEN:

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1 Q. State your name, please.

2 A. John Carona.

3 Q. Good afternoon, Senator Carona.

4 After saying that to you, I guess it's going to be a

5 little silly to ask you if you hold elected office, but I'm

6 still going to go ahead and for the record and ask you if

7 you hold an elected office?

8 A. Yes, sir, I do State District 16.

9 Q. Could you generally describe District 16, that is the
10 geographic area that it encompasses?

11 A. Generally it's the -- really the heart of Dallas County
12 north of the downtown area. It encompasses the Park Cities,
13 Preston Hollow, most of Richardson, a large portion of
14 Garland, all of east and northeast Dallas, and a small
15 portion of Mesquite.

16 Q. And -- and do you mind, sir, if I ask you how much you
17 are paid for being a Senator?

18 A. No, sir, I don't mind. It's \$600 per month.

19 Q. Have you had -- have you held elected office before you
20 became Senator?

21 A. Yes, sir. I have. I served for six years in the Texas
22 House of Representatives.

23 Q. Coming back to your current position as Senator, can
24 you tell this court which committees you certainly sit on?

25 A. Yes, sir. I sit on the Business and Commerce

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1 Committee, on the Borders -- Border Affairs Committee.

2 I have served on the Nominations Committee, and Health
3 and Human Services Committee in the past. Typically serve
4 on four committees at one time.

5 Q. Okay. And when you're not drawing your astronomical
6 salary for being a Senator, what do you do for a living?

7 A. I am the president and CEO of a national real estate
8 management firm based here in Dallas.

9 Q. Could you tell the court what that firm does?

10 A. Yes, sir. We -- we manage homeowner's associations in
11 14 states.

12 I have about 2500 employees that work for me.

13 Q. Do you also hold any professional licenses?

14 A. Yes, I do. I'm a licensed real estate broker and I'm a
15 licensed insurance agent.

16 Q. Have you served on any boards, for example, the boards
17 of any charitable organizations?

18 A. Yes, sir, I have previously. I'm not currently
19 serving, because of my position in the Senate largely, but
20 I have served on the American Heart Association, the
21 American Diabetes Association. I've served as -- on the
22 board of the Friends of Fair Park, the Dallas Arboretum.
23 It's a fairly extensive list.

24 Q. Do you currently sit on the board of directors of any
25 business, other than your own?

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1 A. No, sir. Not currently.

2 Q. Have you sat on the boards of any businesses?

3 A. I've sat on bank boards previously, yes, two bank
4 boards previously as well as, of course, on the boards of
5 the various corporations that are affiliated with my
6 business interest.

7 Q. All right. Now, turning back to your work as a
8 Senator, for how many bills have you served as the chief
9 sponsor or author since you've been Senator?

10 A. I have -- I've been the author or chief sponsor of just
11 over 300 bills that are now law.

12 Q. And tell me this, Senator: How many bills are
13 typically filed during a Legislative Session?

14 A. Well, it varies somewhat, but these days at least 5,000
15 bills are typically filed and at the end of a regular 140
16 day session about 1200 or some become law.

17 Q. And how long is the Legislature in session?

18 A. We're in session every other year for 140 days, as set
19 in the State Constitution.

20 THE COURT: As every Texan knows.

21 MR. HOHENGARTEN: Well, I know we have some
22 non-Texans here, judge, so I want to educate them about how
23 our Legislature works.

24 BY MR. HOHENGARTEN:

25 Q. When the Legislature is in session, how many people do

99 (Pages 196 to 197)

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1 you typically meet with in the course of a session?

2 And I know you can only give me rough numbers, but I
3 want to get an idea of what your schedule looks like
4 day-to-day when the Legislature is in session?

5 A. Well, it's a full schedule. I would say in the course
6 of a regular 140 day session I meet with several hundred
7 people.

8 Q. Okay. Let me ask you, Senator, in -- in your
9 experience, is it typical for the Legislature when it's
10 considering a bill to hire an expert?

11 A. No, sir. What we do in the legislative process is
12 we -- we hold public hearings and gather information in --
13 in that form. And at that time in the public hearings
14 people that are speaking for the bill, and against the bill,
15 both sides obviously have a part in that process, bring
16 forth their experts, their best people of the field, if you
17 would, the people that they believe are most knowledgeable
18 and can provide the -- the greatest amount of education for
19 those of us that -- that are this serving on that respective
20 committee.

21 Q. Okay. And I'm going to narrow the question a little
22 bit and see if your answer is any different?

23 How about economists, does the Legislature employ
24 economists to advise when they're studying a bill?

25 A. No, sir.

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1 Sometimes we rely on various state agencies to come in
2 and offer their background information, if you will, but,
3 no, we rely on the general public to bring forth those
4 experts, representing each side of the argument when we
5 debate the merits and consider a bill.

6 Q. How about conducting an investigation, swearing out
7 subpoenas, getting witness -- witnesses in that hearing room
8 and documents and hiring a prosecutor to question them under
9 oath. Does the Legislature do something like that, that is,
10 run itself like a court?

11 A. What I was going to say, no. No, sir.

12 You described -- you described it somewhat maybe like a
13 trial might be. It's not that way at all.

14 In the -- in the process in Texas Government we post
15 notice of our -- of our hearings, so that the public has an
16 opportunity to be aware and -- and anticipate. And then we
17 invite people to come. And we want people to come, from all
18 sides of an issue so that we as lay people in the
19 Legislature can make the -- the -- the most informed
20 decision that is -- that is possible with the information.

21 But we rely on the public. We take that, listen to it,
22 sift through it, typically meet with both sides, both during
23 the public meeting and outside the public hearing to gather
24 the information and formulate our opinion on what's best for
25 the citizens.

100 (Pages 198 to 199)

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1 Q. Do you typically prepare a written study in connection
2 with your consideration, or I should say the Legislature's
3 consideration of a bill?

4 A. Well, in the course of a -- of a regular session, when
5 we're actually hearing bills before committee, no, sir.
6 Again, we gather our information and at the conclusion of
7 that hearing process a committee report is -- is prepared,
8 minutes are obviously kept, in a typical meeting but, no, we
9 don't actually formulate a report from that. We listen to
10 both sides and ultimately vote on an issue.

11 If the majority of the committee believe it is worthy
12 of further consideration, that being a vote before the
13 entire body they vote in the affirmative and the issue moves
14 on to the full Senate for a vote.

15 Q. Is there something -- I understand there's not a
16 written study, per se, but is there something called the
17 bill analysis?

18 A. Yes, sir. We do that. It's an internal document, if
19 you would, that's prepared by legislative staff to look at a
20 piece of legislation and really to -- to digest it for us
21 as -- as legislators, to give us good information on -- on
22 what the topic is.

23 It's -- it's a -- a brief summary, if you would. But
24 it's intended to give you a -- a good thorough knowledge of
25 all sides to the issue and -- and to let you know what

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1 you're dealing with.

2 Q. Now, let's turn to HB 1131 itself.

3 Were you the chief sponsor of 1131 in the Senate?

4 A. Yes, sir, I was.

5 Q. And I take it in the Senate the bill had a different
6 number?

7 A. I believe it did originally. But, no, once it comes
8 over and passes from the House, it retains that House Bill
9 number, and I served as the Senate sponsor in the version
10 that finally did pass, which was the House Bill.

11 Q. Okay. So it passed in the House first?

12 A. Yes, sir. That's right.

13 Q. Do you recall what the vote was in the House?

14 A. It was overwhelming. I believe there were only two
15 recorded votes against the bill. I know there were over one
16 hundred votes out of the 150 member House in support of the
17 legislation. It was -- by any standard it was overwhelming
18 passage.

19 MR. HOHENGARTEN: Can we bring up PX 3?

20 Is there any way we can blow the first page up just a
21 little bit?

22 BY MR. HOHENGARTEN:

23 Q. Now, did the House version contain a divestiture
24 provision?

25 A. Yes, sir, it did. As it passed the House it did

101 (Pages 200 to 201)

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1 contain divestiture.

2 MR. HOHENGARTEN: And can you go to the -- go a
3 little lower? I think it's 004.

4 And this is PX 3, judge.

5 THE COURT: PX 3?

6 MR. HOHENGARTEN: Yes. Plaintiff's Exhibit 3.

7 THE COURT: Yes, sir.

8 BY MR. HOHENGARTEN:

9 Q. And do you see, Mr. Carona -- or Senator Carona, it
10 should be on your screen, the divestiture requirements set
11 out at 2306.004 in this exhibit?

12 A. Yes, sir, I do.

13 Q. Okay. So originally in the House any insurance company
14 that owned an interest in a repair shop was going to have to
15 go ahead and -- and let go of that investment, sell that
16 investment by September 1st, 2005. Is that correct?

17 A. Yes, sir. That's the language of the bill.

18 Q. Okay. Now, let me ask you this.

19 Is that language -- or was that language contained in
20 the final version of the Senate bill that passed?

21 A. No, sir. It was not.

22 Q. Okay. Let's -- let's talk about that a little bit.

23 Why was the divestiture provision taken out of the
24 Senate bill?

25 A. Well, really because the Lieutenant Governor, who I

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1 work for, my boss, if you will, preferred that it not be in
2 there.

3 And though we had -- with the provision in the bill we
4 had I believe 20 cosponsors of the legislation with the
5 divestiture language in it the Lieutenant Governor and his
6 staff contacted me that he would -- you know, he did not
7 support that language. And, in fact, I think he spoke of
8 that publicly, that he did not support it.

9 And, so, you know, I did what I thought was the
10 appropriate thing to do if I wanted to see the bill brought
11 to the floor, which is the purview of the Lieutenant
12 Governor, I went to work the parties from both sides, and we
13 sat out through a series of meetings negotiating new
14 language.

15 Q. And, by the way, who actually drafts the bill that is
16 passed and signed into law?

17 A. Well, the legislative counsel. They're like our
18 in-house law firm, if you will, and they -- they put the
19 bills together for us.

20 Q. Now, before we go any further, I do want to call up the
21 Senate bill analysis and that's Defendant's Exhibit DX 243.

22 Does a bill analysis typically state the reason or
23 rationale for the legislation, explain the legislation's
24 purpose?

25 A. Yes, sir, it does. It gives background, it gives

102 (Pages 202 to 203)

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1 purpose.

2 Q. Okay. And do you see on this exhibit where it says
3 purpose, and it says "This bill would make it unlawful for
4 an insurer to hold or acquire any ownership interest in a
5 repair facility.

6 "Additionally, the bill would require an insurer that
7 has an ownership interest in these repair facilities to
8 divest itself --" so this is obviously when the divestiture
9 provision is still in, but it goes on to say the bill would
10 require -- no.

11 I'm reading the wrong place.

12 I'm going to go up on the paragraph and start again. I
13 sort of have that sinking feeling.

14 THE COURT: It's okay.

15 BY MR. HOHENGARTEN:

16 Q. Under background, under current law an insurer's
17 interest in repair facilities is not regulated.
18 Insurer-owned repair facilities may eliminate checks and
19 balances thereby compromising consumer protections.

20 A possible conflict of interest could arise if an
21 insurer paid for a consumer's repairwork completed at an
22 auto repair facility owned by an insurer.

23 Is that statement consistent with your understanding of
24 the purpose of HB 1131?

25 A. Yes, sir, it is.

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1 I mean, my -- my concern from the outset was that
2 insurance companies owning body shops was an inherent
3 conflict of interest.

4 It just seemed so obvious that -- that -- that if you
5 have the insurance company controlling the purse strings --
6 purse strings of the body shop that is preparing the work
7 that natural motivation would be, perhaps, to cut every
8 corner or to certainly avoid spending any more than you
9 absolutely had to spend to get the job done because,
10 obviously, insurance companies are in business to make a
11 profit.

12 I'm certainly not oppose to profit, but I think in this
13 case the interest of the consumer, which was my foremost
14 concern throughout this process, clearly is at
15 cross-purposes with the best interests of the insurance
16 company. And when you have the insurance company owning the
17 body shop, the body shop then in my opinion ceases to be any
18 kind of advocate whatsoever for the consumer.

19 So, no, I would absolutely agree with that statement.

20 THE COURT: Let me stop you.

21 Do you happen to know who drafted this particular piece
22 of legislation originally?

23 THE WITNESS: Well, it was -- it was drafted by
24 the legislative counsel, judge. The original idea came from
25 a story that I read on -- about what was going on in

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1 California.

2 California, they had this very same concern and the
3 Legislature set out to address this issue.

4 As a layperson in the Legislature you read a lot of
5 stuff. Some of it sinks in and some of it goes over your
6 head and some of it just choose to ignore.

7 This caught me as a compelling issue. It was a big
8 issue in California, and I got to thinking about it.

9 If -- if you really are in a position where the
10 insurance company is -- is owning the body shop, then who
11 really does look out for the consumer.

12 And the nature of an auto accident, because it's not an
13 every day occurrence, at least not for most of us, is that
14 you're -- you're caught up in an emergency situation. You
15 find yourself quickly needing to do something or take care
16 of an emergency situation that you're not ordinarily
17 accustomed to. You're in a bit of a panic. I think I have
18 been. I've had wrecks. I know my wife has when she's had
19 wrecks. And you rely on that body shop to be there and give
20 you good information and, to a large degree, while certainly
21 they're there to make money and fix your car, you rely upon
22 them to be your advocate and fix your car.

23 Everybody wants the car put back to like-new condition,
24 which I think is what the promise of an insurance company
25 really largely is.

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1 To answer your question: That's how I found out. I
2 read an article.

3 Shortly thereafter I began -- I was contacted. In
4 fact, somebody I knew -- had known for some time contacted
5 me and we talked further about it. And then it just seemed
6 like I had the folks from the insurance industry contacting
7 me. I had the folks from the body shop interest contacting
8 me. I took all the information together and give it to the
9 legislative counsel and the legislative counsel produced the
10 first piece of legislation.

11 THE COURT: Did the legislative counsel, do you
12 know if they were able to maybe not have to reinvent the
13 wheel, were they able to get a copy of the bill from
14 California?

15 Is this similar to the one in California? That's what
16 I'm really expressing to you.

17 THE WITNESS: Well, it is similar in some ways,
18 yes, sir. The one thing we attempted originally to have was
19 divestiture.

20 Of course, as I mentioned a moment ago, that changed in
21 the process. But I do know that the legislative counsel
22 avails itself of other legislation in other states, and
23 especially when you get a specific issue like this, they
24 will use that as a reference point. That's not uncommon.
25 But basically --

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1 THE COURT: But do you know in this case, did you
2 have the California piece of legislation in front of them?

3 Did somebody bring that to the table?

4 THE WITNESS: Your Honor, I don't honestly know if
5 they had it in front of them or not. My guess is they
6 probably retrieved it, but I would only be speculating.

7 THE COURT: That's okay.

8 Go ahead.

9 MR. HOHENGARTEN: Let's go ahead and call up 3X,
10 Exhibit Number 3, please.

11 Let's go to PX 5.

12 And could we blow up that portion under "background and
13 purpose."

14 BY MR. HOHENGARTEN:

15 Q. And is this, Senator Carona, the -- basically the bill
16 analysis for the House version of HB 1131?

17 A. Let me read it quickly.

18 Q. Certainly.

19 A. I believe it is, but let me read it quickly.

20 Yes, sir, it is.

21 Q. And so basically we have in -- in this bill analysis on
22 the House side the very same rationale and reasons that the
23 Senate has given for passing this legislation, or
24 considering this legislation?

25 A. Yes, sir. And I might add it passed overwhelmingly in

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1 the Senate as well.

2 Q. What was the vote there?

3 A. I don't recall the final vote. I think there were --

4 you know, I don't recall. I believe we had either three or
5 four people in the Senate who did not vote in favor. All
6 other members of the 31 member body voted I believe in favor
7 of the legislation. I don't recall the exact numbers. I
8 know it was overwhelming.

9 We had, as I mentioned earlier, 21 cosponsors of the
10 bill. That's unusual, very unusual.

11 Q. Okay. And do you see the language, the last sentence
12 that states, "This bill would protect"?

13 "This bill would protect the consumer and would enable
14 and foster open and evenhanded competition within the auto
15 repair industry."

16 A. Yes, sir, I see it.

17 Q. Okay. Do you know what that's referring to?

18 Can you elaborate?

19 A. I'll try to. I was concerned about two basic things
20 when I set out on this issue to try to -- try to find an --
21 an appropriate solution.

22 One was, I was concerned about what I felt was a
23 rather obvious inherent conflict of interest. And that was
24 certainly -- you know, that was certainly an issue.

25 But I was also concerned that there seemed to be

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1 rampant anti-competitive, if you will, business practices by
 2 Allstate. The way Allstate handled its -- its process of
 3 steering business, the way Allstate handled its relations
 4 with its own owned or tied shop versus the way it handled
 5 its relationships with its favored facilities, the
 6 facilities it didn't own but that it had special
 7 relationships with.

8 I mean, there seemed to be problems not just in the
 9 fact that there was the financial conflict of interest, but
 10 it just -- it seemed like at every step the -- the --
 11 Allstate's objective was to thwart competition and provide a
 12 system that favored its Sterling facilities and nobody else.

13 And the more testimony I heard and the more testimony I
 14 gathered, the egregious it seemed.

15 Not to -- I don't mean -- I guess I just have to say it
 16 all seemed so obvious. And I think the votes in both the
 17 House and the Senate bear that out. When people looked at
 18 this issue and saw what was happening in the industry and
 19 saw the way that Allstate by its own admission was steering
 20 the business -- some of the information provided to us early
 21 on by Allstate was that 95 percent of all of Sterling's
 22 business was from Allstate policyholders.

23 Q. Well, let me stop you and ask you this.

24 You're aware that Texas already has an antisteering
 25 statute in the Texas Insurance Code, are you not?

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1 A. Yes, sir, I am. But the problem with that statute is
 2 it wasn't strong enough to stop the kind of steering that
 3 they were doing.

4 The statute says basically that you can't force
 5 somebody to use your prescribed in this case repair
 6 facility, but what Allstate was doing was the next closest
 7 thing, in my opinion, just skirting the law.

8 What they would say is, you know, you've had this
 9 accident, you know, obviously they're the first source that
 10 somebody with an accident is going to call. Who are you
 11 going to call? You're going to call your insurance company.

12 And Allstate would say, you know, we've got Sterling
 13 now.

14 Now, of course, you know, you can go anyplace you want
 15 to go, but we've got Sterling right here. And one of -- one
 16 of what seemed to me to be many anti-competitive practices
 17 was the fact that they were -- they were quick and immediate
 18 to give the reference or the referral of their own shop but,
 19 of course, they didn't give the names and specifics of any
 20 other shop.

21 Now, while they made the gesture of saying, of course,
 22 you're free to go anywhere you want, because they're the
 23 first source of contact and because the only name they give
 24 people as a shop at the ready for somebody whose obviously
 25 in a crisis and what confused and concerned about what to

106 (Pages 210 to 211)

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1 do, was their own shop.

2 Q. Of course they say they're actually increasing
3 competition because they're providing this additional option
4 of Sterling, what's your response to that?

5 A. Well, I think that's ridiculous. You know, the reality
6 is they give the information and they steer to Sterling but
7 they don't share with anybody else -- they don't share with
8 any other policyholder who their other options are.

9 It would have been one thing had they said we're so
10 sorry you've had an extent, we're here to help you, here's
11 the name of Sterling and five other shops and all these
12 people you're free to go to and all these people will help
13 you.

14 They don't do business that way. They refer the
15 business to their shop. 95 percent of all their work comes
16 from Allstate policyholders. That, to me, is the evidence
17 that while it might not be a technical violation of the law,
18 steering is absolutely what's taking place and it's
19 anti-competitive.

20 Q. And before we get to the final version of HB 1131 that
21 addresses some of that, let me make sure that we have it
22 clear in the record that there were in fact House hearings
23 on HB 1131. I know you're on the Senate side, but you are
24 aware, are you not, that the House held hearings on this
25 bill?

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1 A. Oh, yes, sir. Extensive hearings. Both the House and
2 the Senate were all sides to the issue, everybody got their
3 fair day.

4 But I also want you to understand that it wasn't just
5 the matter of House and Senate hearings. We had, in my
6 office alone, meeting after meeting with the interested
7 parties. We had Allstate -- I met with Allstate at least
8 half a dozen times myself, and I -- I don't know how many
9 other times my staff may have met with 'em.

10 Q. Let me stop you there.

11 When is the first time you met with Allstate about in
12 particular issue, that is insurer ownership of repair
13 facilities?

14 A. Well, it would have been, you know, well before the --
15 the legislative began. I don't recall the exact date.

16 Q. Perhaps I can refresh your memory.

17 MR. HOHENGARTEN: Can we see Defendant's Exhibit
18 7?

19 Can you go ahead and blow up the first paragraph?

20 BY MR. HOHENGARTEN:

21 Q. This is a memo from Jo Betsy Norton, who has testified,
22 to her boss, William Vainisi, and she is saying, "Bill, see
23 Beaman's summary of his and Jonna Kay's visit with Senator
24 Carona. Carona appears to have a problem with Sterling. He
25 also mentioned the problem with the Mustang, an accident

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1 from a few years involving his son."

2 Now, let's go ahead and skip down to the fourth
3 paragraph under "Senator Carona."

4 I'm sorry. Can we go up one paragraph?

5 It starts with he has a problem with direct repair.

6 "He has a problem with direct repair and mentioned
7 extra angst over insurers buying an interest in repair
8 shops."

9 Does this refresh your memory as to a meeting with a
10 Beaman Floyd and Jonna Kay on or around August 4th of 2002?

11 A. Yeah. As I recall, it would have been before then.

12 But, yeah, I know Beaman, and I recall meeting with him,
13 yes.

14 Q. Okay. Was that the first interested party that you met
15 with as this process began?

16 A. I think it was. I believe it was. It's -- you know,
17 bear in mind, I carry a lot of bills and that -- you know --
18 but, yes, I do remember meeting with them very early on.

19 It may have been the first interested party, other than
20 my own interest which was obvious in watching the situation
21 in California and just thinking through the process and my
22 own concerns with it. And I didn't hesitate at that point
23 early on to share with Beaman my concerns.

24 Q. By the way, how many bills do you carry typically in a
25 regular session?

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1 A. Oh, it varies from one session to the next, but between
2 50 and one hundred bills in a given session. So I carry --
3 I carry a lot of legislation. I pass a lot of legislation.

4 Q. Let's go ahead and move to Plaintiff's Exhibit 1.

5 Senator, is this the final version that was passed and
6 enacted to -- excuse me -- passed and signed into law?

7 A. You'd have to show me a little bit more of it for me to
8 know that for sure.

9 Q. Okay. Let's go ahead.

10 Can you read it if we --

11 A. Yes, sir, I can.

12 Q. Here why don't we just go ahead. I will hand you the
13 Occupations Code.

14 A. All right.

15 Q. In which HB 1131 is now codified.

16 A. All right. Thank you.

17 Q. What I'm really trying to get to, is the final version
18 and the current law still contains a prohibition on insurer
19 ownership of repair facilities, does it not?

20 A. It allows -- the final bill, as-passed, allows
21 insurance companies that owns facilities or were in the
22 process of building them I think April 15th I believe of '03
23 to continue to own them. There's not divestiture in it.

24 What we said though is a matter of good public policy
25 in terms of fulfilling our responsibility to look out for

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1 consumers, that, you know, we didn't want them to continue
2 the practice of -- of acquiring or building these
3 facilities, assuming they would continue to be owned by an
4 insurance company, yes, sir.

5 Q. Okay. Let's go --

6 MR. HOHENGARTEN: Can we go to .006 for the
7 benefit of the rest of us? 2306.006.

8 THE COURT: Just one second.

9 Why is it in the Occupations Code? Why wouldn't it
10 have been in the insurance code? How do you decide that?

11 THE WITNESS: Generally, the legislative counsel,
12 Your Honor, will tell us where they prefer to have it, just
13 for consistency, and they trial to -- they usually will make
14 that call.

15 We sometimes as a Legislature ignore them.
16 Usually, it's out of haste rather than wisdom. But usually
17 it's kept that way for consistency.

18 THE COURT: Okay.

19 BY MR. HOHENGARTEN:

20 Q. Now, what were some of the other changes in the final
21 version, other than the grandfather clause, that allowed
22 companies like Allstate to keep the shops that they
23 currently owned or had broken ground on by a certain date?

24 A. The whole idea, throughout the bill, was to make sure
25 that we safeguarded the welfare of consumers, the body shop

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1 consumer, if you will.

2 And so the other part -- and it became necessary, once
3 we allowed them to continue to remain in the business owning
4 those shops that they already had, or were in the process of
5 building, was a code of conduct.

6 You know, one of our concerns, as I mentioned, there
7 were two -- we start out with two fundamental concerns as I
8 look at this.

9 Q. Let me stop you before you go on.

10 Is 2306.006 entitled "Prohibitions." Is that what
11 you're referring to as the code of conduct?

12 A. Yes, sir, it is.

13 Q. And we have the first five subparagraphs up here on the
14 screen?

15 A. It is.

16 Q. Okay. I'm sorry to interrupting you.

17 A. I was just going to say is a worked on this with my
18 legislative staff, not the -- the two general issues were
19 the inherent conflict of interest in a body shop owning --
20 or an insurance company owning a body shop, and then what
21 seemed to be a series of anti-competitive business practices
22 by Allstate which were in the end not in the best interest
23 of the consumer.

24 Again, we kept focused throughout the entire process on
25 what is best for the consumer. This issue just seemed so

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1 obvious as we worked our way through it.

2 Yes. If the insurance companies were going to be
3 allowed under the final version of the bill to continue to
4 stay in the business then we had to correct not just the
5 anti-competitive business practices -- we had to correct not
6 just the conflict of interest but we had to take care of the
7 anti-competitive business practices that go along with it.

8 If they're going to stay in the business, we wanted to
9 make sure that they play fair.

10 All we were asking in the code of conduct, the only
11 thing we were asking, that they treat favored body shops the
12 same way they treat the tied body shops, the body shops they
13 own, because that's what's best for the consumer.

14 And that's the consistent thread throughout this code
15 of conduct, is just treat the other body shops just exactly
16 as you treat the ones that you own, no more, no less.

17 And that -- that to me seems to be the very essence of
18 fair competition. And that was the goal.

19 Q. Was this code of conduct patterned around any other
20 Texas law?

21 A. It was. With the help of the Lieutenant Governor's
22 staff we modeled it after what we had done with PURA, the
23 public utilities statutes that had -- had dealt with similar
24 code of conduct provisions similar. That seemed like it was
25 a successful model. The state government had experience

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1 with it. We knew it was reasonable and we knew it had met
2 the test of practicality. And I thought it was wise on the
3 part of the Lieutenant Governor's staff to suggest that
4 direction.

5 So we were -- in order to find compromise and in the
6 spirit of compromise that's what we did.

7 Q. Okay. Let's talk about a couple of these provisions,
8 just to take a couple of examples.

9 Let me go to 4 first, subparagraph which says "An
10 insurer may not provide its tied repaired facilities a
11 recommendation, referral, description, advantage or access
12 to its policyholders or other beneficiaries under its
13 insurance policies that is not provided on identical terms
14 to other repair facilities with which the insurer has
15 entered into a favored facility agreement".

16 What's wrong with an insurance company recommending
17 solely Sterling?

18 Why are you requiring insurance companies to disclose
19 to its customer that it does business with other favored
20 facilities that also --

21 A. Well, first, because there is a conflict of interest
22 and the financial -- the financial objectives of an
23 insurance company I believe really are at cross-purposes
24 with the best interest of the consumers.

25 If you believe that the insurance company is in the

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1 body shop business to make money and keep cost as low as
 2 possible and perhaps in that pursuit to cut everywhere they
 3 could cut, you want to make sure that somebody who uses one
 4 of these shops knows at least that the insurance company
 5 owns it.

6 Now, after --

7 Q. My question was slightly different. This requires the
 8 insurance company, if the insurance company owns body shops,
 9 to when it makes a recommendation recommend its other -- or
 10 disclose its other direct repair shops as well as its tied
 11 repair facilities.

12 And my question is: What is the rationale behind that
 13 requirement?

14 A. Well, because it's only fair. If you stop and think
 15 about it, at the time somebody has an accident, that's an
 16 infrequent current, people are -- people don't, what to do.
 17 They're in somewhat of a panic. That's what most people do
 18 in an accident. It's a particularly vulnerable time for a
 19 consumer.

20 If Allstate as a participant in the body shop business
 21 now as an owner is going to make a recommendation at a time
 22 when people are vulnerable and apt to jump at the first
 23 avenue to get out of the crisis at hand, it's only
 24 reasonable and fair that they not only tell people, oh, by
 25 the way, you have other choices, but they say here's also

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1 some choices, here's Sterling, here's this shop and this
 2 shop and these other shops.

3 But that -- but giving the consumers information and
 4 choices and keeping the playing field level, that just seems
 5 to be the only way to avoid the type of anti-competitive
 6 business practices that were otherwise underway.

7 Q. So does this subparagraph 5(n) increase competition or
 8 reduce competition?

9 A. No, the idea, what we're trying to do here is increase
 10 competition. You want to make sure that everybody has an
 11 even shot. If there's competition there and the consumer is
 12 free to make the choices, then it's fairer for everybody.

13 THE COURT: What if Allstate just drops all this
 14 other direct repair facilities?

15 THE WITNESS: And -- Your Honor, I'm not sure I
 16 understand the question.

17 THE COURT: Okay. They have five or six other
 18 shops now that they recommend that are under their PRO -- I
 19 think they call it PRO, but their direct repair facilities.

20 And they say, okay, under this legislation we're stuck,
 21 so we're just going to drop our direct repair program, we're
 22 not going to have that anymore, consumers can find whatever
 23 they want, we're not participating in that?

24 THE WITNESS: You know, if Allstate would simply
 25 not make the recommendation of any shop, then -- then

111 (Pages 220 to 221)

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1 obviously that would be one way to cure the problem.

2 THE COURT: No. No. They wouldn't do that.

3 Obviously they wouldn't do that.

4 They're going to say I looked at that legislation, the
5 way around it is I'm going to drop Herb's, I'm going to drop
6 Service King, I'm going to drop Maaco -- I don't know
7 who-all is in their program. I'm going to drop all those
8 people except I'm going to have my own in-house shop,
9 Sterling, therefore, I get around this legislation, I don't
10 have to tell them about the others because there aren't any
11 others. And I have a -- wait. Wait. Wait. I don't have a
12 favored facility agreement with anybody else.

13 THE WITNESS: Well, as a practical matter they may
14 be doing that anyway right now. I don't know. But in
15 reality when they steer to one company and it's a company
16 they own, then it truly I think magnifies the problem.

17 You've got a lack of competition. You've got a --
18 you've got, while perhaps not technically illegal, you've
19 certainly got steering at a time when consumers are
20 particularly vulnerable.

21 By steering to competition you need to steer, in my
22 opinion, to everybody, or a wide range or assortment of
23 people, so consumers aren't taken advantage of.

24 One of the things, again, I mentioned earlier, Sterling
25 by its own admission in our discussions in Austin said 95

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1 percent of their customers come from their own
2 policyholders. And that in my opinion points out the very
3 fact that unfortunately these other people that wish to
4 compete, they're not asking for anything special, they just
5 wish to compete, are being left out of the equation. It's
6 part of the problem.

7 I think it magnifies the conflict of interest.

8 THE COURT: Well, here's maybe their answer to
9 that: Farm, Safeco, I don't know who else -- I didn't say
10 Safeco, they are in this market -- everybody else in this
11 market immediately quit using Sterling when it got bought
12 out, we don't have any choice but to do it this way because
13 everybody else took their repairwork someplace else and they
14 weren't going to send it to Sterling anymore?

15 THE WITNESS: I don't -- I can't speak to that,
16 Your Honor. I don't know enough about that side of the
17 argument to know. And I know that that was not something,
18 as I recall, that Sterling brought up as an issue in the
19 Senate hearings.

20 THE COURT: But if I told you that's the testimony
21 here, you'd see that as a concern?

22 THE WITNESS: Well, I think it would, but I think
23 it would be something when you make the decision, as any
24 business makes the decision to -- to adopt a particular
25 business model or business plan -- I can tell you as a

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1 businessman myself, I try to look at all of the risk and all
2 of the likely outcomes of the decisions I make before I
3 embark on anything that's, you know, major or costly.

4 I know I do that in my own business anyway, and I would
5 think that that would have been something they would have
6 weighed.

7 But I would also think that -- that -- under the right
8 competitive environment people are generally driven by the
9 best service in the market and the best pricing.

10 And I would suspect if Sterling -- I can't speak to
11 whether their quality is good or bad. That's for somebody
12 else more qualified than me, but I would think that if
13 Sterling in fact maintained the best quality in the market
14 and the best pricing in the market and they maintained good,
15 consistent quality, that -- that anybody, even another
16 insurance company, would be driven to use them.

17 I suspect that truth be known that the results of their
18 finished product, and perhaps even the results of their
19 pricing are -- are in and of themselves not as -- not as
20 of -- as great a quality, or perhaps not as competitively
21 priced as might be necessary to attract other people in the
22 market.

23 I don't know that but it certainly makes me wonder if
24 that's not the case. I think their problem may be greater
25 than just the fact that they are owned by Allstate. It may

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1 be pricing and quality as well.

2 THE COURT: Okay.

3 BY MR. HOHENGARTEN:

4 Q. Now, Senator, you testified -- I believe your testimony
5 was you didn't try to make a determination by comparing the
6 other direct repair shops to Sterling as to whose quality
7 was better --

8 A. No, I didn't feel like that was my position to do.

9 Q. But I want the record to be clear about that.

10 Are you saying that you didn't have any concerns about
11 Sterling quality?

12 A. No. I've -- you know, again, the whole legislation is
13 to try to safeguard consumers.

14 The job of the Legislature is to try to protect
15 consumers before problems occur or try and keep problems
16 contained --

17 Q. But if you didn't do a comparison of it to the direct
18 repair shops and Sterling, how is it you had a concern about
19 Sterling quality?

20 A. Well, just frankly, I think that anytime you have a --
21 a lack of competition you're going to have quality issues.

22 I can tell you as an experienced businessman the best
23 determinative of quality in a marketplace is competition.

24 When competition is driven out or a business has the
25 advantage of not having to compete, typically quality falls.

113 (Pages 224 to 225)

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1 I don't know if that's proven to be in this case or not
2 but I suspect it could be.

3 Q. Okay. Let's move to the second subparagraph which
4 starts the insurer -- well, it's above.

5 "The insurer may not" -- and then down to 2, -- "share
6 information with its" --

7 MR. HOHENGARTEN: I need to go back up to 2 again.

8 Thank you.

9 -- "may not share information with its tied repair
10 facility that is not made available on identical terms and
11 conditions to other repair facilities with which the insurer
12 has entered into a favored facility agreement."

13 What is wrong with just sharing information exclusively
14 with your tied repair facilities and cutting out your other
15 direct repair facilities?

16 THE WITNESS: Well, in this case, again, because
17 of Allstate's unique position of owning a shop on one hand
18 and attempting on the other to do these favored facility
19 relationships, what I understood was taking place from the
20 parties that talked with me is that Allstate gathers the
21 information on its competitors on its favored facility shops
22 and then shares all that pricing and performance and other
23 information with its tied facility, with its own facility.

24 BY MR. HOHENGARTEN:

25 Q. Now, let me stop you there.

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1 But based on what you know, doesn't Allstate share
2 information about Sterling with its other favored
3 facilities?

4 A. No, they don't.

5 There's the problem. I don't know you would have near
6 the argument if it was a free flow of information.

7 On this case it's all one side. Allstate gathers the
8 information because of the unique position it holds from
9 these other companies, pricing, methods, quality,
10 performance. And they give all of that back to -- to their
11 tied facility, their own facility, Sterling, but those other
12 shops don't get Sterling's information.

13 And, obviously that's -- I mean, I can't imagine being
14 put in that position in my profession, to see all of my
15 information shared with my competitors and yet I didn't know
16 a thing in return about what my competitors were doing.

17 MR. KASS: Your Honor, I object and move to strike
18 on the basis of lack of foundation. He's just speculating.

19 MR. HOHENGARTEN: Actually, we can we can --

20 THE COURT: I'll overrule that.

21 BY MR. HOHENGARTEN:

22 Q. Let's talk a little bit about the negotiations that
23 transpired once the Senate started looking at this.

24 Well, before we do that, I want to ask you this
25 question: Allstate says that the Senate and the House

114 (Pages 226 to 227)

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1 didn't hear any hard, credible evidence of consumer injury
2 before it passed HB 1131.

3 How do you respond to that?

4 A. Well, we -- I mean, I would respond that I don't agree
5 with it at all. We gathered evidence, if you will,
6 information, as I think we would referred to it in the
7 legislative process, from all sides.

8 We heard from -- from shop owners. We heard from
9 insurance professionals. We heard from Allstate. We heard
10 from other companies like Allstate. We heard from
11 automotive dealers.

12 You know -- you know, with any piece of legislation,
13 but particularly one that drew as much attention as this one
14 did, it's incumbent upon us, and I believe we fulfill that,
15 to gather as much information as we can. But the gathering
16 of that information, you have to understand, is through a
17 public process where all sides get to come to us and bring
18 the information.

19 That's the legislative process, not unique to this
20 bill, but on all bills. That's how we work in Austin.

21 Q. And did Allstate bring you information?

22 A. Yes, they did.

23 They had -- they had every opportunity, not only in the
24 committee hearings, both the House and Senate, but they met
25 with us on numerous occasions.

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1 Q. How many times did they meet with you?

2 A. At least half a dozen and that's just with me.

3 Q. Did they meet with your staff --

4 A. In addition they met with my staff numerous other
5 times, and we were all party to at least four formal
6 meetings of negotiation at the behest of the Lieutenant
7 Governor to work on this issue.

8 Q. And I promise I'm going to get to those four meetings
9 with all the interested parties. But before I do that, I
10 want to ask you another question.

11 I've heard concerns raised in this very court about the
12 fact that if the consumer is injured because his car suffers
13 a diminishment in value or because an accident occurs when
14 he leaves a Sterling shop, he can always come to court and
15 get a remedy.

16 So what's the need for this legislation when the courts
17 are open for business and people that are injured can come
18 and get a remedy in the courts?

19 A. Because that's not our job as responsible legislators
20 to wait until the public is harmed to do anything about it.

21 Our job is to do our best to anticipate problems, and
22 in this case it was so obvious. I mean, the -- the -- the
23 business purposes are -- are -- business interests, if you
24 will, are at cross-purposes.

25 What Allstate has as its business model and its best

115 (Pages 228 to 229)

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1 interest clearly, obviously, is not in the best interest of
2 that consumer when Allstate owns the body shop, the very
3 advocate, if you would, for the consumer.

4 This one -- in my opinion this one was just so
5 obvious. And -- and -- and so the Legislature did what it
6 should do.

7 The Legislature sees a problem, hopefully sees the
8 train coming, if you would and rather than wait for the
9 train to hit it responds by passing legislation to -- to
10 head off the problem. And -- and that's what we did.

11 Q. Let me play devil's advocate with you some more.

12 Allstate has also said, come on, Senator, you know darn
13 well that this legislation benefits the auto body shops,
14 your buddies. Doesn't it benefit the auto body shops?

15 A. You know, if it benefits the auto body shops, only to
16 the extent that competition is good and we were trying to
17 eliminate anti-competitive business practices.

18 But I can tell you, the goal was to benefit consumers.
19 You know, the goal was not to address the concerns of the
20 insurance industry or the -- the body shop industry.

21 The primary interest was always the consumer.

22 But let me -- let me -- if I could, let me state this
23 briefly.

24 I've always considered myself a friend of the insurance
25 industry. This is the very first time I can recall in my 14

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1 year legislative history that I have not been on the same
2 side as the insurance industry.

3 I think it's important to make that distinction here,
4 that the insurance industry represents long-time friends of
5 mine.

6 The only reason I stepped out on this issue and took
7 the position I did, obviously to the dismay of the insurance
8 industry, is because this one seemed to egregious.

9 Q. Okay. Now, let's go ahead and move to those
10 negotiations.

11 I think we had testimony earlier regarding those
12 negotiations and I know you or your staff participated in
13 those.

14 Tell me how those negotiations got started, that is,
15 what was the trigger for all the interested parties coming
16 together and trying to negotiate a compromise on HB 1131?

17 A. Well, as I mentioned earlier, my boss, the Lieutenant
18 Governor, did not like the divestiture provision in the
19 House Bill.

20 I believe he was -- well, in fact, I feel confident in
21 saying he was -- had not -- did not indicate at least
22 concern in any of the -- any of the other provisions. It
23 was divestiture. And that's what drove the train.

24 And so I was asked to go back and try to remove
25 divestiture and yet achieve a bill that met the -- the

116 (Pages 230 to 231)

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1 concerns of protecting consumers. And so I think we -- you
2 know, we did that. We in good faith met at least four
3 different occasions formally with all sides of the table
4 that had expressed an interest.

5 I can assure you that no one side had any greater
6 access or any -- any greater access to information than did
7 the other.

8 I knew that I had the Lieutenant Governor, or at least
9 the Lieutenant Governor's staff, looking over my shoulder to
10 make sure that the process was fair and to make sure that we
11 addressed the Lieutenant Governor's concern.

12 And so not only did we meet, but we kept the Lieutenant
13 Governor abreast of the progress as each of those meetings
14 took place.

15 Q. Well, let's talk about that.

16 Let's pull up Plaintiff's Exhibit 34. And let's do the
17 first paragraph at the top. This is a terrible copy, but
18 we'll do our best.

19 Did you write this letter to Senator Dewhurst -- I'm
20 sorry, Lieutenant Governor Dewhurst?

21 A. Yes, sir, I did.

22 Q. Okay. And in the first paragraph you say, "Dear
23 Governor, on behalf of myself and the parties interested in
24 the passage of S345 and HB 1131, thank you for arranging
25 this meeting in your office last Wednesday. Your concerns

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1 with the bill and those of your chief of staff, Mr. Gibson,
2 were clearly --" can you read that? Clearly something.

3 "Were clearly enunciated and well understood by the
4 meeting participants."

5 Do you recall writing that?

6 A. Yes, sir.

7 Q. Okay. Is that the meeting in which Lieutenant Dewhurst
8 said, you know, we don't want divestiture in a bill but
9 let's see if y'all can get together and work something out?

10 A. That was one of the occasions he made that known.

11 Q. Did someone at the meeting then suggest some kind of
12 code of conduct?

13 Was that the first time this idea was floated or was
14 that a possibility that came up earlier?

15 A. I don't recall if it was at this meeting or the one
16 right next to it, but the Lieutenant Governor's staff, as I
17 recall, floated that idea and felt like that was a
18 reasonable way to pursue it. And I -- you know, again, he's
19 my boss. I owed it to him to look into that, and I did, and
20 felt like it was a good, reasonable way to address it.

21 The final bill, in fact, as ultimately passed reflected
22 a code of conduct.

23 Q. Okay. Let's go down to number 2. It's actually number
24 2. Under the paragraph starting with participates. About
25 the middle of the page.

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1 THE COURT: But it was really your desire for
2 divestiture, correct?

3 THE WITNESS: Yes, sir.

4 THE COURT: If you could have had it that way,
5 that's a better way to do it?

6 THE WITNESS: Truthfully so. I think that would
7 have been better. But I knew if I didn't make the change
8 that the Lieutenant Governor, who has the authority to allow
9 bills to come up for a vote or not, wasn't going to let it
10 come up for a vote. So it was either fix it or see the bill
11 go down in flames.

12 BY MR. HOHENGARTEN:

13 Q. And you also told the governor in this letter,
14 "Insurers should be allowed to retain ownership in existing
15 tied facilities, for the operations of these facilities, a
16 code of conduct, in quotes, similar to that promulgated by
17 the public utilities commission, regarding public electric
18 utility companies and their affiliates should be employed."

19 Do you recall writing that letter?

20 A. Yes, sir, I do.

21 Q. Okay. Is it safe to say at this point you were trying
22 to communicate to the Lieutenant Governor you were trying to
23 work on a compromise that would address his concerns about
24 divestiture?

25 A. We did. And we kept working through a series of

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1 meetings. You know, we weren't able to get there in the
2 first meeting, so we kept working at it meeting after
3 meeting, trying to make progress as we went.

4 Q. Where did those meetings take place?

5 A. Typically in the Lieutenant Governor's meeting room or
6 dining room next to his office. It was a large room and we
7 had a pretty good crowd.

8 Q. Did those meetings take place in April of 2003?

9 A. As well as I recall, yes, sir.

10 Q. Now, were those the meetings in which all the
11 interested parties sat at the table?

12 A. Yes, sir.

13 Q. Okay. And who mediated those?

14 Who led the meetings?

15 A. For the most part, I did. I -- you know, I was -- it
16 was -- it was my legislation once it reached the Senate and,
17 you know, at times representatives of the governor's --
18 Lieutenant Governor's staff were there. Of course, I was
19 there. We -- you know, we -- everybody took part. You
20 know, it's hard to say who led it per se. Everybody took
21 part.

22 But obviously it was called by me and it was my job to
23 get the parties together, try to keep them talking and try
24 to find compromise or middle ground on these issues so we
25 could move something forward.

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1 Q. Let's go ahead and pull PX 37, Plaintiff's Exhibit 37.

2 And in this letter, dated May 8th, and let's highlight
3 the paragraph that starts "Since my prior letter," and that
4 was the letter that we were just showing, was it not?

5 "Since my prior letter, and at your request, I have
6 moderated a total of four meetings among those interested in
7 this bill. The meetings were substantive and characterized
8 by sincere negotiation. As a result of those meetings we
9 have produced four new versions of the bill, the last of
10 which I have attached."

11 Now, let's go down to the next paragraph.

12 And do you recall writing that?

13 A. Yes, sir, I do.

14 Q. "The first thing I want to note in this: Every change
15 that has been made in this bill since its arrival in the
16 Senate, and as you will see, the changes are legion,
17 represents a step backward for me and the bill supporters in
18 terms of the tightness of the regulatory structures and
19 procedures the bill would put in place. Whether or not they
20 liked it, the supporters of the bill gave important ground
21 on multiple major issues. At no point did the bill's
22 opponents give any ground, nor did I ask them to. I make
23 that point for one reason only: To emphasize that the
24 supporters of this bill have been more than willing to
25 compromise on the real gut-level issues in the bill."

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1 Do you still believe that's a real statement?

2 A. I do.

3 Q. Do you still believe as you sit here today the
4 supporters of the bill gave much ground when they were
5 negotiating with Allstate?

6 A. They not only gave much ground but they negotiated all
7 times in good faith. And I'll be very blunt in saying I
8 don't believe that the same was had on the part of Allstate.

9 Q. Why don't you believe Allstate was negotiating in good
10 faith?

11 A. Because, despite all of our meetings and all of the
12 ground that -- that was given, in terms of what the bill
13 originated at versus the changes we were willing to make,
14 not the least of which, of course, was the -- the removal of
15 the divestiture language, we never could get to a bill that
16 we could finally agree to terms on that Allstate would --
17 would accept.

18 They -- we would continue to listen to them, we would
19 continue to accept recommendations of changes, draft
20 changes, draft changes in language. We made every overture
21 you could to try to satisfy them and -- and I know -- I can
22 only speak for myself, but I know that my feeling was
23 they -- they never gave in. And I don't -- I believe their
24 objective, candidly, was to run the clock out of the
25 Legislative Session and to see the bill die. And I don't

119 (Pages 236 to 237)

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1 believe until the final hour of the Legislative Session they
2 ever believed, given their -- their lobbying might and
3 legislative might, that this bill would pass, but it
4 obviously did.

5 THE COURT: Did it pass the last day?

6 THE WITNESS: No, sir.

7 THE COURT: You were saying at the last minute, I
8 was just wondering if it came down to the last minute.

9 THE WITNESS: When you get into that final month
10 of the Legislative Session you're always, you know, counting
11 the hours.

12 THE COURT: Okay.

13 MR. HOHENGARTEN: Let's go ahead and pull
14 Plaintiff's Exhibit 43.

15 And the first paragraph.

16 And let's go ahead and try to get a highlight on House
17 Bill 1131.

18 BY MR. HOHENGARTEN:

19 Q. Okay. And this is another letter from you to Governor
20 Dewhurst, is it not?

21 A. Yes, sir, it is.

22 Q. Okay. And this one is dated May 15, and in that letter
23 you say "House Bill 1131 would regulate ownership of body
24 shops by an insurer. On August -- excuse me -- on April 9th
25 the House Bill passed -- the House passed the bill with a

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1 vote exceeding two-thirds of that body. This past Wednesday
2 Bruce Gibson expressed to me and to the other supporters of
3 the legislation your further concerns with the bill as
4 redrafted. We have taken your and Bruce Gibson's latest
5 concerns, coupled with previous communications, and drafted
6 legislation that we feel fulfill your requirements."

7 Am I reading that correctly?

8 A. Yes, sir.

9 Q. So as late as May 15th you are still responding to
10 changes that the Lieutenant Governor wants and his chief of
11 staff wants in this bill?

12 A. Yes, sir.

13 Q. Okay. Incidentally, do you recall Jo Betsy Norton of
14 Allstate providing you with substitute draft language in the
15 course of these negotiations?

16 A. Yes, sir, I do. At least on one occasion. Maybe
17 more.

18 MR. HOHENGARTEN: Okay. Let's go ahead and pull
19 up Plaintiff's Exhibit 48.

20 Could we go ahead and just blow up the -- not the --
21 let's try that. Okay.

22 BY MR. HOHENGARTEN:

23 Q. Is this an example?

24 Do you recall her sending you this letter?

25 A. Let me read it just a second.

120 (Pages 238 to 239)

Page 240

1 Q. Certainly.

2 A. Yes, sir, I do.

3 Q. Okay. And in that letter she says "Attached please
4 find a draft substitute, which we believe addresses many of
5 the concerns espoused by the automobile dealers and body
6 shop owners. The substitute requires an insurer to disclose
7 to a beneficiary or third-party claimant its ownership
8 interest in a repair facility, and provides significant
9 sanctions for steering to an insurer-owned repair facility."

10 Now, I think you may have sent it once or more, but do
11 you recall whether or not this was the only time she sent
12 the draft language or were there other times?

13 A. I recall this one. I don't recall others.

14 Q. How many times did you meet with Jo Betsy Norton?

15 A. Well, several. You know, she -- she was obviously, you
16 know, a very interested party in the process and so she had
17 come by my office a number of times. And she was -- she was
18 in our meetings when we convened them in the Lieutenant
19 Governor's meeting room. And, of course, she was -- she was
20 a lobbyist for Allstate, so we -- I knew her and, in fact,
21 had always had nice working relations with her.

22 Q. I was just about to ask you that.

23 Have you worked with Jo Betsy Norton on other bills?

24 A. Yes, sir, I have.

25 Q. Okay. Where both of you were working for the bill?

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1 A. As I mentioned earlier, I don't think I've ever not
2 been on the side of the insurance companies, until we got to
3 this issue.

4 THE COURT: Did that language get in the bill that
5 she provided?

6 THE WITNESS: Your Honor, I think perhaps a
7 portion did, but I don't believe all of it.

8 THE COURT: I haven't seen any language like
9 that.

10 MR. HOHENGARTEN: I believe that's correct, judge,
11 this is not in the bill. It's just something that Allstate
12 proposed.

13 THE COURT: It was an alternative?

14 MR. HOHENGARTEN: Yes.

15 THE COURT: Okay.

16 BY MR. HOHENGARTEN:

17 Q. Senator Carona, do you know if other states are
18 currently considering legislation similar to HB 1131?

19 A. That's my understanding. Yes, sir. I don't know the
20 specifics of -- of what they're doing in each of the states,
21 but -- but I know that a number of other states are.

22 This has been an issue of concern, not just in
23 California, not just in Texas, but I think in a large part
24 of the country.

25 Q. Do you know what some of those states are that are

121 (Pages 240 to 241)

Page 242

1 considering the bills?

2 A. As far as current status, sir, I don't.

3 Q. That's fine.

4 Well, let me ask you this.

5 If you could sum up your governing philosophy, your

6 guiding principles in your work as a Senate -- Senator,

7 excuse me, what would those words be?

8 A. Well, no question, you know, I'm -- I'm -- you know,

9 I'm a capitalist. As a business owner and someone that

10 understands that businesses need to be -- need to be

11 profitable, need to make money, I support -- you know, I

12 support Allstate as an insurance company. You know, I want

13 them as an insurance company to do well. I want -- I want

14 body shops to -- to -- to all play fair. But, you know, but

15 I want consumers, you know, to do well, too. It's -- it's

16 got to be a fair and -- and balanced approach. It's not my

17 nature to propose regulation and -- and -- in Austin unless

18 I believe it's absolutely necessary.

19 Candidly, I -- I -- I'm of a political party that

20 believes in limited government and limited regulation, and I

21 can tell you that I would not have proposed what I proposed,

22 unless I believed that there was a serious problem and that

23 we had to find a way to deal with it before it did serious

24 harm to consumers, and that was -- and that was -- that was

25 the goal and the belief, as I -- as a worked on this

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1 project.

2 MR. HOHENGARTEN: Thank you, Senator.

3 I pass the witness.

4 THE COURT: Okay.

5 (CROSS-EXAMINATION)

6 BY MR. KASS:

7 Q. Senator Carona, you testified on direct examination

8 that your foremost concern was to protect consumers. True?

9 A. That's correct.

10 Q. And in your deposition at least you said you did not

11 recall any secondary concern. True?

12 A. I don't recall exactly what the language was, Mr. Kass,

13 but I -- but I've always been consistent in saying that,

14 that this issue was important to me because of the

15 implications for consumers.

16 Q. You don't recall any secondary concern. True?

17 A. Pardon?

18 Q. There's no secondary concern in your view. True?

19 A. No. Well, there -- there obviously are concerns.

20 I'm concerned about the consumers.

21 I'm concerned about anti-competitive business

22 practices.

23 I'm concerned about gross conflicts of interest.

24 I'm concerned about what seemed to me to be

25 inappropriate business practices on the part of Allstate.

122 (Pages 242 to 243)

1 I'm concerned with a number of aspects pertaining to
 2 this topic, but above all my concern is to find a solution
 3 or an environment that protects consumers.

4 MR. KASS: If we could put up on the video an
 5 excerpt from his deposition, page 41, 9 through 13.

6 (Videotape playing.)

7 "A. I've -- I've already answered this question. This
 8 bill -- this bill was based upon what is best for
 9 consumers. That was at all times the primary concern and
 10 objective.

11 "Q. Was there a secondary concern?

12 "A. Not that I recall."

13 BY MR. KASS:

14 Q. You said that, correct?

15 A. Yes, sir.

16 Q. In fact, one of the things that you really wanted to do
 17 was to protect the profits of local body shops. True?

18 A. No, sir. That's outrageous.

19 Q. Well, right before you introduced HB 1131 you gave a
 20 speech at the National Auto Body Conference and Exposition,
 21 true?

22 A. Yes, sir. That's right.

23 Q. And body shop owners attended this conference, correct?

24 A. They were among the attendees, yes, sir.

25 MR. KASS: And if we could pull up PX 61.

1 If we could pull up the quote.

2 BY MR. KASS:

3 Q. What you told them was "It's an issue of fairness for
 4 business owners in Texas. It's in the best interest of
 5 consumers" -- he said -- I'm sorry -- "It's in the best
 6 interest of consumers that body shops make a profit."

7 That's what you told the body shop owners you were
 8 talking to, you wanted to protect their profits. True?

9 A. You're taking that out of context, Mr. Kass. And while
 10 I acknowledge that that quote is correct, if you will take
 11 into consideration the entire paragraph, the environment in
 12 which it was stated, that was not the case.

13 Q. In any event, you said that it was in the best interest
 14 of consumers that body shops make a profit, true?

15 A. You're taking my comments out of context entirely.

16 MR. KASS: Your Honor, I move to strike that
 17 answer.

18 The question was: --

19 THE COURT: I'm going to overrule your objection.
 20 I think he's trying to answer your question.

21 MR. KASS: Okay. Okay.

22 BY MR. KASS:

23 Q. In any event, you did say that it's in the best
 24 interest of consumers that body shops make a profit, true?

25 A. It's in the best interest of consumers that all

1 businesses make a profit.

2 Q. One of the things that I want to focus on is the
3 specific events leading up to the passage of HB 1131. First
4 I want to focus on the things that you can recall and things
5 that you can't recall.

6 As of three weeks ago when you were deposed, you
7 couldn't recall a single customer ever complaining to you
8 about insurer ownership of body shops. True?

9 A. That's correct.

10 Q. And you can't recall how many Texas consumers testified
11 for or against HB 1131. True?

12 A. I relied on the testimony both in the House and the
13 Senate, and it was extensive. We heard from a number of
14 people.

15 Q. You can't recall how many Texas consumers testified for
16 or against HB 1131?

17 A. Sir, I didn't count them. You're correct.

18 Q. And you can't recall any discussions that you had with
19 any representative regarding HB 1131, true?

20 A. Pardon me, I don't -- what do you mean by
21 representative? I don't understand.

22 Q. As opposed to a Senator or representative?

23 A. You mean House member? I'm sorry.

24 Q. Yes. House member.

25 A. No, sir, I can't recall a specific conversation I -- I

1 had.

2 You understand that in the course of the Legislative
3 Session we're -- we're meeting in the halls, we're meeting
4 morning, noon, and night talking about, you know, the
5 literally over 1,000 -- well, I say -- over 5,000 bills that
6 are being -- that are part of the Legislative Session. No,
7 I don't -- I hope I've answered your question.

8 Q. And you didn't attend the House hearings?

9 A. No, sir, I did not attend them.

10 Q. And you don't recall receiving any report on the House
11 hearings?

12 A. No. That's not the case.

13 We receive regularly all sorts of information, both of
14 Senate hearings as well as House proceedings in our office.
15 That's part of -- part of the daily -- daily flow of mail.

16 Q. Did you receive information from even a single customer
17 that was hurt as a result of insurer ownership?

18 A. Mr. Kass, I sat there through testimony in the Senate
19 proceedings in our -- in our open, public policy, our public
20 hearing, and we heard from numbers of people. I don't
21 recall how many people came and went that day during that
22 process. I don't recall the name of a specific individual,
23 if that's what you're asking. But -- but I can tell you
24 that the testimony was exhaustive from parties on all sides
25 of the issue talking about their -- their concerns for and

1 against the bill.
 2 So, you know, I -- I don't want to leave you with the
 3 impression that -- that we didn't hear from a large
 4 audience, because it was -- it was a very diverse and very
 5 large audience.
 6 Q. The fact of the matter is, you don't recall a single
 7 customer of Sterling complaining about insurer ownership,
 8 because it didn't happen. True?
 9 A. If you're asking me did a Sterling customer come and
 10 testify at those committee -- at those committee hearings, I
 11 don't recall the name of a specific individual.
 12 Q. You also don't recall the detail of the committee
 13 hearing in the Senate regarding HB 1131. True?
 14 A. No, sir.
 15 I don't understand your question. I'm not saying
 16 that's true.
 17 Could you -- could you help me with the question?
 18 Q. Okay. With regard to the issue of whether customers
 19 were hurt, you don't recall the detail of the Senate
 20 hearings. True?
 21 A. Well, -- well, I do. Certainly. I was there in the
 22 committee hearings, so I certainly recall the gist and the
 23 outcome of the hearings and have substantial experience in
 24 knowing about this subject and about the reports leading up
 25 to and the outcome and -- and final bill.

1 So I guess I'm still not entirely understanding what
 2 you're asking.
 3 MR. KASS: Okay. Can we play from the deposition
 4 page 30, line 13 through 19.
 5 MR. HOHENGARTEN: Judge, I don't believe he's
 6 laid the proper predicate. Senator Carona has never -- he
 7 hasn't asked Senator Carona if he said it in his deposition
 8 and Senator Carona hasn't denied saying anything in his
 9 deposition that Mr. Kass asserts he said.
 10 THE COURT: I'm assuming it's what he just asked
 11 about.
 12 MR. KASS: Correct.
 13 THE COURT: Isn't that what he just asked about?
 14 MR. HOHENGARTEN: I didn't hear Senator Carona
 15 say.
 16 MR. KASS: It's right here, Your Honor.
 17 THE COURT: Let's see. Let's see. Overrule your
 18 objection.
 19 BY MR. KASS:
 20 Q. I asked the question:
 21 "Q. Did any of that information include a single
 22 customer who was hurt as a result of insurer ownership?
 23 "A. I don't recall what -- the detail of the
 24 committee hearing in the Senate and would direct you to the
 25 Senate hearing."

1 That's the question I asked you and the answer you
 2 gave. True?
 3 A. If it's in the record, it must be.
 4 Q. Now, we just talked about what you don't recall. What
 5 I want to turn to now is what you do recall.
 6 You would agree that the motivation for HB 1131 was not
 7 the fact that -- the asserted fact that Sterling provides
 8 lower quality than its competitors. You would agree with
 9 that?
 10 A. I mean, could you -- could you -- would you mind
 11 restating the question?
 12 Q. You would agree that HB 1131 was not motivated by the
 13 asserted fact that Sterling provides lower quality than its
 14 competitors. True?
 15 A. The purpose of the bill was to try to minimize the
 16 effects of the conflicts of interest that existed by the
 17 insurance company owning the body shops. That I've -- that
 18 I've tried to make clear throughout.
 19 My concern has been what affect this would have on
 20 consumers.
 21 Q. I just need a yes or no.
 22 A. But I don't understand your question. That's --
 23 that's -- I recognize you're not from Texas, but it's hard
 24 to understand your questions. I think you try to twist my
 25 words and I just want to make sure I give you a clear

1 answer.
 2 Q. Okay. Well, let me put up on the ELMO page 2 from your
 3 deposition.
 4 The question I asked you was -- I was referring to part
 5 of a deposition from Paul Reyes at the time --
 6 MR. KASS: Which we have designated for Your
 7 Honor.
 8 BY MR. KASS:
 9 Q. And the question in that deposition was:
 10 "Q. Was the motivation for HB 1131 the asserted
 11 fact that Sterling provides lower quality than its
 12 competitors? Answer, no." In that deposition. "Do you see
 13 that?
 14 "A. I do.
 15 "Q. Do you agree with that?
 16 "A. I think I do agree with that." You gave that answer,
 17 correct?
 18 A. Yes.
 19 Q. You agree with that?
 20 Now, at some point you were approached by Alan Walne at
 21 Herb's Paint and Body concerning the need for this
 22 legislation?
 23 A. I did speak with Mr. Walne about his concerns with the
 24 direction of the industry and about the -- about these
 25 issues, yes. And I asked a number of questions.

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1 Q. In fact, he was the first person to approach you,
2 correct?
3 A. No, sir. I don't believe so.
4 Q. Let me show you from your deposition, page 104, I asked
5 you the question.
6 "Q. Did you approach anyone prior to the time that Mr.
7 Walne approached you on the issue of insurer ownership?
8 "A. I think Mr. Walne may have been the first who
9 approached me.
10 "Q. And you didn't approach anybody?
11 "A. Not that I recall."
12 A. That's right. I didn't. But Beaman Floyd approached
13 me.
14 Q. Let me turn to 154. Okay. And here line 17. If we
15 could highlight line 17.
16 "A. As I mentioned --" line 17 through 19.
17 "A. As I mentioned earlier, I believe I was approached
18 first by Alan Walne. I'm not certain of that, but I believe
19 that to be the case."
20 That's what you -- that's the testimony you provided
21 during your deposition. True?
22 A. Yes, sir. I believe it was. And I mentioned to you I
23 wasn't certain of it.
24 Q. Now, Mr. Walne is the designated representative of
25 ASA. Were you aware of that?

Page 253

1 A. What?
2 Q. That he was the designated representative of ASA
3 sitting here in this court today?
4 A. That Mr. Walne is?
5 Q. Yes.
6 A. No, sir, I wasn't aware of that.
7 Q. Now, when he approached you, the issue that he was
8 approaching you about was related to the issue of the
9 emergence of Sterling into the Dallas market, right?
10 A. He was talking about the issue of insurance-owned body
11 shops, and to that -- to that extent, yes, I believe
12 Sterling was mentioned.
13 Q. Now, he approached you in -- sometime in mid 2002,
14 correct?
15 A. I said mid, I want to say the latter part of 2002, but
16 I don't recall the exact dates.
17 Q. And Mr. Walne is a friend of yours?
18 A. Yes, sir, he is.
19 Q. And he's a constituent of yours, correct?
20 A. He is. He lives in District 16.
21 Q. Now, other people also -- or other body shop interests
22 also approached you about HB 1131, including
23 Mr. Vandergriff. True?
24 A. Yes, sir. I don't recall at what -- at what point in
25 the process, but, yes, that's correct.

127 (Pages 252 to 253)

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

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1 Q. And Mr. Vandergriff is affiliated with Vandergriff
2 Collision Centers?

3 A. I believe so, yes.

4 Q. Okay. And Tom Blanton, he's the vice president of
5 Legislative Affairs for the Texas Automobile Dealer's
6 Association, he also discussed the issue of insurer
7 ownership with you?

8 A. Yes, sir.

9 Q. And many automobile dealers do have body shops,
10 correct?

11 A. Yes, sir. That's right.

12 Q. And some of these body shops are constituent -- some of
13 these auto dealers with body shops are constituents of
14 yours, correct?

15 A. I don't know what you mean by that.

16 Q. In other words, there are auto dealers with body shops
17 in your districts?

18 A. Yes, sir. That's correct.

19 Q. And one of the things that your local body shop
20 friends and constituents came to you about was their concern
21 about the emergence of Sterling into the Dallas market.
22 True?

23 A. I believe what they came to me and talked about or the
24 focus of their discussion was the concern of the concept of
25 insurance -- insurance-owned or insurer-owned body shops.

1 I really can't say that the focus of their conversation
2 was Sterling per se, no, sir.

3 Q. Well, didn't they tell you that they needed to stop
4 Sterling because it was having an adverse impact on their
5 businesses?

6 A. No, sir, I don't recall that specific -- that specific
7 statement.

8 Q. And that was part of the testimony that was provided
9 during the public hearings. Isn't that true?

10 A. I believe that -- what do you mean?

11 I'm sorry. What do you mean?

12 Q. Isn't it true that the body shop lobbyists, your
13 friends and constituents, testified about the fact of the
14 need to stop Sterling because it was having an adverse
15 impact on their businesses?

16 MR. HOHENGARTEN: In all fairness if there's a
17 document that Mr. Kass is looking at that he could provide
18 the Senator, then he should do that.

19 THE COURT: Is there?

20 MR. HOHENGARTEN: It sounds like he's quoting from
21 some portion of the hearings, regarding what somebody said
22 at the hearings.

23 THE COURT: I don't know if he is or he's not.

24 If you are, let him see it.

25 MR. KASS: Your Honor, I'm just quoting from his

1 deposition.

2 THE COURT: Okay.

3 THE WITNESS: I'm sorry, would you mind repeating
4 it again?

5 BY MR. KASS:

6 Q. The fact of the matter is the testimony at the hearings
7 involved body shops, your friends and constituents,
8 testifying about the need to stop Sterling because it was
9 having an adverse impact on their businesses?

10 A. I don't recall that being literally the words out of
11 their mouths, Mr. Kass. I think really that's your --
12 that's your interpretation, but I don't believe that was
13 perhaps the way they said it.

14 But I would also tell you that there was also testimony
15 at that meeting from my friends in the insurance industry.
16 You keep mentioning my friends. Well, my friends are also
17 in the insurance industry, not just in the auto repair
18 industry.

19 Q. Okay. Well, let's play page 40, lines 13 through 18.

20 (Videotape playing.)

21 "Q. Did they tell you that they needed to stop
22 Sterling because it was having an adverse impact on their
23 businesses?

24 "A. Among the concerns addressed, I believe that
25 was -- that was part of the information that was provided in

1 public testimony at the committee hearing."

2 Okay. That's what you said during your deposition.

3 True?

4 A. Yes, sir.

5 Q. Okay. Now, when Mr. Walne came to you to express
6 concerns about the emergence of Sterling in mid 2002, when
7 Sterling was entering the Dallas market, what he told you
8 was that he wanted a level playing field and a bigger bite
9 at the apple. Isn't that what he told you?

10 A. No, sir, I don't recall that being his words.

11 Q. You do understand that's what he told the Legislature
12 when he was speaking publicly?

13 A. No, I didn't understand that. I couldn't quote it. I
14 mean, we heard hours of testimony from -- from dozens of
15 people and so, no, those -- those are your words, and if
16 that's public record, I'm sure it's accurate, but otherwise
17 I can't testify as to the accuracy of what you're saying.

18 Q. Okay. Let's put up PX 7. Let's go to page 29.

19 This is the House hearings on March 2002 and it's Mr.
20 Walne testifying. If you look at line 4 through 8 -- I'm
21 sorry. If we look at line -- in any event, this is Mr.
22 Walne testifying and what he's telling the Legislature is we
23 want a level playing field, we want a bite at the apple.

24 That's what he told the Legislature, true?

25 A. Well, again, if it appears in the record, then it must

1 be accurate.

2 Q. Okay. And this is basically what he told you when you
3 met privately with him in mid 2002, when all -- when
4 Sterling was entering the Dallas market, right?

5 A. No, sir. I've told you before that that is not --
6 those are not words that came out of his mouth in that
7 meeting, and I've -- I've tried to be as clear to that point
8 with you as I can be.

9 Q. Tom Blanton was another person that approached you
10 concerning the emergence of Sterling in the Dallas market?

11 A. Again, I don't recall Sterling being the focus or even
12 the mention of the conversation.

13 What I recall the focus being is the concern over
14 insurer-owned body shops.

15 Q. That's fair.

16 Let's put up PX 53, which is an e-mail which
17 memorializes the conversation. This was an e-mail dated
18 March 28, 2003, which is right after it passed the Senate.
19 And he's sending the -- an e-mail to the TADA members,
20 that's the Texas Automobile Dealer's Association. True?

21 A. I believe so. Yes, sir.

22 Q. And Senate District 16, and that's your District?

23 A. Yes. To people inside my District. I think you're
24 right. Right.

25 Q. Okay. And he's explaining to the members -- the TADA

1 members in your District that, "If we don't stop this
2 incursion of the insurance industry here and now, there will
3 be no way to do it later."

4 Do you see that?

5 It's the highlighted portion.

6 A. Now I do. Yes, sir.

7 Q. Okay. Now, if you go down to the next two paragraphs
8 he's recounting the conversation with you, and what he says
9 is "Did Senator Carona ever bat an eye when the going got
10 tough? Nope. Not once. What he said to me was: I

11 understand this issue, I understand why dealers are so
12 important to Texas and how detrimental it would be to Texas
13 if insurance companies are allowed to sneak into this
14 business. I'll handle it. And that's exactly what he did."

15 That's what you told Tom Blanton about the effort to
16 stop Sterling from competing in Texas, true?

17 A. No, sir. I'm not representing that that's a quote at
18 all.

19 Q. So this would be a lie?

20 A. You know, I'm not going to say that. I'm just going to
21 tell you that is not -- that is not any quote, nor is it
22 represented, by the way, as a quote of my remarks.

23 Q. Now, after Mr. Walne, Mr. Blanton and Mr. Vandergriff
24 approached you to discuss Sterling's emergence in the Dallas
25 market, what you did was you drafted a bill that would force

1 Sterling out of the Texas market. True?

2 A. Are you asking me if one was predicated on the other?

3 Then I would tell you the answer was no.

4 I mentioned earlier in my testimony that before any of

5 them approached me I became aware of the issue on my own and

6 felt concerned about it, just as obviously the people in

7 California did and -- and as other states are now.

8 Q. Okay. Well, let's put up PX 14 on the screen. And

9 this is a fax from your office. It's Marge McCloskey is the

10 sender. She's your chief of staff?

11 A. Yes.

12 Q. And Alan Walne is the recipient of the e-mail, true?

13 A. It appears so.

14 Q. Okay. And in the message, if we could just bring up

15 the message, it says, "This is the bill that Senator Carona

16 had drafted at your request."

17 Do you see that?

18 A. I do.

19 Q. Okay. And attached to that is the draft of the

20 legislation that would have forced Allstate -- Sterling from

21 the State of Texas. True?

22 A. Attached is the -- is the -- well, I don't see the

23 attachment, but -- but I'm assuming there was a bill

24 attached.

25 Q. And Tom Blanton, that's again from the Texas Automobile

1 Dealer's Association, so this bill was sent to him as well?

2 A. It was. And as -- as one of the things that -- that I

3 cited specifically in the deposition, your interpretation of

4 what that says and my interpretation of what that says,

5 recognizing neither one of us wrote it, is not the same.

6 Q. And, in fact, at this point -- by this point, in

7 October 11th, 2002, you hadn't gathered any information

8 about Sterling's repair practices. True?

9 A. I -- at that particular date?

10 By that point I believe -- pardon me -- by that point I

11 believe I had heard from various sources, you know, on the

12 topic. I'm -- I'm not quite sure what information

13 specifically would have been gathered at that point, but the

14 process of preparing legislation and ultimately filing a

15 bill requires literally months of gathering information and

16 talking with people and hearing from both sides and --

17 hearing from all sides.

18 I can't tell you what information I had at what point,

19 but I can tell you obviously at some point I gathered

20 information.

21 Q. You're not certain whether you gathered any additional

22 information prior to the drafting of this legislation on

23 October 11th, 2002. True?

24 A. No, not at all. It depends on what you mean by

25 information. We gather information every time we talk with

1 people. That's part of the legislative process. Much of
 2 what we gather is what people come in on any issue and talk
 3 to us about and share with us on their own experiences,
 4 voice their concerns, and we listen. Sometimes they provide
 5 supplemental information, sometimes they provide handouts,
 6 sometimes they provide nothing but the opportunity to sit
 7 and discuss the problem.

8 So, I mean, information in a legislative environment,
 9 Mr. Kass, takes on a variety of different forms.

10 Q. Okay. If we could put on the screen page 112.

11 THE COURT: Stop just a minute.

12 Do you have any idea how much longer you're going to
 13 be?

14 MR. KASS: I'm just about getting started, so I've
 15 got probably another 45 minutes or so.

16 THE COURT: Okay.

17 I hate to ask you to come back another day.

18 THE WITNESS: Whatever you need.

19 THE COURT: We've been working pretty long hours
 20 and I'm about to wear my staff out, so I guess we'll just
 21 stop today and come back in the morning and, you know, get
 22 going on it then.

23 Okay?

24 All right.

25 MR. KASS: Thank you, Your Honor.

1 THE COURT: All right. See you at 9:00 in the
 2 morning.

3 Let me see a lawyer from each side up here just for a
 4 second.

5 (Discussion at the bench off the record.)

6 (End of proceedings on 9/23/04)

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CERTIFICATION

I, PAMELA J. WILSON, CSR, certify that the foregoing is a transcript from the record of the proceedings in the foregoing entitled matter.

I further certify that the transcript fees format comply with those prescribed by the Court and the Judicial Conference of the United States.

This the 23rd day of September, 2004.

PAMELA J. WILSON, CSR
Official Court Reporter
The Northern District of Texas
Dallas Division