

No. 06-10500

**IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT**

ALLSTATE INSURANCE COMPANY and
STERLING COLLISION CENTERS, INC.

Plaintiffs-Appellants,

v.

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

Defendants-Appellees,

AUTOMOTIVE SERVICE ASSOCIATION, and
CONSUMER CHOICE IN AUTOBODY REPAIR

Intervenors-Appellees.

On Appeal from the United States District Court
for the Northern District of Texas, Dallas Division
Case No. 3:03-CV-2187-K

BRIEF OF INTERVENORS-APPELLEES-CROSS-APPELLANTS

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CERTIFICATE OF INTERESTED PERSONS

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

1. The State of Texas
2. Greg Abbott, in his official capacity as the Texas Attorney General
3. Carol Keeton Strayhorn, in her official capacity as Texas Comptroller of Public Accounts
4. Plaintiffs/Appellants/Cross-Appellees Allstate Insurance Company and Sterling Collision Centers, Inc.
5. Intervenors/Appellees/Cross-Appellants Automotive Service Association and Consumer Choice in Autobody Repair
6. Don Cruse, Assistant Solicitor General of the State of Texas, and Jack Hohengarten, Assistant Attorney General of the State of Texas, who are counsel for the State Defendants/Appellees/Cross-Appellants
7. Locke Liddell & Sapp LLP, Michael V. Powell, Thomas G. Yoxall, W. Scott Hastings, and Ricardo A. Bedoya who are counsel for the Intervenors/Appellees/Cross-Appellants
8. Kirkland & Ellis LLP, Kenneth W. Starr, Tefft Smith, Colin Kass, Amanda Basta, Nicole Goldstein, and Scott Abeles, who are counsel for Plaintiffs/Appellants/Cross-Appellees Allstate Insurance Company and Sterling Collision Centers, Inc.
9. Akin Gump Strauss Hauer & Feld LLP, Orrin Harrison, William H. Church, and Cara Foos Pierce, who are counsel for Plaintiffs/Appellants/Cross-Appellees Allstate Insurance Company and Sterling Collision Centers, Inc.

Dated: September 18, 2006

/s/ W. Scott Hastings

W. Scott Hastings

STATEMENT REGARDING ORAL ARGUMENT

For decades, state legislatures have used vertical integration restrictions to implement state policies and promote the best interest of consumers. Vertical integration restrictions apply to a variety of industries. *See, e.g.*, TEX. BUS. CORP. ACT §2.01B(3)(a) (prohibition against raising cattle while operating stockyards, slaughterhouses, or meat packing facilities); TEX. BUS. CORP. ACT §2.01B(3)(b) (prohibition against the same corporation producing oil and operating a pipeline); TEX. ALCO. BEV. CODE §102.11 (manufacturers and distributors of alcohol may not own an interest in businesses involved in the retail sale of beer); TEX. UTIL. CODE §39.051 (requiring electric utilities to separate operations for power generation, transmission and distribution, and retail electric service); TEX. OCC. CODE §2301.476 (automobile manufacturers may not be licensed as dealers). Vertical integration restrictions have been upheld against repeated constitutional attack. *See, e.g. Exxon v. Maryland*, 437 U.S. 117, 125 (1978); *LensCrafters v. Robinson*, 403 F.3d 798, 802-07 (6th Cir. 2005); *International Truck and Engine Corp. v. Bray*, 372 F.3d 717, 725-27 (5th Cir. 2004); *Ford Motor Co. v. Tex. Dept. of Transp.*, 264 F.3d 493, 499-502 (5th Cir. 2001); *Ford Motor Co. v. Ins. Comm’r*, 874 F.2d 926, 942-945 (3d Cir. 1989); *S.A. Discount Liquor, Inc. v. Tex. Alcohol Beverage Commission*, 709 F.2d 291, 292-94 (5th Cir. 1983). Allstate and Sterling seek to cause a continental shift in state power by arguing that the dormant

Commerce Clause prohibits the State of Texas from imposing a classic vertical integration restriction to prohibit automobile liability insurance companies from owning interests in autobody collision repair shops. Oral argument will assist the Court to understand why the district court correctly rejected Allstate's and Sterling's attempt to upset the balance of state power.

Grandfathering provisions are also a common tool used by legislatures when enacting new laws. Here, the Texas Legislature adopted a grandfathering provision to allow Allstate to continue to own interests in fifteen existing Sterling autobody collision repair shops in Texas, but required Allstate and Sterling to abide by a code of conduct that included four commercial speech restrictions. The code of conduct was modeled after that used by the Texas Legislature when it adopted the Public Utility Regulatory Act, TEX. UTIL. CODE §39.157(d). Oral argument will assist the Court to understand how the district court erred when it struck the four commercial speech restrictions as violating the First Amendment. Oral argument will also assist the Court in understanding the implications of the district court's erroneous ruling, which extend beyond the present case.

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MISCELLANEOUS

*J. Macey & G. Miller, The McCarran-Ferguson Act of 1945:
Reconceiving the Federal Role in Insurance Regulation, 68
N.Y.U. L. Rev. 13, 22 (1993).....38*

STATEMENT OF JURISDICTION

Appellees removed this case to federal court because it involves significant issues of federal constitutional law. The district court entered a final judgment on March 9, 2006. (R10:2411, 2490). Appellants filed their notice of appeal on April 6, 2006. (R10:2491). Intervenors filed their notice of cross-appeal on April 10, 2006. (R10:2494). The State Appellees filed their notice of cross-appeal on April 13, 2006. (R10:2497). This Court has appellate jurisdiction under 28 U.S.C. §1291.

STATEMENT OF THE ISSUES

1. Whether the district court correctly found that HB 1131 does not violate the dormant Commerce Clause.
2. Whether the McCarran-Ferguson Act immunizes HB 1131 from a dormant Commerce Clause challenge.
3. Whether the commercial speech restrictions in TEX. OCC. CODE §§2307.006(3), (4), (6), and (9) violate the First Amendment.
4. Whether Appellants are constitutionally estopped from challenging TEX. OCC. CODE §§2307.006(3), (4), (6), and (9).

STATEMENT OF THE CASE

Appellants' Brief is based on two unfounded assumptions: (1) HB 1131 was enacted to prohibit interstate competition in the autobody collision repair market, and (2) Sterling is the most "competitively significant" interstate collision repair chain. The truth, as found by the district court, is that the Texas Legislature enacted HB 1131 to combat the encroachment of automobile liability *insurance companies* into the collision repair business, and there are significant interstate competitors already in that business. The Legislature did not want the collision repair industry to become the new HMO, with insurance companies exerting their influence over repair service providers to cut corners, exerting influence over consumers to direct business to insurer-owned or "tied" shops regardless of repair quality, and providing insurer-owned shops with confidential information obtained from non-insurer-owned competitors.

A. HB 1131 Does Not Stop the Expansion of Interstate Repair Shops, Many of Which Are Already Present in Texas.

There are many autobody collision repair shops in Texas that are part of interstate businesses and enterprises. The district court correctly recognized that "the market is currently composed of both intrastate and interstate firms," including: "the Boyd Group, CarStar, VT, Inc., Automotive Investment Group, Sonic, Group One, AutoNation, and all interstate new car dealers that have repair shops. . ." [CoL ¶¶42, 46]. The district court even noted that "Allstate reviewed

and evaluated several interstate autobody repair consolidators, including ABRA, AutoNation, the Boyd Group, Caliber, CTA, True 2 Form, and M2” before it acquired Sterling.¹ [FoF ¶49].

Appellants misrepresent the district court’s findings when they argue that “[a]s the district court found, ‘the number of interstate collision repair businesses that will continue to operate in Texas is relatively few (about 5).’” (*See* Appellants’ Brief at 14 citing FoF ¶97). The district court did not *find* that there are only 5 interstate competitors in Texas. The district court actually wrote: “*Allstate and Sterling contend* that . . .” there are only 5 interstate competitors.² [FoF ¶97 (emphasis added)]. In the preceding sentence the district court explained:

¹ On page 7 of their Brief, Allstate describes the nine repair chains it evaluated as only a “few.” The characterization of Sterling as the “best of the best” on page 7 is Allstate’s characterization, and not the district court’s. [*See* FoF ¶¶49-50].

² Appellants misrepresent the record in other places too, attempting to transform their own beliefs and contentions into district court findings. For example:

- Appellants omit “Allstate found that . . .” when they purport to quote the district court as finding “[I]ndependent repair shops [have] no incentive to provide speed and quality repairs to a one-time customer, because they were being paid for repairs at cost-plus pricing . . . on a flat hourly rate.” [*Compare* Appellants’ Brief at 6 *with* FoF ¶33].
- The district court did not find that “The problem . . . is that the highly-fragmented, local body shop industry has been characterized by waste, fraud, and inefficiency.” [*Compare* Appellants’ Brief at 6 *with* FoF ¶¶22-33]. This is Appellants’ contention, and not a finding of fact.
- Appellants omit “Allstate’s experience with autobody repairs was that . . .” when Appellants purport to quote the district court as finding that repairs were inefficient. [*Compare* Appellants’ Brief at 6 *with* FoF ¶31].

If H.B. 1131 is upheld, and Sterling is unable to further expand its network of shops in Texas, collision repair work that may have been done by Sterling will go to either locally-owned autobody repair shops or interstate collision repair chains (including interstate auto dealerships that operate collision repair facilities).³

[FoF ¶97; *see also* CoL ¶35 (“If there is any shift in business from Sterling to other autobody repairers, some of that business should shift toward these other interstate companies.”)].

The district court’s findings are supported by Dr. House’s testimony at trial. Dr. House refused to agree with Appellants’ assumption that HB 1131 would cause most of Sterling’s purported lost sales to shift to local firms.⁴ [6 Tr. 16:21-17:1,

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- Appellants fail to mention that its claims regarding customer dissatisfaction on page 6 of their Brief are based upon Allstate’s “concern[.]” and “internal marketing research.” [FoF ¶25].
 - On page 7, Appellants change the phrase “typical independently owned autobody repair shops” into the phrase “local shops.” [*Compare* Appellants’ Brief at 7 *with* FoF ¶59]. These phrases do not have the same meaning.
 - In FoF ¶47, the district court did not find that Allstate could achieve cost savings from its greenfield stores. [*See* FoF ¶47]. Appellants’ quotation from FoF ¶47 on page 8 of their Brief omits the words “Allstate thought. . .” from the beginning.

³ On page 13 of their Brief, Appellants misrepresent the district court’s findings to argue that “the district court conceded” that HB 1131 would “shift business from interstate Sterling to the predominantly local body shops.” The district court actually found that business would also shift from Sterling to other interstate collision repair chains. [*See* FoF ¶97; CoL ¶35].

⁴ HB 1131 does not force Sterling to close its shops. Instead, it provides Allstate and Sterling with a favored position over other insurance carriers. [6 Tr. 17:3-17:20]. To the extent Sterling has lost business due to HB 1131, Sterling’s

104:7-11, 106:14-106:20, 112:25-113:12]. Appellants' discussion of Dr. House's deposition testimony on page 15 of their Brief takes Dr. House's testimony out of context. Dr. House's deposition testimony continued by showing that he was confused by the initial question he had been asked. [6 Tr. 105:5-106:20]. Dr. House clarified his testimony:

Q: That number going to interstate providers would be higher but for HB 1131 and the number going to in-state providers would be lower but for HB 1131?

* * *

A: I cannot agree with that. There are interstate providers that are not vertically integrated.

[6 Tr.106:14-106:20]. No party conducted a study to show the exact number of such interstate shops that currently compete in the Texas market.⁵ The burden to produce such evidence to support their charge of discrimination belonged to Appellants. *See* [CoL ¶24]; *LensCrafters*, 403 F.3d at 802; *USA Recycling, Inc. v. Town of Babylon*, 66 F.3d 1272, 1281 (2d Cir. 1993).

In Appellants' attempt to portray HB 1131 as legislation designed to benefit only local, intrastate repair shops, they omit the fact that one of HB 1131's chief losses are caused by the provisions of HB 1131 that prohibited Sterling from engaging in anticompetitive practices and using its relationship with Allstate to capitalize upon the conflict of interest found by the district court.

⁵ As reflected in the testimony of Allstate's expert Scott Harrington, it would be difficult to conduct such a study because it is hard to identify or define what an interstate competitor is. [See 4 Tr.178:2-189:3]. Allstate's expert admitted that when forming his opinions he "[has] not dealt with legal nuances or distinctions about what might be interstate or intrastate." [4 Tr.180:25-181:1].

supporters was Mr. Victor Vandergriff of VT, Inc. and Automotive Investment Group (“AIG”). VT and AIG operate collision repair shops in 11 states. [5 Tr. 136:21-137:19]. Accordingly, when Appellants argue on page 9 of their Brief that HB 1131 was ““drafted at [the] request”” of Sterling competitors, Appellants should have added that the “request” was made by both *interstate* and *intrastate* competitors.

B. HB 1131 Regulates Texas-Based Insurers Too.

Appellants’ suggestion that HB 1131 is targeted at out-of-state entities also ignores the fact that there are Texas-based automobile liability insurance companies that are equally subject to HB 1131’s prohibitions. USAA is based in San Antonio, Texas. [4 Tr.8:24-9:1, 168:4-12]. There are also twenty-four county mutual insurance companies operating under Texas law. [4 Tr.9:25-11:1; *e.g.* DX410, DX411, DX412, DX413]. Allstate writes a substantial portion of its automobile insurance policies in Texas through a county mutual insurance company based in Irving. [DX410; 4 Tr.9:25-10:4, 167:14-168:3]. HB 1131 does not distinguish between in-state and out-of-state insurers. HB 1131 provides that any insurer that chooses to be licensed to sell motor vehicle insurance in Texas is prohibited from acquiring additional interests in a collision repair shop. TEX. OCC. CODE §§2307.001(4) & 2307.002.

C. The Texas Legislature Enacted HB 1131 to Stop the Encroachment of Insurance Companies Into the Collision Repair Market.

HB 1131 is directed at all automobile liability insurance companies, and not interstate competition. It addresses conflicts of interest and anticompetitive conduct. [FoF ¶¶99-105; CoL ¶¶28, 54]. The Legislature’s goals are reflected in HB 1131 official Bill Analysis. [PX5; PX6; DX243; DX247]. The Legislature was concerned that “consumers will suffer under the practices of insurers that operate repair facilities” similar to the way consumers have suffered due to HMO’s. [PX6]. The Legislature also wanted to “eliminate an incentive” for insurers to steer business. [PX6].

Rep. Flores proposed HB 1131 in the House Committee on Licensing, explaining that the existence of tied auto repair shops hurts consumers by eliminating their advocate (the independent repair facility) in the auto repair process:

By eliminating the only independent voice that the car owner has in the repair process, that of an independent body shop owner, insurance companies control both the money to pay for damage to a claimant’s car and the person who will decide what repairs need to be made to get the car out of the door.

Because publicly traded insurance companies have a responsibility to stockholders to seek the highest premium possible and pay the lowest claims for which they can negotiate, the consumer, caught in the middle of that equation, becomes irrelevant.

* * *

What this bill seeks to do, Mr. Chairman and members of the committee, is to ensure that, number one, that the consumer has a choice.

[FoF ¶99; DX10 at 2-3]. On the House floor, Rep. Flores further explained: “we are trying to address an issue that deals strictly with conflict of interest.” [FoF ¶100; DX2 at 2].

Other Legislators expressed concern that insurers would steer customers to insurer-owned body shops. Rep. Nixon explained:

There’s only one reason for them to have an auto shop is that it’s for them to direct your banged-up vehicle to their shop so they can make an extra buck off you. That’s it.

[FoF ¶102; DX2 at 18]. Rep. Puente concluded:

Essentially what we’re trying to do with this bill is to look at conflicts of interest, make sure insurance companies that have control over body shops don’t steer business towards them so they can earn a premium twice.

[FoF ¶103; DX2 at 25-26]. Thus, the goal expressed by House members was not protectionism (as Appellants contend), but was to prevent Allstate from using its influence to steer business to its tied repair shops. In other words, House members wanted to preserve competition in the auto repair market, free from artificial influence and steering from insurers.

Senator Carona, who offered HB 1131 in the Texas Senate, explained that his chief motivation was to eliminate the obvious conflict of interest that arises when an insurance company owns the repair facility. [FoF ¶104; DX3 at 2-4].

Appellants do not address the extensive legislative history that supports the district court's conclusions, choosing instead to label the proceedings as "perfunctory." (*See* Appellants' Brief at 10). But the record shows that the Legislature received significant testimony regarding the industry and market before enacting HB 1131. [FoF ¶105]. Witnesses testified regarding all of the following:

- Insurance companies "force repairers to use cheaper, more inferior parts, place caps on the prices that can be charged . . . or steer business away from specific shops." [DX10 at 9, 100-05].
- They gave low estimates of what it cost to make repairs, making it more difficult to obtain competitive bids from shops Allstate did not control. [DX10 at 25-26].
- Insurers forced the repair of vehicles under where qualified repair shops concluded that the vehicle was a "structural total." [DX10 at 30-31].
- Allstate directed repair facilities to perform only partial repairs or to cut corners when they could get away with it. [DX10 at 104-05].
- Insurers tried to mandate the parts to use for repairs and at what cost, even though state law grants consumers a right to choose. [DX10 at 30-31, 100-05].
- Sterling did not engage in significant advertising but, instead, relied upon Allstate for referrals or customer steering. Sterling employees even admitted that they relied upon steering from Allstate agents. [DX10 at 11-12, 14-15].
- Allstate agents attempted to steer business by telling customers that the repair facility they chose on their own was not an option. [DX10 at 18-19, 102].

- Allstate terminated repair facilities from their PRO program that were near Sterling shops to increase the business available to Sterling. [DX10 at 18-19].
- After Allstate opened a Sterling facility down the road from Toyota of Irving, Allstate pressured that dealership until it went off Allstate's program. Toyota of Irving's Mr. Shoemaker testified: "[t]hey were out to drive us out of the market and that was their intent for the shops up and down the street." [DX10 at 10-11].

Witnesses testified that allowing insurers to own auto repair shops was equivalent to letting HMOs own the hospital and also directly employ the doctor. [DX10 at 5]. There would be no checks and balances to protect consumers. [DX10 at 8]. The legislative history is replete with testimony regarding the harm caused by such vertically tied relationships.

Appellants produced no evidence of "irregularities" during the legislative process relating to HB 1131. [CoL ¶26]. Appellants exercised their rights before the Legislature, presented witnesses, and attempted to persuade legislators that there is no harm arising from such conflicted relationships. [FoF ¶¶106, 108]. Allstate's Mr. Thompson, Mr. Edelen, Ms. Norton, and its lobbyists had several meetings with legislators during which Allstate and Sterling had every opportunity to tout the supposed benefits of the Allstate/Sterling relationship. [2 Tr.117:9-121:25; 4 Tr.16:10-17:14, 54:19-68:4]. In the end, the Legislature concluded that insurer-owned shops resulted in more harm than good.

Appellants' claim that there was no evidence of consumer harm before the Legislature is meritless. All of the testimony cited above reflects consumer harm

that is caused by insurer behavior in the collision repair industry. [FoF ¶105]. Moreover, prior to purchasing Sterling, Allstate conducted its own consumer surveys on this issue confirming that harm. [FoF ¶107]. Allstate’s own survey found:

- “There’s too much probability of cost-cutting.” [DX45 at 12].
- “If Allstate owns the shops, are the workers working for me or for Allstate?” [DX45 at 12].
- “I’m concerned about the quality of the staff and the work in a ‘captive’ company.” [DX45 at 12].
- “Profitability might become too important.” [DX45 at 12].
- “It’s a conflict of interest. They’re saving money at my expense.” [DX45 at 13].
- “It’s like an HMO. I don’t want Allstate to have total control.” [DX45 at 13].
- Nearly half of the consumers involved in one of the surveys believed that Allstate should not own body shops because Allstate should be “sticking to insurance” and because of the potential for a “conflict of interest.” [DX48 at 13].

[FoF ¶107]. Prior to entering the collision repair market, Allstate knew that its purchase of a collision repair chain would be “a difficult practice to defend.” [DX6]. Allstate did not disclose its survey evidence to the Legislature.

Allstate failed to disclose other key facts to the Legislature, including:

- when Allstate touted the benefits of Sterling, Allstate had “hard evidence of quality issues” with Sterling, [FoF ¶75; DX100; DX146; 4 Tr. 37:14-40:20];
- when Allstate claimed its ownership of Sterling was important to combat fraud, Allstate’s review of the Texas autobody repair industry failed to reveal a compelling case of fraud in the industry, [DX11; 4 Tr.53:6-11]; and

- when HB 1131’s proponents complained about conflicts of interest and anticompetitive conduct [DX12; DX345], Allstate realized that the “current Allstate/Sterling oversight model does not provide a basis in fact and practice to counter these arguments.” [DX8; 2 Tr.122:9-125:18].

Accordingly, it is misleading for Appellants to argue about an alleged absence of evidence before the Legislature of problems with the Allstate-Sterling relationship (*see* Appellants’ Brief at 16-17), because Appellants did not share the data about their own performance with anyone, including the Legislature. [*See* FoF ¶80]. Allstate’s own evidence that was not provided to the Legislature would have bolstered concerns already raised by legislators.

The Texas Legislature had ample justification to enact HB 1131.

D. The Texas Legislature Did Not Assert Protectionist Rationales to Support HB 1131.

Appellants’ attempt to paint Texas legislators with a “protectionist” label is unfounded. In contrast to the substantial testimony and evidence addressing conflicts of interest and anticompetitive harm, Appellants cite only a few statements that allegedly support their claim of a protectionist motivation, and they attack only a few individual members of the Legislature. Viewed in context, though, none of Appellants’ statements comes near establishing that the Legislature was motivated by unlawful protectionism:

1. Sen. Carona: On page 9 of their Brief, Appellants write: “According to Senator Carona, H.B. 1131’s purpose was to . . .” Then, Appellants falsely

attribute two purported quotations from PX58 to Sen. Carona. But, PX58 was a letter that was neither sent from nor to Sen. Carona. Appellants cannot manipulate a record to support their protectionist charge.

Appellants also quote Sen. Carona as explaining that he spoke to a friend in the collision repair industry and believed that it would be “detrimental . . . if insurance companies are allowed to sneak into this business.” (*See* Appellants’ Brief at 10 citing PX57, PX53). On its face, this statement shows that Sen. Carona was concerned about “insurance companies” entering the market. This is not a statement directed against interstate competition.

Next, Appellants cite to Sen. Carona’s statements on the Senate floor explaining that he wanted to prevent Sterling from having a “competitive edge” in Texas. (*See* Appellants’ Brief at 11). Sen. Carona’s statements (read in context) show that he was addressing the grandfathering and code of conduct provisions in HB 1131. [PX9 at 11]. His stated goal was to prevent grandfathered insurer-owned shops from receiving preferential treatment because of their relationship with a parent insurance company. [PX9 at 11]. Again, this is commentary against insurance companies, and not interstate competition.

Finally, Appellants accuse Sen. Carona of acting with a protectionist purpose based upon his staff’s contact with USAA (a Texas-based insurer) prior to the enactment of HB 1131. (*See* Appellants’ Brief at 14). Of course, Appellants

fail to mention that Sen. Carona’s staff also contacted State Farm and Farmers (who are not based in Texas). [See PX16]. More importantly, Appellants omit the conclusion reached by Sen. Carona’s staff that: “USAA is most likely opposed to never having the option of obtaining an interest in a repair facility.” [PX16]. Indeed, USAA’s representative testified against HB 1131. [PX9 at 22-23; 4 Tr.8:24-9:3].

2. Rep. Flores: On page 9 of their Brief, Appellants attempt to paint Rep. Flores as “protectionist” based on a hypothetical question drafted by a staff member that was included among talking points relating to HB 1131.⁶ Rep. Flores’ position is not stated in a hypothetical question furnished by staff. There is nothing in those talking points that can be read as an admission (either implicit or explicit) that Rep. Flores was motivated by a desire to protect the collision repair market from interstate competition. [PX25]. To the contrary, the talking points suggest that the true focus of HB 1131 was to counteract insurance company encroachment into the collision repair market because “no one ever dreamed that an insurance company would attempt to exploit such an obvious conflict of interest.” [PX25].

⁶ The allegedly protectionist question immediately follows a discussion of the law this Court upheld against a dormant Commerce Clause attack in *Ford Motor Co. v. Texas Dept. of Transp.*, 264 F.3d 493 (5th Cir. 2001).

The remaining statements allegedly attributed to Rep. Flores (on pages 10, 11, and 26 of Appellants' Brief) show on their face that Rep. Flores was concerned about "insurance companies" and not interstate competition.

3. Rep. Driver: The two statements attributed to Rep. Driver (on pages 11 and 17 of Appellants' Brief) show that Rep. Driver was concerned about "Allstate" competing against collision repair shops. In other words, Rep. Driver was complaining about insurance companies, not interstate competition.

4. Rep. Wise: On page 11 of their Brief, Appellants take Rep. Wise's comments out of context to try to create an appearance of protectionism. Rep. Wise was concerned about steering business to Sterling, not protectionism against interstate commerce:

MR. RODRIGUEZ: So, where is the unfair competition?

REP. WISE: See, I disagree with you. The vast majority of the auto market in this state is controlled by only three companies. So, if one of those three companies is directing its covered premium holders to one company, well, then what do you think that does to mom-and-pops? Obviously, it cannot be a satisfactory result for those folks. It will drown them out.

[PX7 at 115]. Earlier in the proceeding, Rep. Wise expressed concern that repair shops may have invested substantial resources to meet Allstate's referral standards, only to be cut off when Allstate gives preferential treatment to Sterling. [PX7 at 16-17].

5. Rep. Homer: Appellants’ attack against Rep. Homer on page 11 of their Brief may be the most baffling considering that Rep. Homer voted against HB 1131. [PX7 at 118-119]. The statement attributed to Rep. Homer reflects a question, not a statement of position. [PX7 at 118-119].

In the end, it is clear that Appellants have selected a few legislators’ statements (out of context) to attempt to create an appearance of protectionism that did not exist. The Legislature was not enacting a law targeted against interstate commerce; it enacted a law regulating the activities of all insurance companies writing automobile liability insurance in Texas regardless of their location.

E. The Allstate-Sterling Relationship Highlights the Need for HB 1131.

Appellants’ discussion of Sterling’s drop in business demonstrates that Sterling was not “competitively significant” but, was competing based on preferential treatment and anticompetitive conduct. When left to compete on its own (without Allstate’s preferential treatment), Sterling performed poorly. [FoF ¶¶115-124]. Prior to the enactment of HB 1131, Sterling conducted business by:

- relying on preferential referrals (without regard to the quality of repair), [FoF ¶¶75, 85-86, 94-95, 131];
- relying on Allstate to create business for Sterling (often by terminating its relationship with other, higher quality repair shops that were within the “*circle of death*”, meaning that the shops were too close to Sterling),⁷ [FoF ¶¶81-85]; and

⁷ On page 9 of their Brief, Appellants admit that “when Sterling entered the Dallas market with six greenfield facilities, referrals to competing local PRO shops

- using confidential information that Allstate obtained from Sterling’s competitors to give an unfair competitive advantage to Sterling,⁸ [FoF ¶¶77-80].

The Legislature’s concern about unfair competition was not just a “euphemism;” that concern materialized in the way Sterling actually conducted its business before HB 1131. Of course, HB 1131 applies to the entire industry, and not just Sterling. Even if Allstate and Sterling had not engaged in anticompetitive conduct, the Legislature would have been justified in enacting legislation to prevent less scrupulous insurance companies from engaging in anticompetitive practices and conduct that is detrimental to consumers. The Legislature acted well within the State’s authority when it enacted HB 1131 to prohibit such conduct.

F. Course of Proceedings and Disposition in the District Court.

Intervenors believe that the State Appellees have accurately presented the procedural history of this case.

were ‘dialed down.’” This admission confirms that Allstate had the ability to direct work flow to its own facility regardless how well other shops performed. At trial, the evidence of this “dialing down” included terminating a Herb’s facility from the referral network that had a high customer approval rating to replace it with a Sterling facility that had lower ratings. [See FoF ¶82; 5 Tr.77:13-22; PX536 at ¶11; Bledsoe Dep. at 57:1-3, 57:6-57:21, 57:24, 140:14-22].

⁸ On pages 15 and 16 of their Brief, Appellants emphasize the district court’s finding that “Allstate continued to try and improve Sterling’s operations.” The district court’s findings on this point are *not* something Appellants should be proud of. The district court explained that Allstate continued to try and improve Sterling’s operations *using confidential business information from Sterling competitors*. [FoF ¶¶77-80].

SUMMARY OF THE ARGUMENT

This Court should uphold HB 1131 in its entirety. HB 1131 does not violate the dormant Commerce Clause. It is even-handed regulation applicable to all auto liability insurance companies. Nothing in the law discriminates against interstate commerce or interstate competitors. Indeed, after HB 1131, all interstate competitors (except insurance companies) are free to compete in the Texas market for collision repair services. The district court correctly analyzed HB 1131 under the *Pike* balancing test to conclude that the benefits of HB 1131 (eliminating conflicts of interest and anticompetitive conduct) outweighed any incidental burden that the law places upon interstate commerce.

Alternatively, this Court should reject Appellants' dormant Commerce Clause challenge based upon Section 2(a) of the McCarran Ferguson Act (the "Act"), which grants states primary authority to regulate the business of insurance. Section 2(a) immunizes state laws that *relate to* regulation of the business of insurance from dormant Commerce Clause attack. The district court's decision to reject Appellees' McCarran-Ferguson Act defense failed to recognize that Section 2(a) of the Act requires the court to employ a different legal standard than is used to analyze arguments under the antitrust exemption in Section 2(b) of the Act. Employing the correct legal standard under Section 2(a), this Court should

conclude that HB 1131 is a law relating to the regulation of the business of insurance that is immune from dormant Commerce Clause challenge.

By way of cross appeal, this Court should reverse the district court's decision finding the commercial speech restrictions in TEX. OCC. CODE §§ 2307.006(3), (4), (6), and (9) unconstitutional under the First Amendment. Those sections exist as part of the code of conduct imposed upon insurer-owned shops that qualify for HB 1131's grandfathering provisions. This Court should find that TEX. OCC. CODE §§2307.006(3), (4), (6), and (9) are immune from challenge under the First Amendment for each of the following independent reasons: (1) those section regulate false and misleading speech, (2) they are incidental to HB 1131's broader regulations of conduct, and (3) Appellants are constitutionally estopped from challenging those restrictions. Even if this Court finds that Sections 2307.006(3), (4), (6), and (9) are subject to First Amendment scrutiny, this Court should conclude that those provisions are constitutional under *Central Hudson*.

ARGUMENT

I. STANDARD OF REVIEW.

“States are not required to convince the courts of the correctness of their legislative judgments . . .” *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456, 464 (1981). “[I]t is not the function of the courts to substitute their evaluation of legislative facts for that of the legislature.” *Id.* at 470. “[I]t is not [the Court’s]

function to weigh the policy arguments on either side of the [] debate . . .” *Greater New Orleans Broadcasting Association v. U.S.*, 527 U.S. 173, 186 (1999). Indeed, courts “are not at liberty to substitute [their] judgment for the reasonable conclusion of a legislative body.” *Turner Broadcasting Systems, Inc. v. Fed. Communications Commission*, 520 U.S. 180, 212 (1997). But Appellants plainly ask this Court to substitute its opinion for that of the Texas Legislature in determining whether auto liability insurers should be allowed to own collision repair facilities. The district court correctly rejected Appellants’ invitation to act as a super-legislature.

Contrary to Appellants’ argument on page 23 of their Brief, this Court does not sit to try this case anew on appeal. Instead, this Court reviews Appellants’ challenge to the district court’s decision upholding HB 1131 under the Commerce Clause using the traditional standard of review that findings of fact are reviewed for clear error, and conclusions of law are reviewed *de novo*. *Nat’l Solid Waste Mgmt. Ass’n. v. Pine Belt Reg’l. Solid Waste Mgmt. Auth.*, 389 F.3d 491, 497 (5th Cir. 2004).

Appellants erroneously rely upon *Parson v. Kaiser Aluminum & Cham. Corp.*, 575 F.2d 1374, 1382 (5th Cir. 1978), to argue that the district court’s findings of “nondiscrimination” are findings of “ultimate fact” subject to *de novo* review. (See Appellants’ Brief at 23). Appellants’ argument is wrong. In

Pullman-Standard v. Swint, the Supreme Court expressly rejected and overruled *Parson*. 456 U.S. 273, 285-90 & n.16 (1982).

This Court reviews *de novo* the question of whether the McCarran-Ferguson Act applies to HB 1131. See *Moore v. Liberty National Life Ins. Co.*, 267 F.3d 1209, 1220 (11th Cir. 2001). This Court's review of the district court's decision finding that portions of HB 1131's code of conduct violate the First Amendment is also *de novo*. See *White Buffalo Ventures, LLC v. University of Texas at Austin*, 420 F.3d 366, 374 (5th Cir. 2005); *Moore v. Morales*, 63 F.3d 358, 361 (5th Cir. 1995).

II. HB 1131 DOES NOT VIOLATE THE DORMANT COMMERCE CLAUSE.

“The commerce clause prevents state and local regulations that promote parochial interests by discriminating against interstate commerce.” *New Orleans Steamship Ass'n v. Plaquemines Port, Harbor, and Terminal Dist.*, 874 F.2d 1018, 1021 (5th Cir. 1989). The dormant Commerce Clause protects the interstate market, but does not protect any particular interstate firm or method of doing business. See *International Truck and Engine Corp. v. Bray*, 372 F.3d 717, 727-28 (5th Cir. 2004) (citing *Exxon Corp. v. Maryland*, 437 U.S. 117, 127-28 (1978)). Thus, Appellants are wrong to challenge HB 1131 under the dormant Commerce Clause based upon that law's impact on Allstate's ability to own Sterling shops in Texas. HB 1131 is even-handed, non-discriminatory legislation that does not violate the dormant

Commerce Clause. Appellants did not meet their burden to show that HB 1131 is unconstitutional. *See Am. Target Adver., Inc. v. Giani*, 199 F.3d 1241, 1254 (10th Cir. 2000); *E. Ky. Res. v. The Fiscal Court of Magoffin County, Ky.*, 127 F.3d 532, 545 (6th Cir. 1997); *USA Recycling, Inc.*, 66 F.3d at 1281-1282 (citing *Hughes v. Oklahoma*, 441 U.S. 322, 336 (1979)).

A. Appellants Misconstrue the Test to Determine Whether a Law is Discriminatory under the Dormant Commerce Clause.

The proper analysis of a dormant Commerce Clause challenge begins by analyzing whether the law in question discriminates against interstate commerce. Laws that discriminate against interstate commerce are virtually *per se* invalid. *See Oregon Waste Systems, Inc. v. Dept. of Environmental Quality*, 511 U.S. 93, 99 (1994). But state statutes that regulate even-handedly are reviewed under the lower level of scrutiny known as the *Pike* balancing test:

Where the statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits.

Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970).

A statute is considered to be even-handed when it is “both facially neutral and treats interstate and intrastate interests equally.” *Pelican Chapter, Associated Builders & Contractors, Inc. v. Edwards*, 128 F.3d 910, 918 (5th Cir. 1997). This Court further explains:

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

Ford Motor Co. v. Texas Dept. of Transp., 264 F.3d 493, 501 (5th Cir. 2001); *See Int'l Truck and Engine Corp.*, 372 F.3d at 725 (same).

HB 1131 is an even-handed regulation. It applies to all insurance companies licensed to sell motor vehicle insurance in Texas, regardless of the location of their principal office. It prohibits insurance companies from acquiring interests in all collision repair shops, regardless whether the shops are local or part of nationwide chains. HB 1131 is a vertical integration restriction that does not discriminate between similarly-situated entities. It is analogous to the laws upheld as constitutional in *Exxon v. Maryland*, 437 U.S. 117, 125 (1978); *LensCrafters v. Robinson*, 403 F.3d 798, 802-07 (6th Cir. 2005); *International Truck and Engine Corp. v. Bray*, 372 F.3d 717, 725-26 (5th Cir. 2004); *Ford Motor Co. v. Tex. Dept. of Transp.*, 264 F.3d 493, 499-502 (5th Cir. 2001); *Ford Motor Co. v. Ins. Comm'r*, 874 F.2d 926, 942-943 (3d Cir. 1989); and *S.A. Discount Liquor, Inc. v. Tex. Alcohol Beverage Commission*, 709 F.2d 291, 292-94 (5th Cir. 1983). None of

those challenged vertical integration restrictions were subjected to strict scrutiny.⁹

Accordingly, this case should be analyzed under the *Pike* balancing test.

B. HB 1131’s Purpose Is To Regulate Insurance Companies, and Not to Discriminate Against Interstate Commerce.

HB 1131 is a classic vertical integration restriction targeted at a business model that the Texas Legislature found to be harmful to consumers and to competition.¹⁰ Appellants failed to show that HB 1131 has a discriminatory purpose that would justify strict scrutiny of the law. Appellants cannot establish a discriminatory purpose based upon their selective citation of the legislative record, and their selective discussion of facts regarding the makeup of the collision repair market.¹¹

⁹ This case is different than *Lewis v. BT Investment Managers, Inc.*, 447 U.S. 27 (1983). In *Lewis*, the Court addressed a Florida law prohibiting *only* out-of-state banks, holding companies, and investment companies from vertically integrating into the investment advisory services market. *Id.* at 42. Although the Court ultimately found it unnecessary to apply strict scrutiny to the law, the Court relied heavily on the disparate treatment of in-state and out-of-state interests that appeared on the face of the statute when striking the law under the *Pike* balancing test. *Id.* at 42-44.

¹⁰ *South Dakota Farm Bureau, Inc. v. Hazeltine*, 340 F.3d 583 (8th Cir. 2003) is distinguishable from the present case because unlike here, there was an extensive record in *Hazeltine* to establish purposeful discrimination, and there was a complete absence of evidence to support the legitimate governmental purposes allegedly furthered by the challenged South Dakota law. *Id.* at 593-96.

¹¹ On page 27 of their Brief, Appellants argue that the State attempted to justify HB 1131 as necessary to “level the playing field” and to “save an industry from collapse.” But, the authority Appellants cite on this point is not even part of

As explained on pages 12-16 above, Appellants mischaracterize isolated statements from Texas legislators to concoct an appearance of discrimination where none actually exists. Appellants run afoul of the established rule that “[t]he remarks of a single legislator, even the sponsor, are not controlling.” *Chrysler Corp. v. Brown*, 441 U.S. 281, 311 (1979). See also *Clover Leaf Creamery Co.*, 449 U.S. at 471 n.15 & 463 n.7 (the Court “will not invalidate a state statute under the Equal Protection Clause merely because some legislators sought to obtain votes for the measure on the basis of its beneficial side effects on state industry”).

As explained on pages 2-6 above, Appellants also ignore the evidence (that was accepted by the district court) showing that there are significant interstate competitors in the Texas collision repair industry. Viewed in context, the only logical conclusion from the evidence is that HB 1131 is directed at one business model (insurer-owned shops), not at interstate competition. The dormant Commerce Clause does not prohibit states from enacting legislation to regulate a particular business structure or model. See *International Truck and Engine Corp.*,

the district court’s Commerce Clause analysis. Instead in CoL ¶80, the district court stated the unremarkable point that the State justified HB 1131’s *code of conduct* by arguing that restrictions on the Allstate-Sterling relationship were needed to prevent them from capitalizing upon conflicts of interest and anticompetitive conduct if the State was going to adopt a grandfathering provision for Appellants’ benefit. The State never claimed that collision repair industry needed to be “saved” from “collapse.”

372 F.3d at 727-28 (citing *Exxon Corp.*, 437 U.S. at 127-28). Appellants concede this point. (See Appellants' Brief at 29).

That some of Sterling's competitors lobbied for the passage of HB 1131 is not proof of an unlawful discriminatory purpose. See *LensCrafters, Inc.*, 403 F.3d at 803. Indeed, as explained above, proponents of HB 1131 included both local repair shops and shops owned by major interstate corporations. [5 Tr. 136:21-137:19].

Appellants cannot convert HB 1131 into discriminatory legislation by anointing Sterling as the "most competitively-significant" interstate competitor in Texas. Appellants' claim is puffery. The evidence showed that Sterling was not very successful. More important, the evidence established that Appellants engaged in the types of conduct that motivated the Legislature to enact HB 1131 in the first place. See pages 16-17 above. The fact that it was Allstate (with a home office in Illinois) that first engaged in this harmful conduct, rather than a Texas-based insurer (such as USAA or Allstate's own Texas county mutual) should not matter to the analysis. The State's ability to enact legislation to address a perceived harm does not depend upon the location of the party that first engaged in conduct the Legislature wants to control. Legislatures do not need to wait for a crisis to develop before taking actions to legislate against harmful conduct. See *Turner Broadcasting Systems, Inc.*, 520 U.S. at 212; see also *Ashcroft v. Free Speech*

Coalition, 535 U.S. 234, 264 (2002) (“this Court’s cases do not require Congress to wait for harm to occur before it can legislate against it.”); *U.S. v. Sage*, 906 F. Supp. 84, 91 (D. Conn. 1995) (“Congress need not wait until a national problem reaches crisis proportions in order to act.”).

C. HB 1131 Does Not Have a Discriminatory Effect on Interstate Commerce.

Appellants also failed to show that HB 1131 has a discriminatory effect. Appellants’ discriminatory effects arguments are based on a *footnote* to the Supreme Court’s opinion in *Exxon v. Maryland*, 437 U.S. at 126 n.16.¹² (See Appellants’ Brief at 20, 23, 24, & 40). Footnote 16 provides:

If the effect of a state regulation is to cause local goods to constitute a larger share, and goods with an out-of-state source to constitute a smaller share, of the total sales in the market, the regulation *may* have a discriminatory effect on interstate commerce.

Exxon, 437 U.S. at 126 n.16 (emphasis added) (internal citations omitted).

Appellants do not quote the entire footnote, and they omit the permissive word “may” from the unprecedented test they attempt to fashion from this footnote (and

¹² Appellants’ attempt to craft broad principles of constitutional law from footnotes is not limited to *Exxon*. On page 39 of their Brief, Appellants argue that “the Dormant Commerce Clause bars any law that ‘increases the market share of local producers or . . . mitigates a projected decline.’” (citing *West Lynn Creamery v. Healy*, 512 U.S. 186 196 n.12 (1994)). Of course, the Supreme Court did not make such a sweeping pronouncement in footnote 12. The Court simply stated that it would treat a law designed to increase the market share of local producers the same as it would treat a law designed to mitigate an anticipated decline in the local producers’ market share.

the footnote alone). Contrary to Appellants' argument, heightened scrutiny does not apply any time that a party shows that a law may cause *some* business to shift from an interstate provider to a local provider of goods or services. In the text of *Exxon*, the Court writes: “[t]he fact that the burden of a state regulation falls on some interstate companies does not, by itself, establish a claim of discrimination against interstate commerce.” *Exxon*, 437 U.S. at 126. *See also McNeilus Truck & Mfg, Inc. v. Ohio*, 226 F.3d 429, 443 (6th Cir. 2000) (“The fact that the burden is borne predominately by one out-of-state firm matters not at all.”).

Appellants' arguments show nothing more than a possibility that HB 1131 might result in business shifting from Sterling to other competitors, some of whom are in-state, others who operate interstate. But, “[t]he fact that a regulation causes some business to shift from one supplier to another does not mean that the regulation burdens commerce; the dormant Commerce Clause ‘protects the interstate market, not particular interstate firms.’” *Int’l Truck and Engine Corp.*, 372 F.3d at 727 (quoting *Exxon*, 437 U.S. at 127-128.)

Appellants did not produce any persuasive evidence to show where its claimed lost business would go.¹³ Moreover, Appellants do not address a critical

¹³ Instead of producing actual evidence regarding the collision repair market, Appellants relied at trial on an assumption that the market is made up of predominately local firms. As discussed on pages 2-6 above, that assumption is not supported by the evidence. Accordingly, the district court did not apply a “prediction with precision test” such as Appellants contend. Instead, the district

fallacy in their argument regarding “business shifting.” Sterling continued to operate its grandfathered shops in Texas after HB 1131. If Sterling competes fairly and does high quality work as it claims, it should not have lost business to any other competitors. To the extent that Appellants complain that HB 1131 prevents Sterling from expanding further in Texas, this is still not a burden on interstate commerce. HB 1131’s restrictions apply equally to Texas-based insurers who may have wanted to open or acquire collision repair shops. There is nothing in HB 1131 that prevents other interstate collision repair chains from expanding in or into Texas, so long as they are not owned by an insurance company. There is no discrimination against interstate commerce here.

D. Appellants Attempt to Obtain a Strict Scrutiny Review of HB 1131 Based on Cases that Do Not Apply.

Throughout their briefing, Appellants invoke authorities from other courts that have no application here. There is not enough space in this brief to address every case cited. Accordingly, this section focuses on the cases most frequently relied upon by Appellants, to the extent that those cases are not already addressed above. This case is not even remotely analogous to *Bacchus Imports Ltd. v. Dias*, 468 U.S. 263 (1984), *West Lynn Creamery, Inc.*, 512 U.S. 186; *Hunt v. Washington State Apple Advertising Commission*, 432 U.S. 333 (1977), *McNeilus*,

court refused to allow Appellants to rely upon unsupported assumptions to meet their burden to prove that HB 1131 was discriminatory.

226 F.3d at 443; *Cloverland-Green Spring Dairies, Inc. v. Pennsylvania Milk Marketing Bd*, 298 F.3d 201 (3d Cir. 2002); or *Walgreen Co. v. Rullen*, 405 F.3d 50 (1st Cir. 2005).

Bacchus Imports and *West Lynn Creamery* involved attempts to tax out-of-state competitors to provide an advantage to in-state competitors, thereby lowering the relative costs of only in-state goods. In *Bacchus Imports*, Hawaii taxed the sale of alcohol, but exempted pineapple wine and okolehao liquor, which are native to Hawaii. 468 U.S. at 269-73. In *West Lynn Creamery*, Massachusetts taxed all dairy products sold by dealers to fund a subsidy paid exclusively to in-state dairy farmers that lowered the cost to produce milk only in Massachusetts. 512 U.S. at 188-91. This case does not involve subsidies for in-state goods or producers by taxing out-of-state competitors.

Hunt involved the sale of apples across state lines. North Carolina required out-of-state sellers to change their labels and to remove labeling that identified the out-of-state apples as higher quality than North Carolina apples. 432 U.S. at 349-352. Those regulations impeded the flow of goods across state lines, thereby discriminating against interstate commerce. *Id.* *Hunt* was not a vertical integration case. The present case does not involve a sale of goods across state lines.

Cloverland-Green Spring Dairies involved a Pennsylvania law imposing minimum wholesale price floors on milk sales that prohibited wholesalers from

selling milk at a lower price, regardless of their competitive position. 298 F.3d at 213-14. The Court was concerned that the law overly burdened interstate commerce by making it harder for out-of-state suppliers to compete for business in Pennsylvania based on price. *Id.* Interestingly, though, the Court did not strike the law as unconstitutional. Instead, the Court found that there were genuine issues of material fact that required development at trial. *Id.* at 219.

Following a trial on the merits, the Third Circuit revisited its dormant Commerce Clause analysis, and concluded that the Pennsylvania law was constitutional. *Cloverland-Green Spring Dairies, Inc. v. Pennsylvania Milk Marketing Board*, ___ F.3d ___, 2006 WL 2521188 (3d Cir. Sept. 1, 2006) ("*Cloverland II*"). The Court rejected the plaintiffs' claim that a law is always discriminatory under the Commerce Clause if it has the effect of eliminating a competitive advantage that an out-of-state firm may have had over in-state competitors. *Id.* at *11-13. The Court explained that for strict scrutiny to apply, the law must have eliminated a competitive advantage that existed for an out-of-state firm based on its place of origin. *Id.* Here, Appellants complain about the elimination of an unfair competitive advantage that exists based on Allstate's status as a liability insurer. That advantage does not depend on Appellants' status as interstate competitors. Accordingly, *Cloverland II* supports the district court's decision upholding HB 1131 against a dormant Commerce Clause challenge.

McNeilus involved an Ohio law that placed a burden that was substantially more onerous for out-of-state entities to meet than it was for in-state entities. 226 F.3d at 442. *McNeilus* dealt with an Ohio licensing scheme that had a discriminatory effect on out-of-state truck re-manufacturers because it required them to obtain binding service agreements for their customers from unwilling in-state dealers. *Id.* Although the licensing scheme applied to both in-state and out-of-state truck re-manufacturers, the discriminatory effect was that in-state dealers would only enter into agreements with in-state re-manufacturers because they were more likely to purchase truck chassis from Ohio dealers. *Id.* The Court found that the in-state dealers and re-manufacturers benefited from the Ohio statute to the exclusion of out-of-state re-manufacturers. *Id.* This discriminatory effect is what made the Ohio statute constitutionally infirm. HB 1131 is not similar to the licensing scheme in *McNeilus*.

Walgreen involved access to the pharmacy market in Puerto Rico. The Court found that a Puerto Rico law requiring new entrants to the market to obtain a “certificate of need” before opening a pharmacy violated the dormant Commerce Clause. 405 F.3d at 52-60. The Court’s ruling is based upon the fact that existing pharmacies were exempted by the law, 92% of those existing pharmacies were local, and they were given a right to object to new entrants. *Id.* at 55-56. The Court also found that out-of-state applicants seeking to open pharmacies were

much more likely than in-state applicants to have to go through a long administrative review process and were more likely to have their applications denied. *Id.* at 56. Unlike the law at issue in *Walgreen*, HB 1131 does not control access to the collision repair market for all new entrants. HB 1131 targets only insurer-owned shops. Moreover, unlike Appellants, the plaintiffs claiming discrimination in *Walgreen* offered a 22 year statistical study to meet their burden to show discrimination. No such evidence exists in this case.

E. HB 1131 Is Valid Under the *Pike* Balancing Test.

The district court correctly found that HB 1131 is valid under the *Pike* balancing test. HB 1131’s benefits outweigh any burdens that it may place upon interstate commerce.

Appellants challenge the district court’s decision by focusing only on the burdens allegedly placed upon Allstate and Sterling. But the proper analysis requires the Court to focus on the burdens, if any, placed upon *interstate commerce*.¹⁴ *See Pike*, 397 U.S. at 142. Appellants failed to show any recognized burden on interstate commerce that will support a dormant Commerce Clause challenge:

¹⁴ On page 53 of their Brief, Appellants quote *Oregon Waste Sys.*, 511 U.S. at 93, for the proposition that: “nondiscriminatory regulations that have only incidental effects on interstate commerce are valid unless the burden . . . is clearly excessive . . .” under *Pike*. The actual quote from page 93 addresses the “burden on interstate commerce,” and not just “burdens” in general. *See* 511 U.S. at 93. Moreover, that quote is from the syllabus, not the Court’s opinion.

- Appellants offered no evidence to show that HB 1131 impacts the flow of goods in interstate commerce.
- Appellants do not claim that HB 1131 has extraterritorial effects preventing Allstate from acquiring or expanding Sterling shops in other states— Appellants admit that they made a voluntary decision to alter their expansion plans because they feared other states would agree with Texas that insurer-owned shops are bad for consumers. (*See* Appellants’ Brief at 61).
- The only burden allegedly created is one preventing insurance companies from owning collision repair facilities. But, both the Supreme Court and this Court have found that the elimination of alleged benefits from vertical integration are immaterial to the Court’s Commerce Clause inquiry. *See Exxon*, 437 U.S. at 128; *Ford Motor Co.*, 264 F.3d at 503.

Under the facts of this case, then, Appellants’ inability to show a discriminatory burden on interstate commerce is fatal to their dormant Commerce Clause challenge, even under the *Pike* test. *See Wood Marine Serv., Inc. v. City of Harahan*, 858 F.2d 1061, 1065 (5th Cir. 1988); *see also Ford Motor Co. v. Ins. Commissioner*, 874 F.2d at 942 (“[L]egislation will not be invalidated under the *Pike* test in the absence of *discriminatory* burdens on interstate commerce.”).

Even if the Court believed that HB 1131 burdened interstate commerce, Appellants failed to show the alleged burden “clearly outweighs” the benefits of HB 1131. *See Pike*, 397 U.S. at 142. The State has a legitimate interest in prohibiting vertical integrations that lead to conflicts of interest, anti-competitive conduct, and anti-consumer conduct. *See Lewis*, 447 U.S. at 43 (“Discouraging economic concentrations and protecting the citizenry against fraud are undoubtedly legitimate state interests.”); *Ford Motor Co.*, 264 F.3d at 503 (Texas had legitimate

interests in preventing auto manufacturers from vertically integrating and taking advantage of their market position and in “preventing fraud, unfair practices, discrimination, impositions and other abuses”); *Int’l Truck and Engine Corp.*, 372 F.3d at 728 (same). The evidence supporting the district court’s findings that HB 1131 serves legitimate state interests is discussed on pages 7-12 above. Accordingly, HB 1131 bears a reasonable relationship to the State’s interests, and, therefore, any claim by Appellants to the contrary must fail. *See Exxon*, 437 U.S. at 124-25 (“Regardless of the ultimate economic efficacy of the statute, we have no hesitancy in concluding that it bears a reasonable relation to the State’s legitimate purpose...”). Appellants’ *Pike* balancing arguments reduce to an impermissible attack on the wisdom and efficacy of the Legislature’s decision to enact HB 1131. *See Ferguson v. Skupra*, 372 U.S. 726, 729 (1963) (“Under the system of government created by our Constitution, it is up to legislatures, not courts, to decide on the wisdom and utility of legislation.”).

Appellants’ suggestion that the Legislature should have adopted less restrictive alternatives is unfounded.¹⁵ The Legislature chose to enact HB 1131

¹⁵ As enacted, HB 1131 is a less restrictive alternative than originally proposed. Because of Appellants’ efforts, the Legislature adopted a grandfathering provision that provided benefits to Allstate and Sterling. After obtaining a less restrictive statute, Appellants immediately filed suit and obtained an injunction against portions of the grandfathering provision that were intended to be the lesser alternative to an outright prohibition.

because it found that existing laws did not adequately protect consumers and the market from the dangers of vertical integration and insurer-owned shops. There is no constitutional prohibition to prevent the Legislature from adopting new laws to address a new problem.

HB 1131 is constitutional under the *Pike* test.

III. THE MCCARRAN-FERGUSON ACT BARS APPELLANTS' DORMANT COMMERCE CLAUSE CHALLENGE.

A. The District Court Employed an Incorrect Legal Standard to Analyze the Impact of the McCarran-Ferguson Act on this Case.

The district court's judgment rejecting Appellants' dormant Commerce Clause challenge to HB 1131 should be affirmed for the additional reason that Section 2(a) of the McCarran-Ferguson Act (the "Act") precludes Appellants' claim.¹⁶ Section 2(a) states:

The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.

15 U.S.C. §1012(a). Section 2(a) immunizes state laws that relate to regulation of the business of insurance from challenge under the Commerce Clause, whether

¹⁶Appellees may defend the district court's judgment on any ground in the record, including one rejected by the lower court. *See, e.g., Hoyt R. Matisse Co. v. Zurn*, 754 F.2d 560, 565 n.5 (5th Cir. 1985). Appellees moved for a judgment as a matter of law at the close of Plaintiffs' case based on the Act, but the district court denied Appellees' motion. [4 Tr.191:15-193:25]. Appellees renewed that motion at the close of evidence both in court, and by written submission. [6 Tr.155:6-157:17; R9:2140].

dormant or exercised. *American Ins. Ass'n v. Garamendi*, 539 U.S. 396, 428 (2003).¹⁷ The Act declares that “uniformity of regulation . . . [is] not required in reference to the business of insurance by the national public interest . . .” *Benjamin*, 323 U.S. at 431.

The district court erred by concluding that the Act does not protect HB 1131 from Allstate’s dormant Commerce Clause attack. [See CoL ¶¶3-17]. The district court’s analysis focused narrowly on Supreme Court opinions addressing a *different* section of the Act—specifically the limited exemption from federal antitrust laws found in the proviso at the end of Section 2(b), 15 U.S.C. §1012(b).¹⁸ In the Supreme Court decisions on which the district court relied, *Pireno*¹⁹ and *Royal Drug*,²⁰ private service providers sued insurance companies for conspiring through private agreements to violate federal antitrust laws. In those antitrust

¹⁷*Accord, Department of Treasury v. Fabe*, 508 U.S. 491, 500 (1993); *Prudential Ins. Co. v. Benjamin*, 328 U.S. 408, 429-30 (1946). Section 1 of the Act expressly addresses the dormant Commerce Clause, stating “. . . silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of the [business of insurance] by the several States.” 15 U.S.C. § 1011. The Supreme Court explains that Congress “clearly put the full weight of its power behind existing and future state legislation to sustain it from any attack under the commerce clause . . .” *Benjamin*, 328 U.S. at 431.

¹⁸The proviso says: “Provided, That after June 30, 1948, the [Sherman Act] and the [Federal Trade Commission Act] shall be applicable to the business of insurance to the extent that such business is not regulated by State law.”

¹⁹*Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982).

²⁰*Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205 (1979).

cases, the Court interpreted the phrase “business of insurance” in Section 2(b) narrowly in accordance with the rule disfavoring expansive interpretations of antitrust exemptions. *See Pireno*, 458 U.S. at 126; J. Macey & G. Miller, *The McCarran-Ferguson Act of 1945: Reconceiving the Federal Role in Insurance Regulation*, 68 N.Y.U. L. REV. 13, 22 (1993). The broad grant of authority in Section 2(a) for states to enact laws that “relate to the regulation of the business of insurance” is not narrowly circumscribed.

The district court’s analysis overlooked the teaching of *Fabe*, which held the *Pireno/Royal Drug* considerations²¹ for defining the “narrowly circumscribed” antitrust exemption in Section 2(b) do not confine the scope of state regulatory power under the “reverse preemption” in the first part of Section 2(b). *Fabe*, 508 U.S. at 504. Focusing on the statutory language, the Court wrote that “[t]o equate laws ‘enacted for the purpose of regulating the business of insurance’ [the language of the reverse preemption in Section 2(b)], with the ‘business of insurance’ itself [the language of the antitrust exemption] . . . would be to read words out of the statute.” *Id.* It is even more certain after *Fabe* that the language

²¹The Supreme Court has described the *Pireno/Royal Drug* factors as merely “considerations [to be] weighed” in determining whether a state law regulates insurance. *UNUM Life Ins. Co. v. Ward*, 526 U.S. 358, 373-75 (1999).

in Section 2(a) of the Act, which is “laws . . . which *relate to* the regulation of the business of insurance,” must be read more broadly than the antitrust exemption.²²

This appeal does not involve even an asserted conflict with a federal statute that would require analysis under the reverse preemption provision of Section 2(b). Allstate asserts only that the dormant Commerce Clause invalidates HB 1131. Thus, this appeal falls within the zenith of the State’s authority to legislate under the Act—Section 2(a)—in which Congress stated the dormant Commerce Clause does not restrict state laws that relate to regulation of the business of insurance.

The Supreme Court has not prescribed a test for Section 2(a) except to say in a similar context that the statutory language, “which relate to,” found in Section 2(a) means “if it has a connection with or reference to” the subject that follows, which here is regulation of the business of insurance. *See Pilot Life Ins. Co. v. Dedeaux*, 481 U.S. 41, 47-48 (1987). Section 2(a) certainly cannot be any more constrained than the test the Supreme Court crafted in *Fabe* for the reverse preemption of Section 2(b) of the Act. The *Fabe* Court wrote: “The broad

²²As the Seventh Circuit recently wrote: “The problem with [the *Pireno/Royal Drug*] approach is that it casts too small a net to capture all of the statutes that were ‘enacted . . . for the purpose of regulating the business of insurance.’ There will be cases where the regulated activity does not constitute the ‘business of insurance’ as that term is defined in *Pireno*, yet the statute that regulates the activity may have been enacted ‘for the purpose of regulating the business of insurance.’” *Autry v. Northwest Premium Serv., Inc.*, 144 F.3d 1037, 1041-42 (7th Cir. 1998).

category of laws enacted ‘for the purpose of regulating the business of insurance’ consists of laws that possess the ‘end, intention, or aim’ of adjusting, managing or controlling the business of insurance.” *Fabe*, 508 U.S. at 505. Thus, it is correct to say that under Section 2(a), Congress gave states authority to enact laws “that have a connection or reference to” the “end, intention, or aim of adjusting, managing, or controlling the business of insurance,” without being restrained by the dormant Commerce Clause. As this Court has observed, “[t]he category of laws enacted ‘for the purpose of regulating the business of insurance’ is broad.” *Munich Am. Reins. Co. v. Crawford*, 141 F.3d 585, 590 (5th Cir. 1998).

HB 1131 is certainly such a law. HB 1131’s prohibitions apply to “insurers.” TEX. OCC. CODE §2307.002. The statute defines “insurer” to mean an insurer authorized by the Texas Department of Insurance to write motor vehicle insurance. *Id.* §23007.001(4). Arranging and paying for collision repairs is a major part of what automobile insurers do. Indeed, Appellants admit on page 6 of their Brief that “[c]ollision repair services are a core component of an insurer’s business.”

The trial court found that “insurance companies have the ability and market power to exert substantial influence and control over where its customer will take a wrecked car for repairs,” and that there is “an inherent conflict of interest between the insurance company’s desire to make a profit for its shareholders, and thus to

keep its costs of repair low, with the insurance company's obligation to provide its insured with a high quality and safe repair in accordance with the terms of its applicable insurance contracts." [FoF ¶¶8, 9]. HB 1131 addresses that conflict of interest not only for an insurer's own policyholders, but also for other persons whose vehicles were damaged in a collision for which the insurer's policyholder was at fault.

The "actual performance of an insurance contract is an essential part of the 'business of insurance.'" *Fabe*, 508 U.S. at 505. By enacting HB 1131, the Legislature identified and prohibited a conflict of interest that it reasonably believed would negatively affect the proper performance of insurer policy obligations. HB 1131 demonstrates that the Legislature also precluded insurer ownership of repair shops to preserve effective State regulation of insurers' rates. For insurer-owned facilities that were "grandfathered" under HB 1131, the Legislature prohibited the inclusion of "earnings or costs of a tied repair facility in a rate filing made under Chapter 5, Insurance Code." TEX. OCC. CODE §2307.006(13). Of course, there is no danger of the earnings or costs of a repair facility becoming intertwined with an insurer's regulated costs and profits if the insurer does not own a repair facility, which is the principal rule of HB 1131. *Id.* §2307.002(a).

In *Gilchrist v. State Farm Mut. Auto. Ins. Co.*, 390 F.3d 1327 (11th Cir. 2004), insurers, including Allstate (*id.* at 1329) convinced the Eleventh Circuit that the Act barred a consumer antitrust class action attacking insurers' arrangements with repair facilities that required use of non-OEM parts for repairing damaged vehicles. The court wrote that plaintiffs' claim that "Insurers used 'inferior, imitation crash parts' in the repair of their policyholders' vehicles . . . is an attack on how Insurers perform their contractual obligations to their policyholders." 390 F.3d at 1332. The court concluded that "repair of the insured's automobile, and the way in which it is repaired, are the obligation of Insurers under their policies of insurance," and are "the business of insurance." *Id.* at 1334. Accordingly, the Eleventh Circuit held the antitrust exemption in Section 2(b) of the Act barred the *Gilchrist* plaintiffs' claims.

Here, the State enacted HB 1131 to address, as the regulator, the same types of repair activities and practices and conflicts of interest plaintiff-consumers attacked in *Gilchrist*. The Eleventh Circuit accepted the insurers' defense in *Gilchrist* that such activities and practices constitute "the business of insurance" within the Act's narrow antitrust exemption.²³ Texas enacted HB 1131, as a

²³In *Arroyo-Melechio v. Puerto-Rican American Ins. Co.*, 398 F.3d 56, 68-69 (1st Cir. 2005), the Court agreed that a consumer antitrust complaint challenging practices of imposing depreciation percentages on liability for repairs and requiring use of non-OEM parts addressed the "business of insurance" within the Act's antitrust exemption.

regulator, because the State thought such problems would be exacerbated by insurer-owned repair shops. That was within its authority to enact laws related to regulating, managing, and controlling the business of insurance under Section 2(a), free from challenge under the dormant Commerce Clause.

There also is guidance in *Kentucky Ass'n of Health Plans v. Miller*, 538 U.S. 329 (2003), which is the Court's recent "any willing provider" ("AWP") statute decision. A Kentucky statute prohibited health insurers from discriminating against any medical service provider willing to work within an insurer's provider network. *Id.* at 331-32. Health insurers made the same type of argument Allstate makes in this appeal, *i.e.*, that the Kentucky statute "will frustrate their efforts at cost and quality control, and will ultimately deny consumers the benefit of their cost-reducing arrangements with providers." *Id.* at 332. The insurers attacked the Kentucky statute as preempted by ERISA and not within the savings clause of the ERISA preemption statute excepting from the preemption "state law[s] which regulat[e] insurance" 29 U.S.C. §1144(a) & (b)(2)(A). The Supreme Court rejected the insurers' argument based on *Royal Drug* that the Kentucky AWP statute did not "regulate insurance" because it focused "on the relationship between an insurer and third party-providers." 538 U.S. at 337. The Court held that the statute "regulates" insurance by imposing conditions on the right to engage in the business of insurance in Kentucky. *Id.* at 338.

HB 1131 regulates the same subject matter as Kentucky’s AWP statute—the general structure of an insurer’s provider network. The Kentucky statute required health insurers to include all willing providers within their networks. The Texas statute regulates auto insurers’ repair shop networks by excluding insurer-owned shops. Accordingly, HB 1131 is a law that “relate[s] to the regulation” of the business of insurance within Section 2(a) of the Act.²⁴

B. Even Under the Analysis Used, The District Court Should Have Found Appellants’ Claim Is Barred by the Act.

As stated above, Intervenors believe the district court erred by using the *Pireno/Royal Drug* considerations to limit the State’s power under Section 2(a). To the extent those considerations continue after *Fabe* to inform the determination whether a state statute relates to regulation of the business of insurance under Section 2(a), Intervenors also suggest the district court failed properly to apply those considerations to HB 1131.

²⁴Citing the importance of an insurance agent within the insurer-insurance relationship, this Court has held that insurers’ contracts prohibiting insurance agents from having other employment are within the “business of insurance” under the Act. *Thompson v. New York Life Ins. Co.*, 644 F.2d 439, 444 (5th Cir. 1981). Appellants agree that like insurance agents, the collision repair process is an integral part of the insurer-insurance relationship. [See Appellants’ Brief at 6-7]. This Court also has held that the Act bars federal law suits attacking the state’s licensing of insurance agents. *Lawyer’s Realty Corp. v. Peninsular Title Ins. Co.*, 428 F.Supp. 1288 (E.D. La.), *aff’d on the basis of the district court opinion*, 550 F.2d 1035 (5th Cir. 1977).

As to the first factor, which the district court described as “transfer or spread of policyholder risk” [CoL ¶6-8], courts uniformly have concluded that state laws governing the *manner* in which insurers perform their contracts do affect policyholders’ risk. In *Fabe*, the Supreme Court wrote that “actual performance of an insurance contract falls within the ‘business of insurance.’” 508 U.S. at 503. In *Am. Bankers Ins. Co. v. Inman*, 436 F.3d 490, 492-94 (5th Cir. 2006), this Court held that a Mississippi statute prohibiting arbitration clauses in insurance policies affected policyholders’ risks because it subjected policy disputes to jury trial. HB 1131 affects the risks to which insurers’ policyholders and third party victims of automobile collisions are subject by preserving the role of a repair shop not owned by the insurer in the performance of the insurance contract. Texas reasonably believed that policyholders and third party victims would be subjected to greater risks of inferior and improper repairs because of the conflict of interest inherent in insurer-owned shops. In *Miller*, the Supreme Court held that Kentucky’s AWP statute substantially affected the “risk pooling arrangement between insurer and insured.” 538 U.S. at 338.

The second *Royal Drug/Pireno* factor is whether the practices at issue affect the insurer-insured relationship. [CoL ¶9-15]. HB 1131 was enacted to prevent abuses in the insurer-policyholder relationship arising from the conflict of interest presented by insurer-owned repair shops. [See FoF ¶¶8-11, 86-87, 99-105, 107].

HB 1131 is aimed at preventing abuses in the repair process, which Allstate agrees is integral to its policyholder relationships (Appellants' Brief at 6-8). Policyholders certainly have interests in how well insurers perform their repair obligations and in preserving the independent voice of a repair shop not owned by the insurer.

The final factor is whether the practice is limited to entities within the insurance industry. [CoL ¶¶16-17]. The prohibitions of HB 1131 are aimed at Texas-licensed auto insurers, not to any other type of entity. In *Miller*, the Supreme Court rejected the argument that Kentucky's AWP statute was not "specifically directed toward" insurers because it also had incidental effects on health care providers who contracted with, or wanted to contract with, insurers. *Id.* at 337-39. Similarly, HB 1131 regulates only insurers, even though it may also have the incidental effect of prohibiting repair shops from becoming owned by insurers.

The McCarran-Ferguson Act precludes Allstate's claim that the dormant Commerce Clause voids HB 1131. The district court's judgment sustaining HB 1131 from Allstate's Commerce Clause attack should also be sustained on that basis.

IV. HB 1131's CODE OF CONDUCT DOES NOT VIOLATE THE FIRST AMENDMENT.

The district court erred when it found four provisions in HB 1131's code of conduct violate the First Amendment. The challenged provisions provide:

An insurer may not . . .

(3) engage in a joint marketing program with its tied repair facilities;

(4) provide its tied repair facilities a recommendation, referral, description, advantage, or access to its policyholders or other beneficiaries under its insurance policies that is not provided on identical terms to other repair facilities with which the insurer has entered into a favored facilities agreement;

* * *

(6) allow a tied repair facility to use the insurer's name, trademark, tradename, brand, or logo in a manner different than that allowed for any other favored facility; [or]

* * *

(9) authorize or allow a person representing the insurer, whether an employee or an independent contractor, to recommend to a policyholder or other beneficiary under the insurance policy that the policyholder or other beneficiary obtain repairs at a tied repair facility, except to the same extent that the person recommends other repair facilities with whom the insurer has entered into a favored facility agreement[].

TEX. OCC. CODE §§2307.006(3), (4), (6), and (9). It is undisputed that those four provisions are commercial speech regulations that exist as part of the grandfathering provision allowing Allstate to retain its ownership interest in fifteen existing Sterling shops in Texas. The Legislature intended the code of conduct (including the four challenged provisions) to prevent Allstate and Sterling from

using their grandfathered shops to capitalize upon the conflict of interest and engage in the unfair competitive practices that motivated the Legislature to enact HB 1131 in the first place.

The district court erred by holding those four provisions to violate the First Amendment for the following reasons: (1) the challenged provisions are aimed at false and misleading commercial speech; (2) the challenged provisions are incidental to HB 1131's broader prohibition against conflicts-of-interest and anticompetitive conduct; (3) Appellants are constitutionally estopped from challenging the code of conduct; (4) the district court's reasoning suffers from a fatal internal inconsistency; and (5) the four provisions are valid under the *Central Hudson* test. This Court reviews the district court's determinations on these First Amendment issues *de novo*. See *White Buffalo Ventures*, 420 F.3d at 374; *Moore*, 63 F.3d at 361.

A. The Code of Conduct Regulates False and Misleading Commercial Speech.

False and misleading commercial speech is not protected by the First Amendment. See *Central Hudson Gas & Electric Corp. v. Public Serv. Comm'n of N.Y.*, 447 U.S. 557, 563-64 (1980); *Dial One of the Mid-South, Inc. v. BellSouth Telecomm., Inc.*, 269 F.3d 523, 526 (5th Cir. 2001). The Supreme Court explains:

[W]hen the particular content or method of the advertising suggests that it is inherently misleading, or when experience has proved that in fact such advertising

is subject to abuse, the States may impose appropriate restrictions. Misleading advertising may be prohibited entirely. But the States may not place an absolute prohibition on certain types of potentially misleading information, *e.g.*, a listing of areas of practice, if the information also may be presented in a way that is not deceptive. Thus, the Court in *Bates* suggested that the remedy in the first instance is not necessarily a prohibition but preferably a requirement of disclaimers or explanation.

In re R. M. J., 455 U.S. 191, 203 (1982). *See Joe Conte Toyota, Inc. v. La. Motor Vehicle Comm'n*, 24 F.3d 754, 756-57 (5th Cir. 1994) (inherently misleading or deceptive advertising was not subject to First Amendment protection); *U.S. v. Buttorff*, 761 F.2d 1056, 1066 (5th Cir. 1985) (“the First Amendment does not protect commercial speech which is inherently misleading or has proven to be subject to abuse . . .”)

By the time this Court reaches this First Amendment issue, the Court will already have seen (as the district court correctly did) that the Legislature enacted HB 1131 to eliminate a conflict of interest that exists when an automobile liability insurance company owns a collision repair facility, and to prevent insurers from engaging in anticompetitive conduct. The record shows the Legislature adopted the grandfathering provision and code of conduct to “stop[] the encroachment of this conflicted business environment while protecting the investment of insurance companies.” [PX9 at 3 (remarks of Sen. Carona when he opened debate on HB 1131 and its grandfathering provision)]. In a contemporaneous letter to Lt. Gov.

Dewhurst, Sen. Carona explained that HB 1131 had been revised to create a “Chinese Wall” “to eliminate the influence upon a tied repair facility by a parent insurance company and prevent the preferential treatment of a tied repair facility by an insurance company.” [PX34].

The Legislature had legitimate cause for concern — Allstate already had used false and misleading speech to direct business to Sterling. Allstate used its script and its influence to tell consumers that Sterling was “highly respected” and “exceptional,” [FoF ¶62], even though Allstate knew its statements were untrue.

The district court correctly recognized that “insurance companies have the ability and market power to exert substantial influence and control over where its customer will take a wrecked car for repairs.” [FoF ¶8]. According to Allstate’s own surveys, “an agent’s recommendation holds a lot of weight with customers,” and “[i]n many cases, the insurance company is the first point of contact for a customer after a collision.” [FoF ¶8]. Thus, Allstate knew it had the opportunity to direct customers to Sterling to generate additional profit, regardless whether that was in the customer’s best interest.

The district court found that Allstate capitalized on that opportunity at the expense of its customers:

Allstate placed its own financial interests in Sterling above those of its policyholders who often turned to Allstate for guidance and recommendations about where to take their vehicles for repair following an accident.

[FoF ¶85].

In May 2003, Allstate admitted that it had “hard evidence” of quality issues related to Sterling. Despite its awareness of these customer satisfaction and quality problems, Allstate continued to refer its policyholders to Sterling.

At trial, Allstate and Sterling attempted to downplay the impact of these quality issues, blaming the problems primarily on the brownfield stores, versus the newer greenfield stores. However, when promoting Sterling to customers, Allstate made no distinction between brownfield and greenfield stores and continued to refer customers to Sterling without regard to the quality and performance of the particular shop recommended.

[FoF ¶¶75-76]. “Allstate continued to refer its customers to Sterling” despite Allstate’s knowledge of the failing grades of many of Sterling’s Texas stores.

[FoF ¶¶94-95, 131]. At the time that Allstate was making preferential referrals to Sterling shops experiencing quality problems, Allstate even terminated its preferred relationship with independent repair shops within the “circle of death,” even if those shops had high customer approval ratings. [FoF ¶¶81-85].

Allstate’s promotion of Sterling was false and misleading in other ways too, including:

- Allstate told customers that most repair shops only provided a limited guarantee on their work, but failed to mention that PRO shops have the same guarantee as Sterling shops. [3 Tr. 51:3-52:25; 5 Tr. 66:7-67:3; DX232].
- Allstate did not tell customers that Allstate held PRO shops to a different, higher standard for technician training. [Brask Dep. 203:6-21; DX95]. Allstate required PRO shops to achieve I-CAR Gold status. [5 Tr. 68:11-70:19, 192:3-17; DX221; DX320]. Sterling facilities had not achieved ICAR Gold status. [2 Tr.100:13-101:4].

- Allstate even created delays and barriers to customers who wished to use repair shops other than Sterling, just to make the Sterling option more attractive. [PX546 at ¶6; PX551 at ¶6].

In light of the specific evidence and factual findings of false, misleading, and deceptive commercial speech to promote Sterling, this Court should reject the district court’s legal conclusion that Appellants’ speech was not false and misleading. [See FoF ¶¶71, CoL ¶64]. Appellants’ false and misleading commercial speech is not protected by the First Amendment and thus could be freely regulated by the Legislature. *See Central Hudson*, 447 U.S. at 563-64 (“The government may ban forms of communication more likely to deceive the public than to inform it. . .”). The four challenged provisions in the code of conduct, TEX. OCC. CODE §§2307.006(3), (4), (6), and (9), prevent Allstate from using deception to generate business for Sterling.

Sections 2307.006(4) & (9) curtail the use of false and misleading recommendations to generate business for Sterling. Under Sections 2307.006(4) & (9), Allstate is required to treat Sterling and its other “favored facilities” on identical terms for purposes of making recommendations and referrals.²⁵ Of course, Allstate has the right to establish the terms needed to obtain a referral. Sections 2307.006(4) & (9) simply prevent Allstate from recommending Sterling over other repair shops solely on the basis of Allstate’s ownership interest in

²⁵ A “favored facility” refers to a repair shop that Allstate has selected on its own to receive referrals. *See* TEX. OCC. CODE §2307.001(3).

Sterling. Thus, nothing under Sections 2307.006(4) & (9) prevents Allstate from using objective criteria (such as customer satisfaction, repair quality, turn-around time, etc.) to determine which shops should be recommended. If Allstate complies with these provisions, customers will receive honest recommendations for repair shops. Allstate will no longer be able to provide misleading recommendations to bolster its failing Sterling facilities.

Similarly, Sections 2307.006(3) & (6) prevent Appellants from doing indirectly (through joint marketing programs and the use of Allstate's trademarks and logos) what they cannot do directly under the other provisions in the code of conduct. Allstate cannot use its name and influence with customers to make them believe that Sterling is a high quality repair shop when it is not.

Notably, nothing in the code of conduct prohibits Sterling from conducting its own advertising to inform customers about its services. Moreover, nothing in the code of conduct prohibits Allstate from making recommendations to Sterling based upon its quality and performance. The challenged provisions of the code of conduct are simply directed to stop false and misleading speech.

B. The Code of Conduct Places Incidental Regulations on Speech as Part of the Broader Prohibition Against Conflicts of Interest and Anticompetitive Conduct.

TEX. OCC. CODE §§2307.006(3), (4), (6), and (9) are also valid and immune from First Amendment scrutiny because those provisions are incidental regulations

that enforce the Legislature’s broader goals under HB 1131. “[T]he State does not lose its power to regulate commercial activity deemed harmful to the public whenever speech is a component of that activity.” *Ohralik v. Ohio State Bar Ass’n*, 436 U.S. 447, 456 (1978). Accordingly, the First Amendment does not prohibit a state from enacting otherwise valid economic regulations simply because those regulations may prohibit some forms of commercial speech. *See Pittsburgh Press Co. v. Pittsburgh Comm’n on Human Relations*, 413 U.S. 376, 389 (1973); *Ford Motor Co.*, 264 F.3d at 506.

The district court erred when it concluded that: “§§2306.006(3), (4), (6), and (9)’s regulation of commercial speech is not incidental to the regulation of unlawful commercial activity.”²⁶ [CoL ¶70]. The district court’s conclusion is based on a comparison of the challenged regulations to the question whether Allstate could continue to own and operate its Sterling facilities. [CoL ¶70]. The true issue, though, is whether Sections 2307.006(3), (4), (6), and (9) were incidental to HB 1131’s broader goal to stop insurance companies from capitalizing upon conflicts of interest and engaging in anti-competitive conduct by vertically integrating into the collision repair industry.

²⁶ The district court’s opinion refers the HB 1131 as being codified at Chapter 2306 of the Texas Occupations Code. HB 1131 has since been moved to Chapter 2307.

“Unlawful conduct” occurs under HB 1131 when an insurance company uses its influence and control to gain preferential treatment for a tied collision repair facility. Under TEX. OCC. CODE §2307.002(b), (c), and (d), an insurance company may continue to own a tied repair facility “only if the insurer and the tied repair facility are otherwise in compliance with this chapter.” That Chapter continues by providing that: “an agreement between an insurer and its tied repair facility must be negotiated and executed as an arm’s length transaction.”²⁷ *Id.* §2307.007. “‘Arm’s length transaction’ means the standard of conduct under which two parties having substantially equal bargaining power, each acting in its own interest, would negotiate or carry out a particular transaction.” *Id.* §2307.001(1).

HB 1131 continues by explaining that an insurer that wants to continue to own a tied repair facility “may use only one favored facility agreement.” *Id.* §2307.004(a). A “favored facilities agreement” is the agreement between the insurer and the repair facility that governs recommendations and the use of influence over policyholders to encourage them to use a particular repair facility. *Id.* §2307.001(3). “Except as otherwise provided by this subsection, the terms under which the insurer enters into a favored facility agreement must be identical

²⁷ Section 2307.007 is a section labeled: “Conflict of Interest Prohibited.” *See* TEX. OCC. CODE §2307.007. That heading was adopted by the Legislature when it enacted HB 1131. [PX1 at 6].

for all repair facilities, including a tied repair facility.” *Id.* §2307.004(b). Appellants do not challenge these regulations of conduct under the First Amendment.

Taken together, these provisions confirm that the Legislature intended HB 1131 (including its code of conduct in Section 23007.006) to prohibit an insurer from giving preferential treatment to a tied repair facility. The enumerations of specific types of commercial speech that may not be used to give preferential treatment to a tied repair facility (such as the ban on joint marketing activity, preferred recommendations, the use of trademarks, etc.) is merely incidental to the broader regulation of conduct under HB 1131. Accordingly, TEX. OCC. CODE §§2307.006(3), (4), (6), and (9) are not subject to First Amendment scrutiny.

C. Appellants Are Constitutionally Estopped from Challenging HB 1131’s Code of Conduct.

The district court also erred when it rejected Appellees’ constitutional estoppel defense. “It is an elementary rule of constitutional law that one may not ‘retain the benefits of the Act while attacking the constitutionality of one of its important conditions’.” *Fahey v. Mallonee*, 332 U.S. 245, 255 (1947) (quoting *U.S. v. City and County of San Francisco*, 310 U.S. 16, 29 (1940)). “The Court will not pass upon the constitutionality of a statute at the instance of one who has availed himself of its benefits.” *Id.* (quoting *Ashwander v. Tenn. Valley Auth.*, 297 U.S. 288, 348 (1936) (Brandeis, J. concurring)). Courts apply constitutional

estoppel in part to protect legislative decisions and compromises. *See Medical Waste Assoc. Ltd. v. Mayor and City Council of Baltimore*, 966 F.2d 148, 152-53 (4th Cir. 1992).

Constitutional estoppel has been applied in many circumstances, including to prohibit a city from accepting a property grant from the United States while simultaneously seeking to remove the restrictions placed upon that grant, *U.S. v. City and County of San Francisco*, 310 U.S. 16 (1940); prohibiting a banking association from challenging limitations placed upon its rights that were part of the same statute that authorized the association's formation, *Fahey v. Mallonee*, 332 U.S. 245, 255-57 (1947); and prohibiting Pat Robertson from challenging the constitutionality of the Federal Election Commission when the FEC sought the return of matching funds from Robertson after he accepted of \$10 million in matching funds from the FEC, *Robertson v. FEC*, 45 F.3d 486, 489-90 (D.C. Cir. 1995).

This case is similar to *U.S. v. City and County of San Francisco*, 310 U.S. 16 (1940), in which San Francisco lobbied Congress to obtain lands in Yosemite National Park for the purpose of building the Hetch-Hetchy Reservoir to generate power for San Francisco. Congress agreed to provide that land to the City of San Francisco only on the condition that the City would not convey the right to sell power from Hetch-Hetchy to a private power company. *Id.* at 18-19. After the statute passed and the City had constructed the reservoir, the City attacked the provision

prohibiting the sale of power to private power companies as an unconstitutional invasion of its rights. *Id.* at 18. The Supreme Court rejected that attack, finding that the City could not challenge the conditions on the property grant after having submitted a brief to Congress to obtain that grant and having accepted the benefits of that grant. *Id.* at 29-30.

The Fourth Circuit's decision in *Medical Waste Assoc. Ltd.*, 966 F.2d 148, is also closely analogous to this case. In *Medical Waste*, the plaintiff lobbied the Baltimore City Council to obtain zoning approval for the conditional use of a medical incinerator in the city. *Id.* at 148-49. The city granted the zoning approval by enacting Ordinance 323, but limited the sources from which the plaintiff could accept waste. *Id.* at 149. The plaintiff accepted Ordinance 323's benefits, but later filed suit under the Commerce Clause to challenge the restrictions placed upon the zoning approval. *Id.* at 149-50. Under those facts, the Fourth Circuit found that the plaintiff was constitutionally estopped from challenging the restrictions because it accepted the benefits of Ordinance 323. *Id.* at 152-53. The Court recognized that the restrictions contained in that Ordinance were part of a political compromise that resulted in the Ordinance's passage. *Id.* The Court refused to undo the "legislative compromise." *Id.* at 152. The Court wrote: "this Court is inclined to find that [the plaintiff] must 'take the bitter with the sweet.'" *Id.* at 153.

Here, Allstate and Sterling must also take the bitter with the sweet. HB 1131

is compromise legislation that was enacted after extensive negotiations with Allstate and Sterling. [See 5 Tr.160:15-20; DX3 at 3-4; DX4 at 23; DX233]. The Legislature removed some language and prohibitions from HB 1131 at Appellants' request, and it included other language that Appellants proposed. [4 Tr.66:1-67:20]. The Legislature offered Allstate an option to avoid having to divest the Sterling shops it already owned in Texas so long as Allstate abided by HB 1131's code of conduct. See TEX. OCC. CODE §2307.002(b), (c), & (d). Avoiding divestiture of Sterling's Texas shops is a benefit that Allstate has accepted. [See 4 Tr. 58:22-58:25; DX24]. Under these circumstances, Allstate is estopped from seeking to keep the benefits from HB 1131's exception while challenging the conditions placed upon those benefits.

The district court rejected the State's and Intervenors' constitutional estoppel defense, however, explaining that constitutional estoppel applied only under circumstances in which the party to be estopped "owed its existence" to the law being challenged. [CoL ¶¶102-103]. The district court failed to recognize that the Allstate-Sterling relationship in Texas owed its continued existence to HB 1131's grandfathering provision. See TEX. OCC. CODE §2307.002(b).

D. The District Court's Reasoning Suffers from a Fatal Internal Inconsistency.

When the district court considered and rejected each of the State's and Intervenors' arguments to uphold TEX. OCC. CODE §§2307.006(3), (4), (6), and (9),

the court considered each argument in isolation. Upon reviewing the district court's conclusions as a whole, though, this Court should find that there is a fatal, internal inconsistency that mandates reversal of the district court's First Amendment ruling. More specifically, to avoid finding that Sections 2307.006(3), (4), (6), and (9) were incidental to otherwise unlawful conduct, the district court found that: "Allstate's ownership of the 15 Sterling autobody repair shops it currently operates in Texas is expressly made lawful under Tex. Occ. Code §2306.002(b)." [CoL ¶70]. But, to avoid a finding that constitutional estoppel barred Appellants' challenge, the district court had to find that: "[Appellants] are not 'creatures' of that statute and do not owe their existence to it." [CoL ¶103].

It is simply not possible for Appellants to rely upon HB 1131's grandfathering provision (reflected in Section 2307.002(b)) as their sole support for the continued lawful existence of the Allstate-Sterling relationship while simultaneously arguing that the Allstate-Sterling relationship does not "owe its existence" to that provision. This Court should correct the internal inconsistency in the district court's decision, and should conclude that TEX. OCC. CODE §§2307.006(3), (4), (6), and (9) do not violate the First Amendment.

E. The Code of Conduct Is Valid under *Central Hudson*.

For the preceding reasons, this Court should not even reach a *Central Hudson* analysis to conclude that TEX. OCC. CODE §§2307.006(3), (4), (6), and (9)

are constitutional. Even under *Central Hudson*, though, those provisions must be upheld. In *Central Hudson*, the Supreme Court explained:

In commercial speech cases, then, a four-part analysis has developed. At the outset, we must determine whether the expression is protected by the First Amendment. For commercial speech to come within that provision, it at least must concern lawful activity and not be misleading. Next, we ask whether the asserted governmental interest is substantial. If both inquiries yield positive answers, we must determine whether the regulation directly advances the governmental interest asserted, and whether it is not more extensive than is necessary to serve that interest.

447 U.S. at 566. When applying that test, the Court considers the effects of the regulatory scheme as a whole, and not just the commercial speech restriction in isolation. *Greater New Orleans Broad. Ass'n v. U.S.*, 527 U.S. 173, 192-93 (1999).

Here, the district court correctly found that the State has asserted legitimate state interests to support Sections 2307.006(3), (4), (6), and (9). [CoL ¶73 (citing *Ohralik*, 436 U.S. at 460, and *Ford*, 264 F.3d at 603)]. The Legislature adopted those provisions to protect consumers from a conflict of interest and to promote fair competition. The district court erred, however, when it found that Sections 2307.006(3), (4), (6), and (9) do not directly and materially advance the State's asserted interests, and were not narrowly tailored to achieve the State's interests. This Court must uphold Sections 2307.006(3), (4), (6), and (9) if the Court finds the

Central Hudson test satisfied for any one of the policy reasons offered in support of those provisions. *See White Buffalo Ventures LLC*, 420 F.3d at 378.

1. *TEX. OCC. CODE §§2307.006(3), (4), (6), and (9) Directly and Materially Advance the State's Interests.*

Given that HB 1131 was enacted to combat anticompetitive conduct and a conflict of interest, the district court should have found that Section 2307.006's commercial speech restrictions directly and materially advance those interests. The district court's analysis of this issue is based on the incorrect view that Sections 2307.006(3), (4), (6), and (9) suppress legitimate advertising and truthful speech. [CoL ¶¶74-83]. But, the Legislature was concerned with something else. The Legislature was concerned that Allstate would use its influence over policyholders and accident victims to steer customers to Sterling without regard to those consumers' best interests. In other words, the Legislature was concerned that Allstate would use its unique influence to recommend Sterling to persons in need of repair services regardless whether Sterling had incentives to cut corners and provided lower quality repairs. As shown above, Allstate engaged in the types of promotions the Legislature wanted to stop. There can be no question that prohibiting Allstate from giving preferential treatment to Sterling directly and materially advances the State's interests.

The district court's concern that Sections 2307.006(3), (4), (6), and (9) might

suppress truthful speech is unfounded. Nothing in those sections prohibits Sterling from advertising and informing consumers of its benefits. Moreover, nothing in those sections prohibits Allstate from disseminating truthful information about repair shop quality, or customer satisfactions. Sections 2307.006(3), (4), (6), and (9) simply prohibit Allstate from giving preferred treatment to Sterling based solely upon its financial stake in that company. If anything, Sections 2307.006(3), (4), (6), and (9) should result in more speech, not less, because those provisions should encourage Sterling to engage in its own marketing activities, and should encourage Allstate to provide more complete information to consumers regarding collision repair shops.

2. *TEX. OCC. CODE §§2307.006(3), (4), (6), and (9) Are Narrowly Tailored to Achieve the State's Interest.*

The district court also erred when it found that TEX. OCC. CODE §§2307.006(3), (4), (6), and (9) were not “narrowly tailored” to achieve the State’s interests. When determining whether commercial speech regulations meet the last prong of the *Central Hudson* analysis, the Court must assess whether there is a “reasonable fit” between the Legislature’s ends and the means chosen to achieve those ends. *Florida Bar v. Went for It, Inc.*, 515 U.S. 618, 632 (1995). The test is not a “least restrictive means test.” *Id.* Instead, the question is whether the means to achieve the Legislature’s interests are “narrowly tailored to achieve the desired objective.” *Id.* So long as the regulations are reasonable, courts “leave it to governmental decisionmakers to judge what manner of regulation may best be

employed.” *Board of Trustees of the State University of New York v. Fox*, 492 U.S. 469, 480 (1989). Here, the Texas Legislature’s regulations are reasonable and should be upheld.

Allstate’s one-on-one communication with its customers following an accident is particularly conducive to overreaching and abuse. The district court correctly found that customers place trust in insurers when seeking advice regarding where to take a vehicle for repairs. [FoF ¶8]. Thus, customers are susceptible to influence. Given that the communications between insurers and their customers occur in one-on-one situations, often over the phone, there is little opportunity for others to police those communications to correct any false statements. In fact, third parties (such as Sterling’s competitors who may want to set a customer straight regarding Sterling’s quality problems) are not likely to know what message Allstate is presenting to customers or even to whom the message is conveyed. The facts of the present case present a situation requiring regulation similar to that presented in *Ohralik*, 436 U.S. at 464-68. As in *Ohralik*, the Texas Legislature could not rely upon third parties to serve the State’s interests by correcting any false, misleading, or incomplete message conveyed by Allstate. Third parties are not likely to know the details of any communications between Allstate and its customers and, indeed, may not even know if or when such communications have occurred.

The Texas Legislature was not required to rely only on existing anti-steering

laws or the possibility of after-the-fact lawsuits as the medicine to address the Allstate-Sterling relationship. [See CoL. ¶¶78, 84, 86, 93]. The Legislature enacted HB 1131 because, *inter alia*, it believed that the State's current anti-steering laws were inadequate to address the problems created by the Allstate-Sterling relationship. [See FoF ¶¶103, 104]. The Legislature was also justified in believing that prophylactic regulations of harmful conduct are better than requiring consumers to risk injury and then endure years of litigation to address any wrongs that they have suffered.

HB 1131 imposes reasonable regulations upon the relationship between Allstate and Sterling. Sections 2307.006(3), (4), (6), and (9) do not violate the First Amendment.

V. INTERVENORS ADOPT THE STATE APPELLEES ARGUMENTS ON APPEAL.

Intervenors expressly adopt and incorporate the State Appellees arguments on appeal, as if fully set forth herein.

CONCLUSION

For the foregoing reasons, Intervenors-Appellees-Cross-Appellants request that this Court affirm the district court's decisions finding that HB 1131 does not violate the dormant Commerce Clause, and reverse the district court's decision striking TEX. OCC. CODE §§2307.006(3), (4), (6), and (9) under the First Amendment.

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CERTIFICATE OF COMPLIANCE

This brief complies with the type-volume limitations of Fed. R. App. P. 28.1(e)(2)(B) because this brief contains 15,925 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

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