**CALIFORNIA SUPREME COURT**

No. S167913

JERRY HILL et al.,
*Plaintiffs and Appellants,*

vs.

STATE FARM MUTUAL AUTOMOBILE INSURANCE COMPANY,
*Defendant and Respondent.*

After a Decision by the Court Of Appeal
Second Appellate District
Case No. B194463

Appeal from the Superior Court for Los Angeles County
The Honorable Carolyn B. Kuhl

# ANSWER TO PETITION FOR REVIEW

JAMES R. ROBIE (No. 67303)
STEVEN S. FLEISCHMAN (169990)
DAVID J. WEINMAN (143286)
ROBIE & MATTHAI,
A Professional Corporation
Biltmore Tower
500 South Grand Avenue,
Suite 1500
Los Angeles, CA 90071
Telephone: 213-624-3062

RAOUL D. KENNEDY (40892)
SKADDEN, ARPS, SLATE,
MEAGHER & FLOM LLP
Four Embarcadero Center, Ste. 3800
San Francisco, California 94111
Telephone: (415) 984-6400
Raoul.Kennedy@skadden.com

Of Counsel:
SHEILA BIRNBAUM
DOUGLAS W. DUNHAM
ELLEN P. QUACKENBOS
SKADDEN, ARPS, SLATE,
MEAGHER & FLOM LLP
Four Times Square
New York, New York 10036
Telephone: (212) 735-3000

Attorneys for Defendant-Respondent

## TABLE OF CONTENTS

**PAGE**

TABLE OF AUTHORITIES ..... iii

I. INTRODUCTION ..... 1

II. FACTUAL BACKGROUND ..... 5

A. State Farm ..... 5

B. Pertinent Policy Language ..... 5

C. The Nature of "Surplus" ..... 6

D. State Farm's Board of Directors ..... 7

E. State Farm's Board of Directors Made Surplus and Dividend Decisions on an Informed Basis and in Good Faith ..... 7

F. The Board's Surplus And Dividend Strategies ..... 10

G. The Directors Affirmatively Determined That State Farm's Surplus Was Never Too High and Sometimes May Have Been Too Low ..... 13

H. The Board Worked Continuously to Strike a Proper Balance Between Additional Surplus, Lower Premiums and Dividends ..... 15

I. State Farm's Board Declared 11 Dividends Totaling More Than $3.8 Billion Between 1983 and 2000 ..... 19

III. HILL HAS FAILED TO IDENTIFY ANY BASIS FOR REVIEW UNDER RULE 8.500 OF THE CALIFORNIA RULES OF COURT ..... 21

A. The Petition Does Not Identify Any Important Unresolved Question of Law Regarding the Liability Under the Business Judgment Rule for Negligence and/or Gross Negligence ..... 21

B. This Petition Does Not Present An Important Unresolved Question of Law Regarding the Proper Analysis of the "Totally Without Merit" Prong of the Illinois Business Judgment Rule .......... 26

C. This Petition Does Not Present Any Important Unresolved Question of Law Regarding a Corporate Board's Duty to Inform Itself Sufficiently .......... 28

D. The Factual Issues Raised by the Petition Do Not Provide Grounds for Review by this Court .......... 33

IV. CONCLUSION .......... 35

RULE 8.204(c)(1) CERTIFICATE .......... 37

# TABLE OF AUTHORITIES

**CASES** **PAGE(S)**

*Boston Children's Heart Found v. Nadal-Ginard* (1st. Cir. 1996) 73 F.3d 429 ....26

*Burt ex rel. McDonnell Douglas Corp. v. Danforth* (E.D. Mo. 1990) 742 F. Supp. 1043 ....26

*City of Gardena v. Camp* (1977) 70 Cal.App.3d 252 ....32

*Desaigoudar v. Meyercord* (2003) 108 Cal.App.4th 173 ....27

*Ferris Elevator Co. v. Neffco, Inc.* (Ill. App. Ct. 1996) 674 N.E.2d 449 ....29

*Goldberg v. Michael* (Ill. App. Ct. 2002) 766 N.E.2d 246 ....24

*Haydinger v. Freedman* (E.D. Pa. June 8, 2000) No. Civ. A. 98-3045 2000 WL 748055 ....26

*Holmes v. McDonald* (Ill. 1907) 80 N.E. 714 ....24

*Katz v. Chevron Corp.* (1994) 22 Cal.App.4th 1352 ....21, 25

*Kelley v. Baggott* (1933) 273 Ill. App. 580 ....24

*Lamden v. La Jolla Shores Clubdominium Homeowners Association* (1998) 62 Cal.App.4th 1143 ....21

*Lee v. Interinsurance Exchange* (1996) 50 Cal.App. 4th 694 ....1, 2, 5, 34

*Leggett v. Missouri State Life Insurance Co.* (Mo. 1960) 342 S.W.3d 833 ....26

*In re Nuveen Fund Litigation* (N.D. Ill. June 11, 1996) No. 94C360, 1996 WL 328003 ....25

*Powell v. West Illinois Electric Cooperative* (Ill. App. Ct. 1989) 536 N.E.2d 231 ....25

*Romanik v. Lurie Home Supply Center, Inc.* (Ill. App. Ct. 1982) 435 N.E.2d 712 ....27

*RTC v. Blasdell* (D. Ariz. 1994) 930 F. Supp. 417 ....25

*RTC v. Dean* (D. Ariz. 1994) 854 F. Supp. 626 ....25

*RTC v. Hovanian* (D.N.J.. 1994) 1994 U.S. Dist. LEXIS 19359 .......... 26

*Shaper v. Bryan* (Ill. App. Ct. 2007) 864 N.E.2d 876 .......... 26, 27

*Smith v. Van Gorkom* (Del. 1985) 488 A.2d 858 .......... 25

*Stamp v. Touche Ross & Co.* (Ill. App. Ct. 1993) 636 N.E.2d 616 .......... 24

*State Farm Automobile Insurance Co. v. Superior Court (Hill II)*
(2003) 114 Cal.App.4th 434 .......... 2, 5, 6, 22

*Terrydale Liquidating Trust v. Barness* (S.D.N.Y. 1984) 611 F. Supp. 1006 .......... 26

*Toland v. Sunland Housing Group, Inc.* (1998) 18 Cal.4th 253 .......... 21

*Towns v. Davidson* (2007) 147 Cal.App.4th 461 .......... 32

*United States Liability Insurance Co. v. Haidinger-Hayes, Inc.*
(1970) 1 Cal.3d. 594 .......... 21

*Washington Bancorp. v. Said* (D.D.C. 1993) 812 F. Supp. 1256 .......... 25

*Weiland v. Illinois Power Co.* (C.D. Ill. Sept. 17, 1990) No. 89-1088,
1990 WL 267364 .......... 25

**STATUTES AND RULES**

California Corporation Code section 309 .......... 21

California Rules of the Court 8.500(b)(1) .......... 3, 21, 33

Illinois Business Corporation Act § 8.85 .......... 33

**OTHER AUTHORITIES**

3A *Fletcher Cyclopedia of the Law of Corporations* .......... 26

5 *Ill. Law & Practice*, Banks § 147 .......... 24

## I. **INTRODUCTION**

Petitioners Jerry Hill, Josephine Hill, Wilson Mallory and Noreen Mallory (collectively "Hill") contend that, in addition to the nearly $3 billion in dividends that were declared during the class period, State Farm's Board of Directors should also have used the Company's surplus to pay untold billions of dollars of additional dividends.

As explained in *Lee v. Interinsurance Exchange* (1996) 50 Cal.App.4th 694, 710, ". . . . [D]ecisions as to strategies for managing the surplus funds of an insurer are quintessential exercises of business judgment." State Farm demonstrated that the Board's surplus decisions were not only rational, and in good faith, but were also highly successful. The Board concluded that by retaining, rather than distributing, surplus, each surplus dollar could be used to perform three functions simultaneously: (1) provide a solvency cushion, (2) fund growth, and (3) reduce premiums. (5AA501164:10). The Board determined that surplus should not be used unless it exceeded what was needed to accomplish these three goals. During the class period, surplus was never that large. (23AA06741).

Concurrently, the Board's dividend strategy was to deliberately price insurance as low as possible, with the expectation of breaking even or even have an intentional underwriting loss, using income from surplus to make up the difference. As recognized in an earlier Court of Appeal decision in this case, "State Farm does not offer insurance policies as investment opportunities but instead provides policyholders with protection against loss. In contrast, a stock insurance company seeks to earn a profit for the benefit of its stockholders, who may or not be policyholders." *State Farm Mut. Auto. Ins. Co. v. Superior Court* ("*Hill II*") (2003) 114 Cal. App. 4th 434, 440. A policyholder buys insurance with "the reasonable expectation . . . that he or she is purchasing insurance and *may*, in the discretion of the Board, receive dividends or other distributions." *Lee*, 50 Cal.App.4th at 723-724 (emphasis in original).

In formulating both its surplus and dividend strategies, the Directors were "concerned with the long-run financial health of the company" (21AA05917:17-5919:17.) The Directors "measure[d] time, not in years . . . but in decades." (12AA03346.)

The wisdom of the Board's approach has been forcefully borne out by recent events ranging from Hurricane Katrina to the crash of the financial markets. Because the Board did not dissipate State Farm's surplus in one-time dividends, State Farm today is not in line for a federal bailout and its policyholders know there will be money to pay their claims. Nonetheless, Hill doggedly insists that this case, which was decided under Illinois law, is an appropriate candidate for review by this Court.

Hill's petition consists of a combination of misstatements of what the Court of Appeal held combined with a string of complaints that do not satisfy the demands of Rule 8.500(b)(1).

The Court of Appeal did not (as Hill claims) hold that the business judgment rule "provides a complete defense against action seeking to hold corporate boards liable for breaches of their duty of care" and did not "immunize" boards of directors from liability for gross negligence. *See* Petition ("Pet.") at 9, 14. Indeed, Hill did not raise the issue of gross negligence and made no argument to the Court of Appeal that the evidence in this case establishes gross negligence on the part of State Farm. The Court of Appeal's holding that the Illinois business judgment rule "precludes liability for a board's mistakes, errors or mere negligence" (Opinion ("Op.") at 55) is fully supported by Illinois case law, including the decisions cited by the Court of Appeal.

Nor did the Court of Appeal "completely immunize corporate boards from judicial scrutiny of their judgments as to the information they need to make informed judgments on major corporate issues," as Hill claims. Pet. at 2. Rather, the Court of Appeal expressly recognized that "[u]nder Illinois law, the business judgment rule requires that the directors 'becom[e] sufficiently informed to make an independent business decision.'" Op. at 42. The Court of Appeal concluded in light of the undisputed evidence of the substantial information provided to State Farm's Board that "as a matter of law the Board was sufficiently informed to make independent decisions about dividends and the surplus," that the "directors relied on what they reasonably believed to be adequate information, and that Board's decisions were anything but faithless acts." *Id.* at 46.

The Court of Appeal's decision also does not raise any unresolved issue of law as to the proper application of the California summary judgment standard. The Court of Appeal did not disregard Hill's evidence or fail to accept as true the facts set forth in Hill's evidence and the *reasonable* inferences to be drawn therefore. The Court of Appeal was not required by California's summary judgment standard to accept Hill's characterizations of the evidence or unreasonable inferences drawn from the evidence by Hill. Nor did the Court "hold that the testimony of an 'outside expert' cannot create a triable issue of fact as to the reasonableness of a corporate decision," as Hill claims. Pet. at 7. Rather, the Court properly made the legal determination as to whether Hill's evidence, including the particular testimony and reports of Hill's experts, supported an exception to the business judgment rule. Hill's factual contentions are not a ground for review by this Court.

For these reasons and the reasons set forth below, the Petition completely fails to establish that review is "necessary to secure uniformity of decision or to settle an important question of law" and should be denied.

## II. FACTUAL BACKGROUND

### A. State Farm

State Farm is an Illinois-domiciled mutual insurance company. "Mutual insurance companies are organized, maintained, and operated solely for the benefit of their policyholders . . . . Such companies do not generate traditional entrepreneurial profits, but rather seek to meet their obligations at the lowest possible cost to the policyholders . . . ." *Hill II*, 114 Cal.App.4th at 440 (internal quotation marks and citation omitted) (2AA00365). Policyholders of a mutual insurance company, like those of an interinsurance exchange, contract to receive insurance coverage "and may, in the discretion of the Board, receive dividends or other distributions." *Lee v. Interinsurance Exch.* (1996) 50 Cal.App.4th 694, 723-24. State Farm, like other mutual automobile and property insurers, "does not offer insurance policies as investment opportunities but instead provides policyholders with protection against loss." *Hill II*, 114 Cal.App.4th at 440.

### B. Pertinent Policy Language

The majority of the class members' State Farm automobile insurance policies contain the following provision relating to dividends: "While this policy is in force, the first insured named in the declarations is entitled to . . . receive dividends the Board of Directors in its discretion may declare in accordance with reasonable classifications and groupings of policyholders established by such Board." (1AA0166; 2AA0365[UF 4]); *see also* Op. at 4.

### C. **The Nature of "Surplus"**

"'[I]t is impossible to specify the "right" amount of [surplus] for most insurers through a formula.' Each insurance company has its own method for determining the amount of surplus it considers to be adequate." *Hill II*, 114 Cal.App.4th at 441 (citation omitted) (second alteration in original) (2AA00366 [UF 10]). A mutual insurance company's surplus provides a "safety cushion" for policyholders: "As the amount of surplus increases, the risk of insolvency decreases. The payment of dividends reduces the surplus." *Id.* (citation omitted) (2AA00366 [UF 9]).

As State Farm's Directors recognized, surplus is "especially important for a mutual company, because having no stockholders, [it] cannot raise money in the stock market." (2AA00367; 21AA06014). Thus, State Farm's "ability to pay policyholders, now and in the future, depends upon retained earnings." *Id.* As one of State Farm's Directors testified, "One of the things I came to learn, personally, as a Board member, was how important the net worth of the company, what you call 'the surplus,' is to the company. It's the difference between promises made and promises broken." (2AA00367-368; 21AA06014).

The surplus is invested, and the earnings derived are used to offset the costs of operations, thus lowering the cost of insurance to all policyholders. (2AA00368 [UF 16]).

### D. State Farm's Board of Directors

State Farm's directors included deans and professors from America's leading business schools, law schools and universities, such as Dr. James Q. Wilson, Professor of Management and Public Policy, UCLA; Jerry L. Porras, Lane Professor of Organizational Behavior and Change, Stanford University; Professor W. H. Knight, Jr., the University of Iowa College of Law and Provost of the University of Iowa; Dr. Robert K. Jaedicke, Professor and former Dean, Graduate School of Business, Stanford University; Curtis W. Tarr, Dean, Cornell University, Graduate School of Management; George L. Perry, Senior Fellow, The Brookings Institution; Professor Burke Marshall, Yale Law School; Robert S. Eckley, President, Illinois Wesleyan University; Wendy L. Gramm, Economist and Former Chief of the Commodity Future Trading Commission; and John C. Partee, Economist and retired Federal Reserve Board member. (19AA5199).

### E. State Farm's Board of Directors Made Surplus and Dividend Decisions on an Informed Basis and in Good Faith

State Farm's Board of Directors met every quarter in Bloomington, Illinois. (2AA00368 [UF 18]). Director James Wilson of UCLA testified that State Farm's financial condition was the "chief concern" of the Board of Directors:

> Every board meeting begins with a very detailed examination of the financial circumstances of the company. In between board meetings, we receive monthly mailings about the financial circumstances. I would say that the financial condition of the company is probably the chief concern of the directors.

(2AA00369 [UF 23]; 4AA01105). Director Dr. Robert Jaedicke of Stanford further testified that the Board specifically discussed the company's surplus at every meeting during his eight years on the Board, collectively examining and evaluating the fluctuations of the various surplus categories. (2AA00369 [UF 25]; 4AA01096-97).

Throughout the class period, the Directors' review of State Farm's surplus and finances was continuous, in-depth and focused on every aspect of State Farm's financial condition, specifically including surplus, as is confirmed by a review of the information each Director received:

**Monthly Financial Statements**: Each month, the Directors reviewed a monthly financial statement (2AA00369 [UF 26-27]; 5AA01374-75), setting forth the net worth of the company – including surplus and changes in surplus – and specifically examining each category of surplus as compared to the same time period from the prior year. (*Id.*) The Directors followed profits, losses, and the growth or contraction of surplus – in each category – on a monthly basis. (*Id.*)

**Quarterly Operations Reviews**: Each quarter, the Directors received an Operations Review that provided a breakdown of each category of State Farm's surplus, as well as a detailed description of State Farm's investment activities. (2AA00370 [UF 29-35]; 5AA01375).

**Quarterly Financial Statements**: The Directors also received Quarterly Financial Statements, which contain line-item detail regarding increases and decreases to surplus (including changes in each category). (2AA00371[UF 36-40]; 5AA01375-76).

**Quarterly "Consolidated Investment Activity" Reports**: The Board also received Quarterly "Consolidated Investment Activity" Reports, which reviewed the performance and composition of State Farm's investment portfolio during the previous three months. (2AA00371-372[UF 41, 42]; 5AA01375).

**Annual Statements**: At the yearly Board meetings, the Directors reviewed the Company's comprehensive Annual Statement, which is filed in every jurisdiction in which State Farm does business and subjected to intense regulatory scrutiny. (2AA00372[UF 43-45]; 5AA01376). These Statements contained complete detail on surplus. (2AA00372 [UF 46]).

**Report on Audits of Financial Statements**: Each year, the Directors met and discussed the reports of the independent accountants who audited State Farm's Annual Statement (2AA00373[UF 52]; 5AA01376).

Each year the auditors reported, without qualification, that the Statements "present[ed] fairly" the financial condition of the company and verified that State Farm's Annual Statement complied with the Statutory Accounting Practices prescribed or permitted by Illinois law and the NAIC. (2AA00374[UF 56, 57]).

**Industry Group Reviews**: The Directors also reviewed an Annual Financial Review of Selected Property & Casualty Insurance Groups, which annually compared State Farm's premium and surplus levels to other major insurers over a three-year period (*Id.* [UF 58, 59]; 5AA01376).

**Actuarial Opinions Regarding Loss Reserves**: State Farm actuaries continuously reviewed and adjusted the company's loss reserves. (2AA00375 [UF 62];5AA01376). Each year an independent certified actuary from Coopers & Lybrand also reviewed State Farm's loss reserves. (*Id.* [UF 63]). Beginning in 1992, the independent actuary annually confirmed the reasonableness and accuracy of reserves in a formal annual opinion, titled "Actuarial Report on Carried Reserves," provided to the Board. (*Id.* [UF 64]).

### F. The Board's Surplus And Dividend Strategies

The State Farm Board's surplus strategy was to use surplus not only to (1) provide a cushion of solvency and (2) fund growth, but also (3) to reduce its policyholder premiums. All of State Farm's surplus is invested and the income and gains from this invested surplus help offset costs and add to State Farm's strength, which in turn allows State Farm "to charge lower and more stable insurance rates than would otherwise be possible." (5AA01164:10-11). Specifically, during the class period State Farm's invested surplus, including the unrealized capital gain, permitted State Farm to move its underwriting target to 0 and then to -5%. (2AA00367-368 [UF:13, 15-16], 00377 [UF:76], 00379-382 [UF:88-89, 91-92, 94, 101, 104-09]).

During the class period, the Board never concluded that State Farm had more surplus than it needed to accomplish these three goals (2AA376-377 [UF:72, 74-75]).

State Farm priced its insurance policies to break even, or even produce an underwriting loss, with no provision for a dividend. Accordingly, the Board generally declared dividends only when results from insurance operations in the previous year had been better than projected and had produced an underwriting profit (2AA00383-384 [UF:111, 113]); (5AA01364:25-28 ("For example, beginning in 1998 State Farm Mutual reduced its target underwriting return for ratemaking purposes to *negative* five percent"), 5AA01166:5-7, 2AA00381:19-23). Invested income from the company's surplus made this possible. As Mr. Joslin, State Farm's Chief Financial Officer explained, "[t]his enormous savings passed by State Farm Mutual to its policyholders simply would not have been possible without the financial strength provided by the growth of State Farm Mutual's surplus." (5AA01365:2-6; *see also* 5AA01165:3-4, 01166:7-8, 01381:9-11).

State Farm's policies were not priced with the expectation of paying dividends. State Farm and its Board believed that its policyholders were seeking insurance protection at the lowest possible cost in the first instance. (AA5-01163:3.) As State Farm actuary Gregory Hayward testified, "State Farm develops its rate with no component or other calculation for a dividend in its rate calculations. . . ." (5AA01163:3-5; *see also* 2AA00378:7-13). During the class period, the Company considered and typically paid dividends only when underwriting income from the previous year exceeded original expectations. (2AA00378:13-23, 5AA01363:1-5, 01382:6-9.) State Farm also utilized greater than expected operating income to reduce premiums. (2AA00379:9-15; 00378:17-23, 00380:24-381:5).

Over the 15-year class period in issue, 1983-1998, the Board declared ten dividends totaling more than $2.8 billion for mutual company policyholders. (2AA00383 [UF:110]). In 2000, the Board declared a $1 billion dollar dividend, bringing the total since 1983 up to $3.8 billion. *Id.*

### G. **The Directors Affirmatively Determined That State Farm's Surplus Was Never Too High and Sometimes May Have Been Too Low**

Based on their ongoing review of State Farm's financial condition, State Farm's Directors never viewed the surplus as too high, and at some times felt the surplus should have been higher. (2AA00376[UF 72]). Dr. Wilson testified:

> There could be in principle "too much net worth." In my judgment, as a director for the seven or so years that I've been on the board, we've never been in a position where we had too much. In fact, right now, I think we have too little.

(2AA00377[UF 73-74]; *see also* 4AA01117 (in the seven years he had been a director, Dr. Wilson thought the net worth of the company had been "inadequate to prudently run State Farm" and that he "did not believe that policyholders would be well served . . . by receiving more of this net worth to them in the form of either lower premiums or higher dividends")).

Dr. Jaedicke testified that during his eight-year tenure as a director, the Board "discussed the details of the financial condition, including the categories of surplus and how they had changed at each meeting. . . . I find it difficult to respond when you say did we ever discuss whether we had surplus surplus, which would indicate we felt we had too much. The main concern was, was our financial strength strong enough? Not was it too strong." (4AA01097). Similarly, Dr. Jaedicke testified that the Board

> considered the amount of the surplus as one element in assessing overall financial condition at almost every

> meeting . . . . As I indicated, I don't think there was ever a time when we were concerned that . . . we had too much.

(*Id.*) Other directors agreed. *See*, *e.g.*, 20AA05558 (Gramm Deposition: "There were times when I did feel that State Farm didn't have as much surplus as I would like to have seen. . . . Sometimes the – I had greater concerns than others, I know. But I think it was pretty much throughout my time on – on the board, that I felt like that there – that I would have been comfortable with having even more surplus."); 5AA01380 (Trosino Declaration: State Farm's surplus "was never excessive").

State Farm's Directors believed that its surplus provided an important margin of financial strength to best serve State Farm's present and future policyholders. (2AA00377[UF 76]; 5AA01157:16-01158:9). State Farm's Directors were aware during the class period that State Farm's premium-to-surplus ratio (one commonly used indicator of insurance company financial strength) was generally within industry averages. (2AA00377[UF 77]; 5AA01160-61). In no year during the class period did State Farm's premium-to-surplus ratio lead the industry and, from 1992 to 1997, it fell below the industry average, even though State Farm's actuaries believed that State Farm's risks required a larger-than-average surplus. (2AA00377 [UF 78, 79]).

### H. The Board Worked Continuously to Strike a Proper Balance Between Additional Surplus, Lower Premiums and Dividends

State Farm's key executives and actuaries continuously monitored surplus levels, underwriting returns, loss trends and reserves, as well as other critical operating statistics. (AA00378-379[UF 85]; 5AA01157, 01362, 01379).

Throughout the class period, State Farm projected and adjusted its rates on a state-by-state basis. (AA00379[UF 87, 88]). During the class period, it repeatedly reduced the underwriting return target on its policies throughout the country. This translated directly into lower insurance rates for all policyholders either through reduced premiums or smaller increases in premiums. (*Id.* [UF 89]; 5AA01164-65, 01381).

State Farm's Directors and Officers consistently determined throughout the class period that it would have been unwise for State Farm to sell any portion of its surplus investments for dividend purposes. (*Id.* [UF90,91], 5AA01364, 01164, 01382-84). Surplus was a critical factor in allowing State Farm to reduce its underwriting return targets and to lower insurance rates for its policyholders. (2AA00380[UF 92]; 5AA01162-63, 01382). The strength of the surplus enabled State Farm to charge lower and more stable insurance rates than would otherwise be possible. (2AA00380 [UF 94]; *see also* 5AA01383:25-01384:8).

In light of the poor underwriting performance in 1995 and 1996, the Board did not feel comfortable declaring a dividend in those years. (2AA00380[UF 99]; 4AA1082-83). Beginning in the fourth quarter of 1996, however, State Farm began reducing premiums significantly in a number of states where underwriting performance exceeded the underwriting target. (2AA00380-381[UF 100]; 5AA01164-65). In 1997, the improved underwriting trend continued, permitting State Farm to reduce premiums again, this time in 33 states, saving policyholders $437,000,000 in premiums. (2AA00381[UF 101]; 5AA01165).

By September 1997, the Board determined that the improvement in underwriting in a number of states and overall financial condition of the company made a dividend appropriate in those states with a favorable performance and declared a dividend of approximately $651,000,000. (2AA00381[UF 102]; 5AA01165). Based upon its continued assessment for the remainder of 1997 and the first half of 1998, the Board declared an additional dividend of approximately $891,600,000 in June of 1998. (*Id.* [UF 103]; 5AA01165-66).

By the end of 1996, the surplus was helping the State Farm to reduce premiums substantially and declare sizable dividends. The rate reductions alone collectively saved State Farm's policyholders billions of dollars in premiums. (2AA00382[UF 107]; 5AA01165-66). Vincent Trosino reported to the Board on the dramatic effects of the rate cuts from 1997 through June 2000, including the fact that in 1999 alone, State Farm was able "to reduce rates in 52 jurisdictions with a net reduction of $945 million in premiums." (*Id.* [UF 108]; *see also* 5AA01164:27-01166:21).[1]

The evidence with regard to premium reductions included Dr. Wilson's testimony recalling that senior management had reported to the Board that "We had done better than we expected in selling insurance and that we had two choices: one was either to try to lower the prices we charged for our policies, the other was to declare a dividend or possibly to do both simultaneously." (4AA01108). Dr. Wilson also testified that

> [t]here is a strategic question that faces the board every time the dividend question arises. That question is this: If we have earned more money than we expected, should we reduce premiums, pay a dividend, or do some combination of both? And I remember, explicitly, discussing that question with Roger Joslin at the meeting in 2000. And his view was, "I think we should do a little bit of both." But I think it is good for our policyholders if we can recognize their loyalty to the company by giving a dividend from time to time, as well as, to the extent regulators permit, lower our premiums. And at the time, I felt that his arguments were persuasive, and so, I voted for it.

[1] State Farm's ability to cut rates and its slowness to raise prices was well-known to its competitors. In February 2001, Warren Buffett wrote to Berkshire-Hathaway shareholders regarding GEICO's performance:

> State Farm – by far the largest personal auto insurer, with about 19% of the market – has been very slow to raise prices . . . . Consequently, State Farm had an underwriting loss last year from auto insurance (including rebates to policyholders) of 18% of premiums, compared to 4% at GEICO . . . . The willingness of the largest player in the industry to tolerate such a cost makes the economics difficult for other participants. (4AA01060).

(20AA05539-05540).

Likewise, Dr. Jaedicke testified to his understanding that the process that led to management recommending a dividend included management's "continually review[ing] the rate structure" "to try to be sure that the rate structure that you had in effect was achieving the goals that you had, the objective – the profit objective that you had set." (21AA06911). According to Dr. Jaedicke, that process of continual analysis could

> lead to various actions. One could be the rates ought to be – we need to propose rate revisions. Another would be the experience has been better than we thought it was or thought it – than we had forecasted, not than what we had thought it was, than we had estimated, and so we are recommending a dividend to the policyholder. Or I suppose in some cases it could be both.

(21AA05912; *see also id.* (if experience better than anticipated, company could also "have taken some other action than the dividend, such as, if we expect this to continue, then maybe we should propose a reduction in rates"). Dr. Jaedicke also made clear that the value of capital assets in State Farm's surplus could be used to "return[] benefits to the policyholders in the form of lower rates." (21AA05932). Thus, for example, "reducing the underwriting goal to a minus five percent of premiums . . . should result to policyholders as a benefit and to incur a – to set a goal of a five percent underwriting loss of five percent, means that you're using the financial strength that you have – that you're using the financial strength that you're gaining through the investment program. So that's one way to – that's a pretty big step in terms of returning benefits to the policyholders in the form of lower rates." *Id.*

### I. **State Farm's Board Declared 11 Dividends Totaling More Than $3.8 Billion Between 1983 and 2000**

From 1983 through 2000 State Farm declared eleven dividends to its policyholders totaling more than $3.8 billion, as follows:

| Date | Dividend Amount |
|---|---|
| April 1983 | $69,600,000 |
| April 1984 | $133,560,000 |
| November 1987 | $202,700,000 |
| November 1988 | $157,000,000 |
| December 1991 | $198,500,000 |
| August 1992 | $169,300,000 |
| October 1993 | $205,900,000 |
| April 1994 | $187,500,000 |
| November 1997 | $651,000,000 |
| June 1998 | $891,600,000 |
| June 2000 | $1,005,500,000 |
| TOTAL | $3,872,160,000 |

(2AA00383[UF 110]).

In the years when dividends were not declared, State Farm evaluated its overall financial condition, including surplus levels and underwriting returns, and concluded that a dividend could not be supported. (2AA00384[UF 115]). The Board never believed it was prudent to liquidate capital assets in State Farm's surplus to pay larger dividends. (2AA00384-385[UF 116-118]).

In other years, however, the Board, after evaluating the financial condition of the company, came to different conclusions. The

$1,005,500,000 dividend declared by the Board in June 2000 represented all of State Farm's pre-tax operating income for 1999 and was made possible, in part, by the extraordinary performance of the stock market. (2AA00385-386[UF 120-121]). State Farm's actuaries reported that State Farm's surplus was sufficient to permit this large dividend. (2AA00386[UF 123]).

Dr. Wilson testified that he evaluated these dividend recommendations based on the following principles:

> When we make a judgment about the financial condition of the company that we think may warrant a dividend, we . . . look at net income before taxes which combines any money we may have earned selling insurance plus payments to us in dividends and interest from our net worth.
>
> [We also] look at the net worth of the company taken as a whole, so that we can feel comfortable that should there be a series of catastrophes in th[e] near future, we would have enough money to pay all of the policyholders.

(2AA00387[UF 126]; 21AA06016-17). The legitimacy of the Board concern that State Farm's surplus be sufficient to withstand a "series of catastrophes" finds confirmation in recent events, including such natural disasters as Hurricane Katrina and Hurricane Rita and the recent crisis in the financial markets.

## III. **HILL HAS FAILED TO IDENTIFY ANY BASIS FOR REVIEW UNDER RULE 8.500 OF THE CALIFORNIA RULES OF COURT**

The Petition does not demonstrate that this Court's review is "necessary to secure uniformity of decision or to settle an important question of law." *See* Cal. R. Ct. 8.500(b)(1). *See also, e.g., Toland v. Sunland Hous. Group, Inc.* (1998) 18 Cal.4th 253, 264 ("Because of these conflicting views by the Courts of Appeal, we granted review to clarify the scope of our holding . . . ."). This case presents no substantive issues of California law. Only the substantive law of Illinois is at issue, and, as shown below, the Court of Appeal correctly determined and applied established principles of Illinois law.

### A. **The Petition Does Not Identify Any Important Unresolved Question of Law Regarding the Liability Under the Business Judgment Rule for Negligence and/or Gross Negligence**

Hill asserts that review by this Court is needed to resolve the purported conflict between *Lamden v. La Jolla Shores Clubdominium Homeowners Association* (1998) 62 Cal.App.4th 1143, *Katz v. Chevron Corp.* (1994) 22 Cal.App.4th 1352, 1366, on the one hand, and this Court's decision in *United States Liability Insurance Co. v. Haidinger-Hayes, Inc.* (1970) 1 Cal.3d 586, 594 and California Corporation Code section 309 on the other hand, as to liability for negligence under the business judgment rule. Pet. at 14; *see also id.* at 11.

This case does not raise questions as to California law under those cases or under the California statute cited by Hill. Indeed, the three cases and the California statute are not even cited or mentioned in the Court of Appeal's Opinion. The Opinion addresses and decides issues under Illinois law regarding the application of the Illinois business judgment rule, and Hill does not dispute that, as the Court of Appeal earlier decided, Illinois law governs their claims. *Hill II*, 114 Cal.App.4th at 442. Hill's tortured attempt to establish that the Court of Appeal's decision implicates issues of California law that this Court should address should be rejected.

Unlike most cases involving the business judgment rule, the issue here is not whether some erroneous and damaging decision by a board can be rationalized as having "seemed like a good idea" at the time it was made. This case involves decisions that were not only rational and free of self-interest, but have also stood the test of time. Accordingly, neither the trial court nor the Court of Appeal had to "stretch" to find that the business judgment rule applied.

In any case, Hill's claim that the Court of Appeal's ruling greatly expands the protections of the business judgment rule is incorrect and does not provide a ground for review by this Court. The Court of Appeal has *not* held that "the business judgment rule precludes liability for *any* form of negligence, ordinary or gross." Pet. at 14. In fact, the decision of the Court of Appeal correctly rejects the position that the Illinois business judgment rule permits liability to be imposed for "mere negligence" in an insurance company's dividend and surplus decisions. *See* Op. at 55.

Moreover, the Court of Appeal did not hold that the Illinois business judgment rule precludes liability for gross negligence. The words "gross negligence" or "grossly negligent" do not even appear in the Opinion. This is not surprising because Hill's briefing before the Court of Appeal contained no suggestion that they could establish gross negligence on the part of State Farm's board in its dividend decisions. Rather, Hill simply argued against a gross negligence standard, asserting that State Farm was not entitled to summary judgment unless it could show that the Board's dividend and surplus decisions "were completely free of ordinary negligence." Pls. ARB at 5.[2] Accordingly, no issues as to gross negligence are presented by this case.

Not only does Hill mischaracterize the ruling of the Court of Appeal, but they are also wrong as to Illinois law. The statement by the Court of Appeal that the "very purpose of the [Illinois business judgment] rule is to preclude liability for a board's mistakes, errors, or mere negligence" (Op. at 55) is a correct expression of Illinois law. The Illinois Supreme Court has long followed the "well-settled rule" that the directors of a corporation are

[2] Hill's opening Brief on Appeal contained no reference to negligence vs. gross negligence.

liable only for gross negligence. In *Holmes v. McDonald*, the Illinois Supreme Court set forth the rule as follows:

> [D]irectors, trustees, and officers of a corporation are bound to manage the affairs of the corporation with at least ordinary care and prudence, and are liable for loss occasioned by their failure to do so. In accepting such a position the trustee or director undertakes that he possesses and will exercise at least the ordinary knowledge, skill, and judgment requisite to the discharge of his duties, and that he will be liable for *gross negligence*.

*Holmes* (Ill. 1907) 80 N.E. 714, 716 (emphasis added). *See also Kelley v. Baggott* (1933) 273 Ill. App. 580, 584 (directors are liable for "such gross negligence or incompetency as shows a reckless disregard of their duty" (citing *Holmes*)); *cf. Goldberg v. Michael* (Ill. App. Ct. 2002) 766 N.E.2d 246, 251 (shareholders are precluded from pursuing derivative suit in the absence of "allegations that the board . . . abused its discretion, was *grossly negligent*, or acted in bad faith or fraudulently" (emphasis added)).

Hill does not cite any Illinois judicial decision showing that the Illinois Supreme Court ever altered the gross negligence standard it adopted in *Holmes*.[3] Indeed, "the Illinois courts recognize the strong preference to

[3] *Stamp v. Touche Ross & Co.* (Ill. App. Ct. 1993) 636 N.E.2d 616, cited by Hill, does not support their contentions that Illinois has abandoned the gross negligence standard. *Stamp* was decided upon a motion to dismiss. Under Illinois law, on a motion to dismiss, allegations of negligence are sufficient to sustain a cause of action that requires gross negligence. *See* 5 *Ill. Law & Prac.*, Banks § 147 (allegations of negligence were sufficient to withstand motion to dismiss even though plaintiffs "on trial in order to recover would be required to prove that directors had been guilty of gross negligence").

the decisions of the corporate boards . . . . 'Their judgment as to any matter lawfully confided to their discretion may not lightly be challenged by an stockholder . . . . It is not a trifling thing for a stockholder to attempt to coerce the directors of a corporation to an act which their judgment does not approve, or to substitute his judgment for theirs.'" *Powell v. W. Ill. Elec. Coop.* (Ill. App. Ct. 1989) 536 N.E.2d 231, 234 (citation omitted).

Hill's characterization of the Court of Appeal's opinion as a "broad expansion of the business judgment rule" (Pet. at 8) and the "most expansive possible reading of the business judgment rule" (*id.* at 9) is incorrect.[4] Gross negligence is the "traditional business judgment rule's standard." *In re Nuveen Fund Litig.* (N.D. Ill. June 11, 1996) No. 94C360, 1996 WL 328003, at *4 (applying Minnesota and Delaware law). The overwhelming majority of states that have addressed the issue follow the gross negligence standard under the business judgment rule. *See, e.g., RTC v. Dean* (D. Ariz 1994) 854 F. Supp. 626, 635; *RTC v. Blasdell* (D. Ariz. 1994) 930 F. Supp. 417, 424; *Katz v. Chevron Corp.* (1994) 22 Cal.App.4th 1352, 1366; *Washington Bancorp. v. Said* (D.D.C. 1993) 812 F. Supp. 1256, 1266; *Smith v. Van Gorkom* (Del. 1985) 488 A.2d 858. *See also* 3A

[4] Hill's criticism of the Court of Appeal's reliance on Delaware and other cases is incorrect. Illinois courts "have often been guided by the decisions of other jurisdictions," and, in particular, Delaware, in deciding questions of corporate law and the business judgment rule. *Weiland v. Illinois Power Co.* (C.D. Ill. Sept. 17, 1990) No. 89-1088, 1990 WL 267364, at *9.

*Fletcher Cyclopedia of the Law of Corporations* § 1036 (business judgment rule "absolves directors for all but gross negligence"); *id.* § 1031 ("Director liability for good faith error is generally confined to gross negligence."); *id.* at § 505 (judgment of directors "will not be reviewed by the courts unless there is fraud, bad faith, or gross negligence amounting to a breach of trust").[5] The Court of Appeal's recognition that the Illinois business judgment rule precludes liability for mere negligence does not require this Court's review.

### B. This Petition Does Not Present An Important Unresolved Question of Law Regarding the Proper Analysis of the "Totally Without Merit" Prong of the Illinois Business Judgment Rule

Hill incorrectly contends that under Illinois law the Court of Appeal erred in refusing to consider "the substance of corporate decisions." Pet. at 12. As the Court of Appeal stated, Illinois recognizes that "[t]he business judgment rule is premised on the reality that '"courts are ill equipped to engage in post hoc *substantive review* of business decisions."' Op. at 55 (emphasis in original) (quoting *Shaper v. Bryan* (Ill. App. Ct. 2007) 864

[5] *Accord Burt ex rel. McDonnell Douglas Corp. v. Danforth* (E.D. Mo. 1990) 742 F. Supp. 1043, 10551-52; *Boston Children's Heart Found. v. Nadal-Ginard* (1st Cir. 1996) 73 F.3d 429, 433; *Terrydale Liquidating Trust v. Barness* (S.D.N.Y. 1984) 611 F. Supp. 1006, 1017 (citing *Leggett v. Missouri State Life Ins. Co.* (Mo. 1960) 342 S.W.3d 833, 851); *RTC v. Hovnanian* (D.N.J. 1994) 1994 U.S. Dist. LEXIS 19359, at 18-24; *Haydinger v. Freedman* (E.D. Pa. June 8, 2000) No.Civ.A. 98-3045, 2000 WL 748055, at *8.

N.E.2d 876, 887). Indeed, the Court of Appeal's review of Illinois business judgment rule decisions demonstrated that Illinois courts do not evaluate the substantive merit of the business decision at issue.[6]

Thus, the Court of Appeal correctly found that the "completely without merit" prong of the Illinois business judgment rule focuses on the decision-making *process*. Under that prong, the Illinois courts do not decide whether the business judgment was correct or incorrect, but look to whether "the board was motivated by a business reason." Op. at 54 (citing *Romanik v. Lurie Home Supply Center, Inc.* (Ill. App. Ct. 1982) 435 N.E.2d 712, 723). In *Romanik*, the court rejected a challenge to a board's withholding of a dividend because "there were several business reasons for the board's decision to not declare dividends" including "the purchase of a warehouse, the expansion of inventory and the possibility that the company might have to finance its own inventory." *Romanik*, 435 N.E.2d at 723.

Here, the record establishes that there were valid business rationales for the Board's decision not to liquidate its surplus to pay dividends. Among those business rationales were the fact that surplus is especially important for a mutual company (such as State Farm), which cannot raise

[6] California also refuses to examine the substantive merit of a corporate decision in determining whether the business judgment rule applies. *See, e.g., Desaigoudar v. Meyercord* (2003) 108 Cal.App.4th 173, 187 (applying California business judgment rule; rejecting scrutiny of "substance" of decision).

money in the stock market and whose ability to pay policyholders depends upon its surplus; that part of State Farm's strategic plan was to use its surplus to fund growth and to allow lower insurance rates for State Farm policyholders. *See* Op. at 13, 15, 19. Given the business rationales for the directors' dividend and surplus decisions, the assertions by Hill's experts that State Farm's directors should have made different decisions are irrelevant to the "totally without merit" prong of the Illinois business judgment rule.

In short, the Court of Appeal was correct under Illinois law in declining to evaluate the substantive merit of the Board's dividend decisions.

### C. **This Petition Does Not Present Any Important Unresolved Question of Law Regarding a Corporate Board's Duty to Inform Itself Sufficiently**

Hill asserts that this Court should grant review "in order to determine whether the business judgment rule bars liability for the harm done by corporate boards which fail to inform themselves adequately before making decisions." Pet. at 15. Hill incorrectly claims that the Court of Appeal "in practice . . . has barred any challenge to the reasonableness of the Board's judgment as to what is needed to make informed judgments on dividends and surplus." Pet. at 16. Hill also wrongly contends that the Court of Appeal improperly rejected the use of expert testimony on the issue of the sufficiency of the information considered by the Board and misapplied California summary judgment standards. None of Hill's contentions raises an important question of law or present any conflict needing resolution by this Court.

The Court of Appeal correctly opined that "[u]nder Illinois law, the business judgment rule requires that the directors 'becom[e] sufficiently informed to make an independent business decision'" and thus "have 'the duty to inform themselves of the material facts necessary to exercise their judgment." Op. at 42 (citation omitted). The Court also concluded that State Farm's directors fulfilled that duty.

Hill claims that the Court of Appeal conducted an "extensive review of the evidence presented by State Farm and "ignored" the purported "conflicting" evidence presented by Hill. Pet. at 17. The Court of Appeal specifically considered Hill's evidence and properly ruled that that evidence was insufficient to rebut the presumption of the business judgment rule. Contrary to Hill's contentions, Illinois law is clear that the question for the courts is not whether a plaintiff has presented some or any evidence, but whether a plaintiff has "presented *enough* evidence" to establish some exception to the business judgment rule. *Ferris Elevator Co. v. Neffco, Inc.* (Ill. App. Ct. 1996) 674 N.E.2d 449, 355-56; *see id.* at 453 ("The burden is on the party challenging the [corporate] decision to present facts rebutting the presumption.").

In determining that Hill's evidence did not rebut the business judgment rule presumption that State Farm's directors were sufficiently informed, the Court of Appeal did not resolve disputed or conflicting issues of fact (as Hill claims). In particular, the Court of Appeal did not disregard the supposedly "contradictory" testimony of State Farm's Chief Actuary Gary Grant that State Farm's "actuaries never analyzed the adequacy of State Farm's surplus to cover its risks and needs." Pet. at 18. The Court of Appeal was not obliged to accept Hill's characterization of Mr. Grant's testimony. *See* Op. at 21. Rather, the Court of Appeal expressly recognized that Mr. Grant did not (as Hill claims) testify that no actuarial analysis was done of the adequacy of the surplus; rather he testified it was the *Board*, not State Farm's actuaries, which made the ultimate determination as to the size and use of surplus. *See* Op. at 21.

State Farm's Board received ample "actuarial" information and analysis regarding the surplus and the actuarial risks faced by State Farm. That evidence and testimony regarding the financial and actuarial information received by the Board on a monthly quarterly and yearly basis is not "contradicted" by the opinions of their experts that they believe that the Directors should have received different or additional analyses of the surplus. As Judge Kuhl pointed out, "[i]t is always possible to allege that something more or different could have been considered in making a corporate decision." (23AA06467).

Nor do Hill's experts support Hill's contention that the Board "ma[de] dividend decisions without the benefit of regular actuarial analyses of the company's surplus needs." Pet. at 19. Professor Bebchuk did not in fact opine that State Farm's Board made its decisions without information as to the adequacy of the surplus. Rather, he complained that the Board was not provided with an analysis of the "minimum necessary level of surplus" that State Farm could get along with, which Professor Bebchuk explained was "quite different from determining whether a given level of surplus (say, one that the insurer now has) is adequate." (8AA2040). The Court of Appeal was not obliged to accept the experts' conclusory statements that the Board was not sufficiently informed because it did not have an actuarial analysis providing a number purportedly representing the "minimum necessary level of surplus." *Id.* Hill provided no evidence, expert or otherwise, that insurance company boards customarily obtain such an analysis. In fact, Hill failed to present any evidence that *any* insurance company board ever obtained such an analysis or regarded such an analysis as necessary for its surplus and dividend decisions. Furthermore, as the Court of Appeal noted, although Hill contended that such an *analysis* was necessary, Hill's experts never identified any additional sources of actuarial data or facts that the Board should have had but did not. *See* Op. at 46.

Contrary to Hill's contentions, California summary judgment standards do not allow a party to defeat summary judgment by offering an expert's conclusory opinion that conduct is reasonable or unreasonable. Here, there is no genuine dispute as to the substantial amount of actuarial and other information that the Board actually received and considered regarding State Farm's surplus and financial condition. Since the underlying facts are undisputed, the reasonableness of the information considered by State Farm's Board and the question of whether the Board was sufficiently informed for purposes of the business judgment rule, became an issue of law that was properly decided by the Court of Appeal and the trial court before it. *See Towns v. Davidson* (2007) 147 Cal.App.4th 461, 473 (holding that plaintiff's expert's testimony did not create triable issue of fact, because expert "added nothing beyond declaring the undisputed facts in his opinion constituted recklessness"); *City of Gardena v. Camp* (1977) 70 Cal.App.3d 252, 255 (reasonableness is an issue of law where underlying facts are uncontradicted and where uncontradicted evidence permits only one conclusion).

The Court of Appeal's conclusion that State Farm's Board was sufficiently informed presents no legal issue as to the proper application of the California summary judgment standard, does not improperly reject expert opinion, and does not present any unresolved legal issue for this Court's review.

## D. The Factual Issues Raised by the Petition Do Not Provide Grounds for Review by this Court

None of the factual issues raised in the Petition satisfy Rule 8.500(b)(1). In addition, those factual claims are incorrect.

First, Hill asserts that the Court of Appeal "disregarded" or "weighed" and "found wanting" evidence supposedly "showing that the Board was misinformed as to its responsibilities to policyholders" because the Board purportedly "erroneously understood itself to be . . . required to 'consider the effects of any action . . . upon employees, suppliers and customers . . . and its subsidiaries.'" Pet. at 20 (quoting Illinois Bus. Corp. Act § 8.85). In fact, the Court of Appeal properly concluded that Hill's evidence did not create any disputed factual question with regard to the Board's dividend and surplus decisions. In particular, the Court found that Hill had not shown that the Board's alleged misunderstanding had any effect on or role in its dividend decisions or disadvantaged policyholders in any way. Op. at 47-48. The Court pointed out that Hill's allegations rested upon testimony given by Dr. Jaedicke, who "was one of 13 directors," and that there was no evidence that Dr. Jaedicke "gave [section 8.85] any thought in making dividend or surplus decisions" or that any other director or officer did so. *Id.*

Likewise, the Court of Appeal properly held that the tax issue raised by Hill "is a red herring." Op. at 48. As the Court explained, Hill "seize[d] on . . . isolated comments" by a State Farm director and a State Farm actuary as to the tax consequences of a sale of capital assets to pay dividends. *Id.* Again, the Court pointed out the lack of any showing of a causal connection between the alleged misunderstanding and the Board's dividend and surplus decisions:

> Plaintiffs seize on these isolated comments in arguing that the *Board's* confusion over tax issues led to the mistaken conclusion that State Farm should not sell any assets from the surplus. To the contrary, the *complete* testimony of Jaedicke and Hayward indicate that their real concern was not tax liability, if any, but the loss of the income-producing asset itself. And, again, Jaedicke was just one of several directors. His individual opinions about taxes were inconsequential given that no other director mentioned the subject. As for Hayward, he too conceded a lack of tax knowledge – "I'm not a tax expert" – and his tax opinions had no effect on the type of data he generated as an actuary. Finally, we have just explained that the Board as a whole, including Jaedicke, gave many reasons – other than taxes – for retaining the surplus.

*Id.* In short, the Court of Appeal did not disregard or improperly weigh Hill's evidence. Rather, the Court provided a correct analysis of why Hill's purported evidence raised no question of material fact.[7]

Finally, the Petition reproduces snippets of testimony that Hill claims raise issues of fact as to the Board's purported failure to deliberate

[7] Hill incorrectly contends that California caselaw "specifically establish[es] that ignorance of relevant tax law defeats application of the business judgment rule." Pet. at 21. Neither *Lee v. Interinsurance Exchange* (1996) 50 Cal.App.4th 694, 715-16, which Plaintiffs cite, nor any other California or Illinois authority establishes any such blanket proposition.

and purported lack of information. The Court of Appeal's lengthy analysis and review of the evidence as a whole refutes the significance that Hill attempts to attribute to these snippets. Indeed, the opinion quotes at length the same testimony by Director Jaedicke that Hill reproduced on page 23 of the Petition. Op. at 22. Moreover, although Hill claims that these small excerpts raise issues of fact, the Petition offers no challenge to the extensive legal analysis by the Court of Appeal that supports the Court's conclusions that "Plaintiffs' attack on the Board's deliberations ignores important principles of corporate governance" and that Hill was wrong in "tak[ing] the position that the Board had to discuss a possible dividend every year." Op. at 38, 40.

Both the trial court and the Court of Appeal conducted extensive and pains-taking reviews of the evidence in this case, and both concluded that Hill failed to substantiate any exception to the business judgment rule. Hill's factual disagreements with those conclusions present no grounds for review by this Court.

## IV. CONCLUSION

The overarching purpose of the business judgment rule is to insure that Board decisions that are rational, made in good faith, and do not involve a conflict of interest, are not subjected to second-guessing by judges and jurors who lack business experience and acumen. Cases involving fact patterns that fall within the protection of the rule should be adjudicated by summary judgment and not left for trial. Here, an outstanding trial judge and an exceptionally experienced appellate panel both performed searching analyses and found under well-established principles of Illinois law that the challenged conduct was clearly protected. Hill has totally failed to demonstrate that there is anything in the Court of Appeal decision that warrants review by this Court. State Farm urges that the Petition for Review be denied.

Dated: November 17, 2008

SKADDEN, ARPS, SLATE,
MEAGHER & FLOM LLP

By:____________________
Raoul D. Kennedy

ROBIE & MATTHAI,
A Professional Corporation

By: James R. Robie (RDK)
James R. Robie

Attorneys for Defendant-Respondent
State Farm Mutual Automobile
Insurance Company

## RULE 8.204(c)(1) CERTIFICATE

The undersigned counsel hereby certifies, pursuant to Rule 8.204(c)(1) of the California Rules of Court, that Respondents' Answer To Petition For Review uses a proportionally spaced Times New Roman 13-point typeface, and that the text of the brief totals 8,185 words, including footnotes, according to the word count provided by Microsoft Word, the word processing software used to prepare the brief.

Dated: November 17, 2008

SKADDEN, ARPS, SLATE,
MEAGHER & FLOM LLP

By:________________________
Raoul D. Kennedy

**STATE OF CALIFORNIA, COUNTY OF SAN FRANCISCO**

I am employed in the county of San Francisco, State of California. I am over the age of 18 and not a party to the within action; my business address is 4 Embarcadero Center, Suite 3800, San Francisco, California 94111.

On November 17, 2008, I served the following document described as:

**ANSWER TO PETITION FOR REVIEW**

on the interested parties in this action by placing true copies thereon enclosed in sealed envelopes addressed as follows:

**SEE ATTACHED SERVICE LIST**

☒ (BY FEDERAL EXPRESS) I am readily familiar with the firm's practice for the daily collection and processing of correspondence for deliveries with the Federal Express delivery service and the fact that the correspondence would be deposited with Federal Express that same day in the ordinary course of business; on this date, the above-referenced document was placed for deposit at San Francisco, California and placed for collection and delivery following ordinary business practices.

☐ (BY U.S. MAIL IN THE ORDINARY COURSE OF BUSINESS) I am readily familiar with the firm's practice for the collection and processing of correspondence for mailing with the United States Postal Service and the fact that the correspondence would be deposited with the United States Postal Service that same day in the ordinary course of business; on this date, the above-referenced correspondence was placed for deposit at San Francisco, California and placed for collection and mailing following ordinary business practices.

I declare under penalty of perjury under the laws of the State of California that the above is true and correct.

Executed on November 17, 2008, at San Francisco, California.

Pat Owens

Pat Owens

## SERVICE LIST

J. Michael Hennigan
Robert L. Palmer
Mark Anchor Albert
HENNIGAN, BENNETT &
DORMAN LLP
865 South Figueroa Street, Suite 2900
Los Angeles, California 90017
Tel: 213-694-1200

Attorneys for Plaintiffs-Petitioners and Appellants

Timothy J. Morris
GIANELLI & MORRIS
A Law Corporation
626 Wilshire Boulevard, Suite 800
Los Angeles, California 90012
Tel: 213-489-1600

Attorneys for Plaintiffs-Petitioners and Appellants

Robert S. Gerstein
LAW OFFICES OF
ROBERT S. GERSTEIN
12400 Wilshire Boulevard, Suite 1300
Los Angeles, California 90025
Tel: 310-820-1939

Attorneys for Plaintiffs-Petitioners and Appellants

Raymond E. Mattison
ERNST & MATTISON
1020 Palm Street
P.O. Box 1327
San Luis Obispo California 93406
Tel: 805-541-0300

Attorneys for Plaintiffs-Petitioners and Appellants

Honorable Carolyn B. Kuhl
Los Angeles County Superior Court
Central Civil West Courthouse
600 South Commonwealth Ave.
Los Angeles, California 90005

Clerk of the Court
California Court of Appeal
Second Appellate District, Division 3
Ronald Regan Building
300 South Spring Street, 2nd Floor,
North Tower
Los Angeles, California 90013-1213