B194463

IN THE COURT OF APPEAL
OF THE STATE OF CALIFORNIA
SECOND APPELLATE DISTRICT, DIVISION ONE

JERRY HILL et al.,
Plaintiffs and Appellants,

vs.

STATE FARM MUTUAL AUTOMOBILE INSURANCE COMPANY et al.,
Defendants and Respondents.

APPEAL FROM THE SUPERIOR COURT FOR LOS ANGELES COUNTY
CAROLYN B. KUHL, JUDGE • BC194491 (CLASS ACTION)

AMICUS CURIAE APPLICATION AND BRIEF OF PERSONAL INSURANCE FEDERATION OF CALIFORNIA, IN SUPPORT OF RESPONDENTS

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AMICUS CURIAE APPLICATION

Pursuant to California Rules of Court rule 8.200(c), the Personal Insurance Federation of California (PIFC) requests that this amicus curiae brief be accepted for filing. PIFC is a California-based trade association that represents insurers, including State Farm, who write approximately 40 percent of the personal lines insurance sold in California. PIFC represents the interests of its members on issues affecting homeowners, earthquake, and automobile insurance before

the California Legislature, the California Department of Insurance, and the California courts.

PIFC's membership includes mutual insurance companies with a strong interest in the main issue presented by this case, namely, under what circumstances does a policyholder have the right to challenge a mutual insurance company's decision to treat surplus as a contingency reserve fund instead of a source of dividends? PIFC's members have a particular interest in the development of a consistent and uniform body of caselaw on this issue.

This issue will be resolved in this case under the law of the State of Illinois. As we show, Illinois law, and the law of every other jurisdiction that speaks to this issue, affirms that it is highly desirable for insurers to have considerable surplus in addition to required reserves; that policyholders, such as plaintiffs here, have no contractual right to have surplus distributed as dividends; and that the decision whether to distribute surplus as dividends is left to the discretion of the company's board of directors and is not to be second-guessed by the courts.

AMICUS CURIAE BRIEF

INTRODUCTION

This court has previously explained the importance of the type of surplus maintained by State Farm here: "'[S]urplus provides a safety cushion to absorb adverse results and protects the policyholder and the company by helping maintain the company's solvency during periods of unfavorable operating results.' [Citation.] As the amount of surplus increases, the risk of insolvency decreases. [Citation.] The payment of dividends reduces the surplus. [Citation.] [¶] State Farm invests its surplus, and the return on that investment is an essential part of the company's overall financial position. An insurer must have an adequate surplus at all times, especially in light of potential catastrophes that may result in substantial damage to numerous policyholders." (*State Farm Mutual Automobile Ins. Co. v. Superior Court* (2003) 114 Cal.App.4th 434, 441 (*State Farm*).)

This court has also previously recognized that determining the proper amount of surplus to maintain is a policy decision best left to each individual insurer: "The financial soundness of an insurance company 'depends on numerous factors that are difficult to quantify, and the insurance market is characterized by substantial diversity across insurers in types of business written, characteristics of customers, and methods of operation. It is impossible to specify the 'right' amount of [surplus] for most insurers through a formula.'

[Citation.] Each insurance company has its own method for determining the amount of surplus it considers to be inadequate." (*State Farm, supra,* 114 Cal.App.4th at p. 441.)

Finally, this court has held that Illinois law governs this dispute over the surplus of an Illinois mutual insurance company: "'It would be impractical to have matters . . . which involve a corporation's organic structure or internal administration [] governed by different laws. It would be impractical, for example, if . . . an issuance of shares, *a payment of dividends,* a charter amendment, or a consolidation or reorganization were to be held valid in one state and invalid in another. . . . In the absence of an explicitly applicable local statute to the contrary, . . . the local law of the state of incorporation has been applied to determine issues involving corporate acts of the sort [mentioned].' . . . [¶] '[U]niform treatment of the shareholders of a corporation is an important objective which can only be attained by having their rights and liabilities with respect to the corporation governed by a single law.'" (*State Farm, supra,* 114 Cal.App.4th at p. 443.)

"Illinois law is in accord with a leading treatise on corporate decision-making: 'The business judgment rule protects a board's decision regarding payment of a dividend or the making of a distribution. A court will not compel a distribution unless withholding the distribution is explicable only on the theory of an oppressive or fraudulent abuse of discretion.'" (*State Farm, supra,* 114 Cal.App.4th at pp. 450-451.)

As PIFC demonstrates in this brief, plaintiffs are seeking the assistance of this court to get around Illinois law. Just as California insurers should not have their internal business decisions second-guessed by sister state courts, this court should affirm the trial court's refusal to second-guess State Farm's lawful conduct under Illinois law.

LEGAL ARGUMENT

UNDER ILLINOIS LAW, PLAINTIFFS DO *NOT* HAVE A CONTRACTUAL RIGHT TO BE PAID DIVIDENDS OUT OF STATE FARM'S SURPLUS.

A. State Farm's contract with its policyholders does not afford them any right to dividends paid out of surplus.

Under Illinois law, the fundamental premise of plaintiff's lawsuit —that they have a contractual right to be paid dividends out of State Farm's surplus—is erroneous. Illinois law gives State Farm's board of directors the discretion to treat surplus as a contingency reserve fund. Plaintiffs have no judicial remedy unless they can prove the board of directors acted *unlawfully, wrongfully, or by mistake.*

Under Illinois law, the "rights and interests of policyholders in the assets of a mutual life insurance company are contractual in nature and are measured by their policies and by the statutes, charter and by-laws, if any, which comprise the terms of their contracts . . . . '*Whatever*

rights a member of a mutual company has are delineated by the terms of the contract, and come from it alone. . . . If the plaintiff depends upon anything but his rights under the contract contained in the policy, he depends upon something that does not exist.' " (*Lubin v. Equitable Life Assur. Soc. U.S.* (1945) 326 Ill.App. 358, 365-366 [61 N.E.2d 753, 756], emphasis in original (*Lubin*).)

Many of the State Farm *insurance policies* involved in this case state that a policyholder "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." (11 AA 2952.) The remaining State Farm insurance policies involved in this case state that a policyholder "is entitled . . . to share in the earnings and savings of the company in accordance with the dividends declared by the Board of Directors on this and like policies." (11 AA 2924.) There is no significant difference between these two policy provisions. (*Boynton v. State Farm Mut. Auto. Ins. Co.* (1993) 207 Ga.App. 756, 757 [429 S.E.2d 304, 306] [both provisions are "clear statements in [State Farm's] policies that [the policyholder] was entitled to share in company earnings and savings only if and to the extent dividends were declared by the Board in its discretion"].) [1/]

1/ It also should be noted that all of the insurance policies involved in this case provide that "this policy contains all of the agreements between *you* and us or any of our agents." (1 AA 135, 151, emphasis in original.)

State Farm's *bylaws*, which are considered part of the insurance contract (*Lubin, supra*, 61 N.E.2d at p. 756), provide that the "Board of Directors may authorize from time to time such refunds or credits to policyholders from the savings and gains of the Corporation and upon such terms and conditions and in such amounts or percentage as may, in their judgment, be proper, just and equitable" (11 AA 2964).

Illinois *statutory law* provides that the "board of directors . . . may from time to time fix and determine the amount of dividends . . . to be returned to each policyholder, . . . after retaining sufficient funds for the payment by the company of all outstanding policy and other obligations." (215 ILCS 5/54(2).) The word "may" in this statute does not mean "shall." (*Rothschild v. New York Life Ins. Co.* (1901) 97 Ill.App. 547 [1901 WL 2081, at pp. *3 -*5] [statute providing that mutual life insurers "'may make distribution of such surplus as they may have accumulated, annually, or once in two, three, four or five years, as the directors thereof may from time to time determine'," did not require that surplus be distributed at least once every five years]. [2/])

Illinois statutory law further provides: "An excess of capital over the amount produced by the risk-based capital requirements contained in this Code and the formulas, schedules, and instructions referenced

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2/ In *Rothschild*, a mutual life insurer issued two life insurance policies to the plaintiff in 1895. The insurer's charter provided that no dividends would be paid on the policies until 1915. In 1895, the insurer's surplus was $20.2 million. By 1900, it was $41.4 million. The insured sued to require payment of his equitable share of the surplus for the first five years of his policies. The trial court sustained the insurer's demurrer. The Illinois Appellate Court affirmed.

in this Code is desirable in the business of insurance. Accordingly, insurers should seek to maintain capital above the RBC levels required by this Code. Additional capital is used and useful in the insurance business and helps to secure an insurer against various risks inherent in, or affecting, the business of insurance and not accounted for or only partially measured by the risk-based capital requirements contained in this Code." (215 ILCS 5/35A-10(e).)

Arguably, these statutes are not just part of the insurance contract; the statutes are themselves outcome-determinative. (See *Lommen v. Modern Life Ins. Co.* (1942) 212 Minn. 577, 583-584 [4 N.W.2d 639, 643] [*policy* provision *requiring* payment of dividends from surplus was void because it violated a *statute* giving the board of directors discretion to decide how much of the earnings and profits to allocate to divisible surplus]; *White Fuel Corporations v. Liberty Mut. Ins. Co.* (1943) 313 Mass. 165, 169 [46 N.E.2d 548, 550] ["Since in our opinion the applicable [Massachusetts] *statutes* gave the defendant power, acting in good faith, to accumulate a surplus and to withhold distribution from the plaintiff of any part of it, we are not called upon to decide whether such power has been created or could be created by the terms of the defendant's by-laws and of the several contracts of insurance. It is enough to say that the by-laws and the policies recognize the existence of the power and contain no qualifications limiting its exercise" (emphasis added)].)

B. Illinois case law strongly supports State Farm's right to decide when and if to pay dividends out of surplus.

In *Lubin, supra,* 61 N.E.2d 753, which is the leading Illinois case on mutual insurers' surplus and dividends, the plaintiffs sued for their proportionate shares of mutual life insurers' undistributed surplus. The plaintiffs' complaints were dismissed. The Illinois Appellate Court affirmed, explaining in detail:

"Surplus is the excess of assets each year over the legal reserve and other liabilities, which consist principally of losses and expenses of operation. Such surplus is usually referred to as the 'total surplus' of an insurance company. That portion of the total surplus determined by each company's board of directors to be available for dividends is called the 'divisible surplus.' Only what remains of the total surplus in any year after the divisible surplus has been determined and set apart for the payment of dividends constitutes what will be variously referred to hereinafter as the 'contingency reserve' or 'safety fund.' The contingency reserve or safety fund as determined at the end of each year is added to the contingency reserve or safety fund previously accumulated since the inception of each of the defendant companies. Such contingency reserve funds were created and are maintained by the defendants as an *additional factor of safety for the protection of their policyholders against extraordinary hazards,* such as major epidemics, wars

and financial crises or panics. [3/] It is to compel the payment to them and other former policyholders of what they claim to be their proportionate shares of each of the defendant company's contingency reserve or safety fund that plaintiffs have instituted these suits." (*Lubin, supra,* 61 N.E.2d at p. 755, emphasis added.)

The Illinois Appellate Court in *Lubin* continued:

"All of the contentions made in plaintiffs' brief add up to the single contention that they . . . have the right to have distributed to them by the defendant companies such portion of their 'contingency reserve' funds as they contributed thereto while their policies were in force. In so far as we have been able to ascertain, *this contention has been rejected by every court of review in every jurisdiction in this country to which it has been presented.* . . . [¶] In view of the fact that the law governing

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3/ "In insurance accounting general contingency reserves are . . . assets reserved or withheld from distribution as dividends for the purpose of meeting losses which may occur in the future from extraordinary, unforeseeable and unpredictable causes. A contingency reserve is set aside and maintained for the purpose [of] providing an extra margin of safety and is held as a second line of defense against insolvency." (*Leggett v. Missouri State Life Ins. Co.* (Mo. 1961) 342 S.W.2d 833, 901.)

"[T]he directors must consider what is known in the casualty industry as the 'ruin problem' in determining the disposition of earnings. The ruin problem is the likelihood, however remote, that a combination of adverse circumstances such as a material decline in investments, a catastrophic loss or a marked increase in ordinary loss and rising expenses will occur simultaneously." (*Gross v. Philadelphia Contributionship* (Ct.Com.Pl. 1975) 73 Pa. D. & C.2d 654, 665 [1975 WL 16907].)

every aspect and phase of the theory of plaintiffs' complaints had been long and well established prior to the filing of said complaints, we are constrained to believe that the . . . suits involved herein were instituted solely for what possible nuisance value they might prove to have." (*Lubin, supra,* 61 N.E.2d at p. 760, emphasis added.)

The Illinois Appellate Court in *Lubin* continued:

"The law is settled that policyholder members of a mutual life insurance company are not partners therein and that the relationship of such a company to its policyholders is not that of trustee and cestui que trust but simply that of debtor and creditor. [Citations.] [4/]

"Defendants insist that 'the determination of the amount and the apportionment of surplus earnings to policyholders is a matter for the exercise of sound business discretion on the part of defendants' boards of directors, acting under controlling statutes and decisions which expressly authorize them to set aside and maintain out of earnings a corporate surplus, contingency reserve or safety fund.' Since none of the complaints alleged that the boards of directors of the defendant companies at any time while plaintiffs' policies were in force failed to properly determine the amount and the apportionment of the divisible surplus [i.e., that portion of the total surplus available for dividends]

4/ "The money paid for premiums is no more the money of the policy holders than the money deposited in a bank is the money of the depositors. In either case the money paid or deposited becomes the money of the corporation, and the policy holder or depositor becomes a *creditor* entitled to payment in accordance with the contract of the corporation." (*Townsend v. Equitable Life Assur. Society of U.S.* (1914) 263 Ill. 432, 437 [105 N.E. 324, 326], emphasis added.)

or that such boards of directors acted *unlawfully, wrongfully or by mistake* in making such determination or in determining the amount of the contingency reserve or safety fund necessary to be maintained to protect the interests of existing or future policyholders, the insufficiency of the complaints in this regard alone constituted adequate ground for their dismissal.

"In *Equitable Life Assur. Soc. v. Brown,* 213 U.S. 25, 29 S.Ct. 404, 53 L.Ed. 682, the plaintiff sought to compel a distribution of the defendant's corporate surplus or contingency reserve fund, which was eighty million dollars in excess of its required legal reserves and the maintenance of which was alleged to be unlawful and unnecessary for the prudent management of its business. The court said, 213 U.S. at page 47, 29 S.Ct. at page 411, 53 L.Ed. 682:

'We also think that there is no ground for the contention on the part of the complainant that he, as a policy holder, had any right to an accounting, and to compel the distribution of the surplus fund in other manner, or at any other time, or in any other amounts than that provided for in the contract of insurance. By that contract he was entitled to participate in the distribution of some part of the surplus, according to the principles and methods that might be adopted from time to time by the defendant for such distribution, which principles and methods were ratified and accepted by and for every person who should have or claim any interest under the policy. It has been held that, under such a policy, how much of the surplus shall be distributed to the policy holder and how much shall be held for the security of the

defendant and its members is to be decided by the officers and management of the defendant, in the exercise of their discretion to distribute, having in mind the present and future business, and, in the absence of any allegations of *wrongdoing or mistake* by them, their determination must be treated as proper, and their apportionment of the surplus is to be regarded prima facie as equitable.' " (*Lubin, supra,* 61 N.E.2d at p. 758, emphasis added.)

C. Every other jurisdiction to consider the question has likewise held that mutual insurance companies have discretion to set surplus levels and to determine whether, and in what amount, to pay dividends out of surplus.

At the end of the passage just quoted by the Illinois Appellate Court from the United States Supreme Court's opinion in *Equitable Life Assur. Society of U.S. v. Brown* (1909) 213 U.S. 25 [29 S.Ct. 404, 53 L.Ed. 682] (a diversity case applying New York law), the U.S. Supreme Court cited a leading New York case, *Greeff v. Equitable Life Assur. Soc. of United States* (1899) 160 N.Y. 19 [54 N.E. 712] (*Greeff*). [5/]

5/ The Illinois Appellate Court itself also directly cited *Greeff* (in another part of the *Lubin* opinion) as an example of a case holding that the rights of a member of a mutual insurance company are delineated by the terms of the contract. (*Lubin, supra,* 61 N.E.2d at p. 756.)

In *Greeff*, the plaintiff bought a life insurance policy in 1882, when the insurer's undistributed surplus was just over $8 million. By 1896, the undistributed surplus had grown to over $43 million. Some surplus had been distributed in the interim, but only from profits accruing during the year, without diminishing the surplus on hand at the end of the preceding year. The plaintiff sued for his proportionate share of the $43 million in undistributed surplus. (*Greeff, supra*, 54 N.E. at pp. 713-714.)

New York's highest court began its opinion by explaining that the "determination of the principles involved will not only affect existing contracts amounting to many million dollars, but may disturb the methods and basis upon which vast business transactions have hitherto been conducted, and create confusion and disorder in a system under which an important branch of business has been transacted for at least a half century." (*Greeff, supra*, 54 N.E. at p. 712.)

The *Greeff* court explained that the "plaintiff's claim, that the whole surplus should be distributed, cannot be sustained, if it is in conflict with the provisions of the contract between the parties, without making a new contract for them, which the court will not do. [6/] Therefore this question depends for its solution upon a proper

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6/ Illinois courts will not do it, either. (*Frederick v. Professional Truck Driver Training School, Inc.* (2002) 328 Ill.App.3d 472, 481 [75 N.E.2d 1143, 1152 ["It is well established that 'where the terms of a contract are clear and unambiguous, they must be enforced as written, and no court can rewrite a contract to provide a better bargain to suit one of the parties'"].)

interpretation of the provisions of the policy." (*Greeff, supra,* 54 N.E. at p. 714.)

The policy provided that the plaintiff was " 'entitled to participate in the distribution of the surplus . . . according to such principles and methods as may from time to time be adopted . . . for such distribution . . . .' " (*Greeff, supra,* 54 N.E. at p. 713.) The *Greeff* court said: "It is manifest that by the terms of the plaintiff's policy the only right he acquired was to share in an equitable distribution of the accumulated surplus. Until a distribution was made by the officers or managers of the defendant, the plaintiff had no such title to any part of the surplus as would enable him to maintain an action at law for its recovery." (*Id.* at p. 715.)

The *Greeff* court asked: "[W]ho is to determine what an equitable distribution of the surplus is? Or, in other words, the question is, who is to determine how much of the surplus shall be distributed to the policy holders, and how much shall be accumulated and retained for the security of the society and its members? Manifestly, that question is to be decided by the officers and managers of the defendant, who are to exercise their discretion in determining it, having in view the present and future contingencies of the business. In the absence of any allegation of *wrongdoing or mistake* by them, their determination of the question must be treated as proper, and their apportionment of the surplus is prima facie to be regarded as equitable." (*Greeff, supra,* 54 N.E. at p. 716, emphasis added.) "As there is in the complaint in this case no allegation of *bad faith, willful neglect, or abuse of discretion* by the

defendant or its officers, it seems clear that . . . this action cannot be maintained." (*Id.* at p. 715, emphasis added.)

The *Greeff* court added: "[W]hen the plaintiff obtained his policy, he knew, or, at least, could have easily ascertained, what principles and methods the defendant adopted in the distribution of its surplus . . . . Presumptively, the plaintiff knew that the defendant had an undistributed surplus . . . at the time his policy was issued, and that it was an added security thereto. That fact may very well have been an inducement to him to take a policy in the defendant's company. Thus, it is quite evident . . . that, independently of the provisions of the policy, he understood and consented to the principles and methods adopted and carried out by the defendant in its distribution." (*Greeff, supra,* 54 N.E. at pp. 716-717.)

The cases in other jurisdictions besides Illinois and New York agree with *Lubin* and *Greeff.* In fact, it remains true, as the Illinois Appellate Court pointed out in *Lubin, supra,* 61 N.E.2d at page 760, that other jurisdictions have *uniformly* rejected the argument that policyholders have a contractual right to the distribution of surplus held in contingency reserve. See, e.g.:

Black v. Pacific Mut. Life Ins. Co. (E.D.Ark. 1940) 31 F.Supp. 805, 806 (policy provided that the "'proportion of the divisible surplus accruing on this policy shall be determined by the company'"), 808 ("Since the contract gives the company the right to determine the amount of divisible earnings and their apportionment among the

policyholders, courts will not interfere unless there is bad faith, wilfull neglect, or abuse of discretion");

Royal Highlanders v. Wiseman (1941) 140 Neb. 28 [299 N.W. 459, 461] (board of directors approved distribution of $810,000 to policyholders; department of insurance directed distribution of an additional $514,000), 463 (bylaws provided that the "portion of . . . surplus to which said member shall be entitled, and the time and manner of payment shall be determined by the Executive Committee in accordance with the Edicts of the Society"), 466 ("where the board of directors is vested with the power . . . to determine the time, amount, and method of distributing surplus, the courts will not ordinarily interfere, in the absence of a showing of fraud or bad faith, or a clear transgression of a legislative mandate. [Citations.] [¶] It would seem that principles which determine the action of our judicial department would be equally potent as requirements to be observed by administrative officials");

Brown v. Royal Highlanders (1941) 140 Neb. 54 [299 N.W. 467, 472] ("The board of directors, in determining the amount of surplus which could safely be distributed, violated no provisions of statute, participated in no fraud and in no way exceeded its statutory powers. . . . It is . . . a matter within the legal discretion of the board of directors with which, in the absence of fraud, gross negligence, bad faith or violation of statutory limitations, the courts are powerless to interfere");

Cohen v. Prudential Ins. Co. of America (1959) 58 N.J.Super. 37, 46 [155 A.2d 304, 309] (policies and statute provided that "dividends shall be ascertained and apportioned by the board of directors"), 311 ("Plaintiffs argue that, since the directors have already set aside large sums for every conceivable contingency, there is no need to retain so large a sum in unassigned surplus and policyholders should be given the benefit of it. But . . . the declaration of dividends is left to the discretion of the company's directors by statute and the insurance contracts, and there is no proof that there has been an abuse of that discretion");

McDonald v. Medical Mut. of Cleveland, Inc. (Ct.Com.Pl. 1974) 41 Ohio Misc. 158, 162-163 [324 N.E.2d 785, 788-789] ("the propriety of the level of accumulated surplus . . . is essentially a business decision to be left in the hands of the board of trustees of Medical Mutual. [¶] Courts traditionally have refused to interfere in such business decisions of corporate managers absent the showing of fraud, abuse of discretion or bad faith. [Citations.] There has been no indication in these proceedings of any fraud, bad faith or abuse of discretion by the board of trustees of Medical Mutual in determining the level of surplus which is appropriate for the company"), affd. without opn. (Ohio Ct.App. 1975);

Gross v. Philadelphia Contributionship, supra, 73 Pa. D. & C.2d 654, 661-662 (charter and resolutions set no limit on the amount of surplus that may be accumulated, nor did they "confer on the policyholders an absolute right in the surplus. Until [a dividend] is declared, no policyholder has a right to demand any part of it"), 675 ("There has

been no abuse of discretion, bad faith, or arbitrary or erroneous conduct on the part of the directors or the defendant Corporation in the accumulation of the surplus");

Pincus v. Mutual Assur. Co. (Ct.Com.Pl. 1976) 4 Pa. D. & C.3d 71, 73 ("The burden a plaintiff must meet to compel such judicial intervention is extremely heavy. Only if clear disregard of official duties, arbitrary or manifestly erroneous actions, abuse of discretion, or bad faith on the part of directors or trustees is established may such relief be properly granted"), 77 ("Basically, plaintiffs would ask the court to decide which of the various assumptions [underlying the evidence] offered by both sides are the more reasonable. This would be a distinctly inappropriate task for the court to undertake. '[T]he court should not address itself to the various accounting theories and contentions which would support the payment of a dividend.' [Citation.] Instead, the court must limit its inquiry to the reasonableness of the actions and motivations of those charged with running this insurance company"), affd. (1977) 251 Pa.Super. 626 [381 A.2d 913];

Barnes v. State Farm Mut. Auto. Ins. Co. (1993) 16 Cal.App.4th 365, 379-380 ("Barnes . . . has failed to allege facts showing that the director's decision regarding the accumulation of State Farm's surplus was not made in good faith or in what the directors believed to be the

best interests of the corporation. He has alleged no facts demonstrating fraud, oppression, corruption or conflict of interest by the directors");[7/]

Boynton v. State Farm Mut. Auto. Ins. Co., supra, 207 Ga.App. 756, 757 [429 S.E.2d 304, 307] (the same policy language involved in the instant case, *Hill v. State Farm Mut. Auto Ins. Co.,* "negated" the policyholder's assertion that she had a "contractual right to her pro rata share of the company's income in excess of its needs");

Priori v. Prudential Ins. Co. of America (M.D.Ala. 2000) 92 F.Supp.2d 1264, 1268-1269 ("the clear language of the policy states that 'the portion, if any, of the divisible surplus of the Company accruing upon this Policy shall be determined annually by the Board of Directors' "; "the amount of dividends to be paid to the insureds is within the discretion of the directors of the mutual insurance company. [Citation.] [¶] . . . Priori would have to present some evidence that the directors abused their discretion, engaged in fraud, or misused corporate funds for a claim to proceed on a challenge to the dividends declared under Lena Priori's policy");

Geller v. Prudential Ins. Co. of America (E.D.N.Y. 2002) 237 F.Supp.2d 210, 217 (" 'The custom in the mutual insurance industry is to commit the declaration of the dividend to the discretion of the

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7/ In *Barnes,* the California Court of Appeal cited the Illinois Appellate Court's opinion in *Lubin, supra,* 61 N.E.2d 753, and stated *Lubin*'s holding this way: "complaint seeking to compel mutual insurer to declare dividends insufficient without factual allegations showing that 'directors acted unlawfully, wrongfully or by mistake.' " (*Barnes v. State Farm Mut. Auto. Ins. Co., supra,* 16 Cal.App.4th at p. 379, fn. 13.)

insurance company's board of directors, and its determination cannot be challenged absent a showing of bad faith,' " quoting *Prudential Ins. Co. v. Miller Brewing Co.* (7th Cir. 1986) 789 F.2d 1269, 1279, fn. 13);

Churella v. Pioneer State Mut. Ins. Co. (2003) 258 Mich.App. 260, 266 [671 N.W.2d 125, 129] ("We hold that policyholders do not have a right to compel distribution of a surplus where there is no statute, company bylaw, or contract provision according them that right, and where they did not sufficiently plead facts to overcome the business judgment rule"), 272 ("because plaintiffs did not explain how the directors' failure to consider a distribution constituted fraud or bad faith dealings, and because plaintiffs have not cited any cases indicating that a failure to declare a dividend, without more, constitutes an abuse of business discretion, we conclude that plaintiffs have not sufficiently pleaded facts that would overcome the business judgment rule"), 273 (conc. opn. of Bandstra, J.) ("[policyholders] are not without a remedy. If a majority of policyholders thinks that a distribution should be made, they can elect new board members who share that view");

5 Couch on Insurance (3d ed. 2005) section 80:51, page 80-56 ("The company officers and managers have the discretion to decide how much of the surplus should be retained by the company and how much of the surplus should be distributed to the policyholders. Courts will not interfere with such decisions when there has been no bad faith, willful neglect, or abuse of discretion").

CONCLUSION

Under Illinois law, and, for that matter, the law of every other jurisdiction in the U.S. that has addressed the issue, plaintiffs have no contractual right to compel payment of dividends from State Farm's surplus — not unless plaintiffs can prove that State Farm's board of directors, by treating surplus as a contingency reserve fund and not a source of dividends, acted *unlawfully, wrongfully, or by mistake.* (*Lubin, supra,* 61 N.E.2d at p. 758].)

By our reading of the parties' briefs, it does not appear that plaintiffs have proffered any evidence that State Farm's board of directors acted unlawfully, wrongfully, or by mistake. Absent such evidence, the trial court's order granting summary judgment in favor of State Farm should be affirmed.

Dated: October 22, 2007.

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CERTIFICATE OF WORD COUNT
(Cal. Rules of Court, rule 8.204(c)(1))

The text of this document brief consists of 5,254 words as counted by the Corel WordPerfect version 10 word-processing program used to generate the document.

Dated: October 22, 2007.

Jeremy B. Rosen

PROOF OF SERVICE [C.C.P. § 1013a]

I, **Caryn Shields**, declare as follows:

I am employed in the County of Los Angeles, State of California and over the age of eighteen years. I am not a party to the within action. I am employed by Horvitz & Levy LLP, and my business address is 15760 Ventura Boulevard, 18th Floor, Encino, California 91436. I am readily familiar with the practice of Horvitz & Levy LLP for collection and processing of correspondence for mailing with the United States Postal Service. In the ordinary course of business, such correspondence would be deposited with the United States Postal Service, with postage thereon fully prepaid, the same day I submit it for collection and processing for mailing. On **October 22, 2007**, I served the within document entitled **AMICUS CURIAE APPLICATION AND BRIEF OF PERSONAL INSURANCE FEDERATION OF CALIFORNIA, IN SUPPORT OF RESPONDENTS** on the parties in the action by placing a true copy thereof in an envelope addressed as follows:

Counsel Name/Address/Telephone	Party(ies) Represented
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The Honorable Carolyn B. Kuhl Central Civil West Courthouse, Dept. 323 600 South Commonwealth Avenue Los Angeles, CA 90005	[Case No. BC194491]
Clerk of the Court California Supreme Court 350 McAllister Street, Room 1295 San Francisco, CA 94102	[4 copies]

and, following ordinary business practices of Horvitz & Levy LLP, by sealing said envelope and depositing the envelope for collection and mailing on the aforesaid date by placement for deposit on the same day in the United States Postal Service at 15760 Ventura Boulevard, Encino, California.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct and that this declaration was executed on **October 22, 2007**, at Encino, California.

Caryn Shields