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Avery v. State Farm: The Potential for Abuse of the Class Action and Its Extraordinary Impact on Insurer and Insured

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CONSUMER NEWS

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I. Introduction

On October 4, 1999, a Williamson County, Illinois jury delivered the largest verdict ever against an insurer in a class action lawsuit, *Avery v. State Farm*, No. 97-L-114.[1] The jury returned a verdict in favor of the class plaintiffs and awarded damages totaling $456 million for State Farm's breach of contract as a result of the company's use of replacement parts.[2] The trial court subsequently affirmed the jury's verdict and awarded an additional $130 million in compensatory damages and $600 million in punitive damages for State Farm's violation of the Illinois Consumer Fraud and Deceptive Business Practices Act ("Consumer Fraud Act").[3] Under this judgment, State Farm has been ordered to pay approximately $1.2 billion to the estimated five million class plaintiffs in forty-eight states (who will each receive a share after their attorneys' substantial share of the verdict is deducted) due to State Farm's practice of specifying the use of non-original equipment manufacturer ("non-OEM") parts in auto repairs and estimates.[4]

This verdict has fueled significant fears amongst auto insurers.[5] Verdicts such as the one handed down in *Avery*, though seemingly pro-consumer, will eventually be paid out of consumers' pockets through higher insurance premiums. In addition, since competition has long been a cornerstone of the United States' economy, large verdicts such as *Avery*, and the future threat of litigation will cost consumers because competition in the repair parts market will be stifled. Finally, the propriety of the use of class actions involving millions of plaintiffs, and affecting states' regula-

tion of insurers' actions across the country, is a questionable practice at best. This article will discuss the recent misuse of the class action lawsuit as a legislative tool, and the impact that such misuse has had (and/or will inevitably have) on the insurance industry and on consumers' pocket books by addressing the details of the *Avery* decision (Part II), analyzing the effect of the decision on consumers (Part III), discussing the impropriety of use of the class action as a legislative tool (Part IV), and assessing the impact of such misuse on the American judicial system (Part V).

II. The Details of the *Avery v. State Farm* Decision

The *Avery* plaintiff class alleged three counts against State Farm: one for breach of contract and two for violations of the Illinois Consumer Fraud Act.[6] Under the Consumer Fraud Act, the plaintiffs were required to prove, by a preponderance of the evidence, ". . . (1) a deceptive act or practice by [State Farm]; (2) [State Farm's] intent that the plaintiffs [sic] rely on the deception (actual reliance on the part of the plaintiffs is not required); (3) the occurrence of the deception in the course [sic] of conduct involving trade or commerce; and (4) damage to the plaintiffs as a result of [State Farm's] violation of the act."[7] In addition, plaintiffs had to prove that the violation "directly and proximately caused their injury."[8]

The court specifically found: ". . . (1) [t]hat the contractual obligation of State Farm under its [sic] insurance policies is exactly the same whether State Farm promised to pay for 'crash parts' of 'like kind and quality' or promised to pay for 'crash parts' which restore a vehicle to its 'pre-loss condition'; (2) [t]hat the State Farm insurance policies allow State Farm to specify and pay for 'crash parts' made by the vehicle's manufacturer (Original Equipment Manufacturer, []) or 'crash parts' from other sources (non-Original Equipment Manufacturer []) so long as the 'crash parts' are of 'like kind and quality which restore the damaged vehicle to its 'pre-loss condition'; (3) [t]hat 'crash parts' are of 'like kind and quality' only if they restore a vehicle to its 'pre-loss condition'; and (4) [t]hat 'pre-loss condition' means the condition of the vehicle immediately before the time it is damaged."[9]

In its ruling, the court agreed with the jury that State Farm had breached its contract with the *Avery* plaintiffs because "the non-OEM 'crash parts' specified and used by State Farm were not

of 'like kind and quality' and did not restore plaintiffs' vehicles to their pre-loss condition as required by the insurance contract between State Farm and the plaintiffs."[10] The court also found that all four requisite elements under the Consumer Fraud Act were proven.[11] The decision specifies that the court found State Farm knew that the non-OEM parts specified in its policies were not "of [] 'like kind and quality' and would not restore their policyholders' vehicles to 'pre-condition'" and that State Farm did not reveal this information to its customers, but instead, misled them.[12] According to the court, "State Farm violated [the position of trust it held with its policyholders]."[13]

III. The Effect of the *Avery v. State Farm* Decision on Competition and Consumer Costs

American public policy has long encouraged competition in the consumer products market. Under the Magnuson-Moss Act of 1975,[14] for example, product manufacturers are prohibited from conditioning continued effectiveness of product warranties upon consumers' use of original manufacturer parts.[15] Replacement parts provide a less-costly alternative to OEM parts, causing the price of OEM parts to decrease. As a direct result, original manufacturers were forced to compete with lower prices offered by non-OEM part makers when insurance companies began using replacement parts for their policyholders' vehicles.[16] Throughout the 1970s, OEM parts monopolized the market.[17] Increased use of replacement parts has generated healthy competition and has stabilized the cost of both auto repair and insurance.[18] With few exceptions, replacement parts are "purely cosmetic" and do not decrease the safety of the car.[19] However, the cost of replacement parts varies immensely from the OEM parts — ranging from twenty to fifty percent less than OEM parts.[20]

The *Avery* jury viewed several memos relating State Farm's executives' concerns and questions about the safety of replacement parts as compared with OEM parts.[21] Yet, the judge and jury concluded that replacement parts, including fenders and hoods, were not "of like kind and quality" having never personally looked at a single repaired vehicle.[22] It is likely that occasional gaps exist between the quality of replacement parts and that of OEM parts.[23] However, the quality of OEM parts also varies from part to part.[24]

Ironically, auto manufacturers often "outsource" the production of their OEM replacement parts and, thus, some of the same companies that produce the allegedly unsafe non-OEM replacement parts implemented by State Farm also produce the purportedly "safe" parts for the automakers themselves.[25]

Based on a recent crash test performed by the Insurance Institute for Highway Safety, the allegation that replacement parts are less safe than OEM parts has been deemed a "red herring."[26] The study, released in February, 2000, revealed "no effect upon safety when vehicles are repaired with cosmetic parts made by aftermarket manufacturers instead of by the makers of the original equipment."[27] The Institute performed its test using a 1997 Toyota Camry. The cosmetic parts on the front of the car — the fender, bumper cover, and door skins, — were stripped from the vehicle and the hood — which does affect safety — was replaced with a non-OEM part.[28] When the vehicle was crashed in the Institute's "standard 40 mph frontal offset test," the results were "essentially identical to those of an original Toyota Camry" with OEM parts.[29] According to the Insurance Institute for Highway Safety, "[w]ith the possible exception of hoods, there are no safety implications of using cosmetic crash parts from any source."[30]

Class-plaintiffs' attorney, Thomas Thrash, called replacement parts "'knock-offs, imitation parts,'" claiming that State Farm never crash-tested the parts and that they were "'substantially inferior to the parts made by Ford, GM, Chrysler and the other automobile manufacturers.'"[31] Elizabeth Cabraser, also an attorney for the *Avery* class plaintiffs, commented that "the judgment illustrated the 'deception' of State Farm."[32] She further stated that "'[t]he punitive and compensatory damages ought to be enough to get State Farm's attention'" and that the *Avery* verdict will act as "'a wake-up call to other insurance companies utilizing the same practice.'"[33]

In contrast, at an October 19, 1999, news conference, the common theme was that the verdict was "a perfect example of abuses of class action litigation in state courts."[34] Participants in the news conference included members of the American Tort Reform Association, the Washington Legal Foundation, the U.S. Chamber of Commerce, the Citizens for a Sound Economy, and the National Association of Manufacturers.[35] If upheld, participants in the news conference predicted that the verdict would "hurt rather than help consumers."[36]

The *Avery* decision and its implied prohibition of insurers' use of non-OEM parts for vehicle repairs, based on little but conjecture and potential safety concerns, will decrease the competition which OEM manufacturers face. In addition, use of strictly OEM parts will cause insurance premiums to rise.[37] The effect: consumers pay — one way *and* another.

IV. Improper Use of the Class Action as a Legislative Tool in cases like *Avery v. State Farm*

State insurance policy makers and regulators, in response to increased use of replacement parts, examined the uses of replacement parts and considered a need for disclosure to consumers. Many, after such consideration, sanctioned insurance companies' use of replacement or non-OEM parts by statute.[38] The majority of the forty states that have enacted such legislation, including Illinois, have taken this "disclosure approach." Two states, Hawaii and Massachusetts, in order to decrease insurance costs, have passed provisions which *require* consideration of replacement parts.[39]

The *Avery* state court, in a single decision, has placed the insurance regulations of forty-seven *other* states in question. Because the *Avery* class included policyholders from every state except for Arkansas and Tennessee, the decision, in effect, "trumped the laws of 47 other states."[40] The *Avery* court did not formally prohibit State Farm's (or any other insurer's) continued use of replacement parts, but insurance companies' fear of similar lawsuits will likely yield the same result. So, what consumers face, aside from increased insurance premiums, is "'regulation through litigation.'"[41] And, though this may prompt more than one plaintiffs' attorney to gush excitedly about the fact that "'[y]ou don't need a legislative majority to file a lawsuit,'" the effect is a violation of one of the most important principles underlying the American democratic system — the separation of powers. As a result, our courts must soon decide whether de facto legislation of the insurance industry (and other industries) through class action lawsuits is an appropriate function of our judicial system.

The number of class actions filed in state courts alone increased 1,315 percent from 1988 to 1998.[42] The current trend in class action litigation, however, is that individual plaintiffs are awarded nominal compensation, while class action attorneys collect millions

in fees.[43] Mike Duncan, Senior Vice President, Secretary, and general counsel for the National Association of Independent Insurers ("NAII"), called *Avery* "'a perfect example of how class action lawsuits filed in state courts are abused by attorneys.'"[44] His conclusion is based on the fact that lawyers "forum shop" – look for a sympathetic judge and jury – when filing class actions.[45]

Cases such as *Avery* illustrate that not all state courts are willing to apply legal rules in a sufficiently predictable and consistent manner so as to eliminate such abuse. The *Avery* court, in rendering its potentially landmark-status decision, obviously takes no other states' laws, regulations, or policies into consideration. The court, instead, applied Illinois' Consumer Fraud Act to all the fraud claims of all class members while many had no ties to Illinois.[46] In the United States, the legal system affords much deference to the ideal of state sovereignty. In multi-state class actions, however, a state court holds the unchecked power to render a decision affecting other states' regulations and laws, and so, deference bends in favor of uniformity. State sovereignty sustains a blow when one state's court imposes its law upon forty-seven other states.[47]

V. Impact of Misuse of the Class Action as a Legislative Tool

As a result of the judgment in *Avery*, the American judicial system sustained yet another blow by the hand of an unchecked and powerful state class action. The auto insurance industry, its players, and the consumers, were also dealt an expensive blow. The rationale in *Avery*, and similar state class actions, does not withstand careful analysis and should not be allowed to stand as precedent. The *Avery* court ignored the decisions carefully made by insurance policy makers who are charged with the duty of overseeing the industry from day to day. It is improper for a court to usurp the decisions made, after years of study, by people whose job it is to make them.[48]

Additionally, the plaintiffs' attorneys purported to represent State Farm's policyholders from almost every state in the nation. Only six class representatives participated in the case. One of the essential elements necessary for proper class certification is that plaintiffs' claims have commonality. Commonality is required in order to assure that all the plaintiffs' claims can be appropriately resolved in one action.[49] "Commonality" is defined as "[t]he prin-

ciple that a group seeking to be certified as a class in a class action suit must share at least one issue whose resolution will affect all or a significant number of the putative class members."[50] Here, "[t]here is no logical way a single court could, in one decision, judge the quality of millions of parts without examining them on a case-by-case basis."[51] Interestingly enough, several similar cases, filed after the *Avery* decision, have been dismissed by other states' courts because of lack of commonality.[52]

In arguing their case, the class plaintiffs did not produce any policyholder that could testify that he had actually been physically or economically harmed by State Farm's practice of using replacement parts. Even more shocking is the fact that neither the judge nor the jury in the case actually examined any replacement parts.[53] The evidence put forth by the plaintiffs consisted, mostly, of expert testimony and conjecture about potential safety concerns. No evidence of injury was ever introduced. With such a low threshold regarding the introduction of evidence in the case, it is surprising that the court did not allow State Farm, in its defense, to introduce any evidence of the millions of dollars saved by consumers as a result of the use of non-OEM replacement parts.[54]

Calls for reform are being heard. A bill has been proposed which would allow multi-state class actions, praying for damages in excess of $75,000, to be removed to federal courts.[55] The proposed legislation, the Class Action Fairness Act, if enacted, would also require clear settlement terms. Specifically, it would determine the amount of and source of attorneys' fees, would set the relationship between the hours spent or the damages and the fees charged, and would provide sanctions for filing frivolous lawsuits. Another proposed provision, the Interstate Class Action Jurisdiction Act, was passed in the House in 1999.[56] If enacted, this Act would also make removal easier for defendants in multi-state class actions.[57] Both of these proposed bills would work to promote uniformity and consistency. Because multi-state class actions such as *Avery* inevitably act to regulate nationally, they should be heard in federal courts.

State Farm, in order to try to avoid subsequent litigation, voluntarily stopped its use of replacement parts. According to its calculations, State Farm's costs were $4.8 million more than anticipated.[58] The *Avery* verdict, and any subsequent verdict of its nature, will hurt the consumer more than it will help him. The verdict

should not stand. As long as laws exist in the majority of states permitting the use of replacement parts when such use is disclosed to the insured, regulation through hard-hitting and costly state class action litigation is not necessary and is improper.

VI. Conclusion

The multi-state class action best serves the demanding mistress of justice when used in the federal courts. Developed as a tool to promote efficiency and fairness, the class action should not be transformed into a means of interfering with the states' ability to regulate issues properly left to them under the American federal system — including the insurance industry. *Avery* is an example of this abuse of the class action. If the *Avery* verdict withstands its appeal, the precedent will encourage forum shopping, increase insurance premiums, and decrease healthy, cost-reducing competition in the replacement parts industry. It all adds up to more money out of consumers' pockets. Therefore, the verdict should not stand and class action reform should be promoted and supported.

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1. No. 97-L-114, 1999 LEXIS 47 (1 Dist. 1999); MEALEY'S LIT. REPORT: INS. BAD FAITH, Oct. 19, 1999.

2. *Avery*, 1999 LEXIS 47, at *4.

3. *Avery*, 1999 LEXIS 47, at *5-11; 815 ILL. COMP. STAT. 505/1-12 (2000).

4. Ronald Rotunda, *Stating the Case for Federal Class Actions*, THE RECORDER (American Lawyer Media, L.P.), May 17, 2000, at 6.

5. Robert L. Zeman & Michael P. Duncan, *Class Action Lawyers: The New Insurance Regulators*, LEGAL BACKGROUNDER (Washington Legal Foundation), June 9, 2000.

6. *Avery*, 1999 LEXIS 47, at *1, *4; 815 ILL. COMP. STAT. 505/1-12 (2000).

7. 815 ILL. COMP. STAT. 505/10(a)a; *Avery*, 1999 LEXIS 47, at *2 (citing Cripe v. Leiter, 184 Ill.2d 185 (1998); Malooley v. Alice, 251 Ill.App.3d 51 (3 Dist. 1992)).

8. *Avery*, 1999 LEXIS 47, at *2 (citing Martin v. Heinold, 163 Ill.2d 33, 68 (1994)).

9. *Id.* at *4-5.

10. *Id.* at *5-6.

11. *Id.*

12. *Id.* at *6-9.

13. *Id.* at *7.

14. 15 U.S.C. § 2301 (2000).

15. Zeman & Duncan, *supra* note 5.

16. *Id.*

17. *Class Action Lawsuit Battle Over Replacement Parts Expands According to the National Association of Independent Insurers*, PR NEWSWIRE, November 3, 1999 [hereinafter *Lawsuit Battle*].

18. *Id.*

19. *Id.*

20. *Id.*

21. Dipka Bhambhani, *Insurer Must Pay in Parts Suit*, WASH. TIMES, Oct. 5, 1999, at B-7.

22. Zeman & Duncan, *supra* note 5.

23. *Id.*

24. *Id.*

25. *Id.*

26. *Crash Parts Fight Heats Up as Texas Attorney General Sues*, FEDERAL & STATE INS. WEEK, Feb. 22, 2000 (comment by Institute President, Brian O'Neill).

27. *Id.*

28. *Crash Parts Fight Heats Up as Texas Attorney General Sues*, FEDERAL & STATE INS. WEEK, Feb. 22, 2000 [hereinafter *Crash Parts*].

29. *Id.*

30. *Id.* (quoting Institute President, Brian O'Neill).

31. Margaret Cronin Fisk, *Insurer Sued for Mandating Use of "Imitation" Parts,*

NAT. L. J., Feb. 28, 2000, at C6.

32. *Class Actions: Avery v. State Farm Mutual Automobile Co.*, ANDREWS INS. INDUSTRY LIT. REP., Nov. 17, 1999, at 12 [hereinafter *Class Actions*].

33. *Id.*

34. *Groups Rally to State Farm's Defense After Verdict*, LIABILITY WEEK, Oct. 25, 1999.

35. *Id.*

36. *Id.*

37. *See Crash Parts, supra* note 28 (State Farm's voluntary moratorium on the use of replacement parts cost the insurer $4.8 million in the first month).

38. *See e.g.*, 215 ILL. COMP. STAT. 5/155.29 (Illinois Insurance Code) (2000); MISSOURI REV. STAT. § 407.295 (1989); Iowa Code § 537(B)4 (1990).

39. Zeman & Duncan, *supra* note 5.

40. Rotunda, *supra* note 4, at 6.

41. *Id.*

42. Zeman & Duncan, *supra* note 5.

43. *Id.*

44. *Lawsuit Battle, supra* note 17.

45. *Id.*

46. *Class Actions, supra* note 32 (comment by Washington Legal Foundation, a public interest law and policy center which filed an amicus brief in support of the defendants).

47. Rotunda, *supra* note 32, at 6.

48. Zeman & Duncan, *supra* note 5.

49. *Id.*

50. BLACK'S LAW DICTIONARY 268 (7th ed. 1999).

51. Zeman & Duncan, *supra* note 5.

52. *Id.* (commenting that Roth v. Amica Mutual Ins. Co., Mass. Sup. Ct, Civil

Action No. 98-3551 (Sept. 3, 1999) and Kenger v. GEICO, CV 1999-001522, AZ Sup. Ct., Maricopa County (1999), were both appropriately dismissed).

53. Zeman & Duncan, *supra* note 5.

54. *Id.*

55. S. 353, 106th Cong. (1999) (Class Action Fairness Act); Zeman & Duncan, *supra* note 5.

56. HR 1875, 106th Congress, 1st Session (1999).

57. *Id.*

58. *Crash Parts, supra* note 28.

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