CASE NO. S167913

IN THE SUPREME COURT OF CALIFORNIA

JERRY HILL, JOSEPHINE HILL, WILSON MALLORY AND NORENE MALLORY
Individually and on Behalf of Plaintiff Class
Plaintiffs-Petitioners and Appellants,

vs.

STATE FARM MUTUAL AUTOMOBILE INSURANCE COMPANY,
Defendant and Respondent.

◊

After a Published Decision by the Second Appellate District, Division 3 (2nd Civ. No. B194463) Affirming an Order Granting Summary Judgment by the Los Angeles Superior Court (Hon. Carolyn B. Kuhl, Judge Presiding)
(Case No. BC194491 (Class Action))

◊

REPLY TO ANSWER TO PETITION FOR REVIEW

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TABLE OF CONTENTS

TABLE OF CONTENTS(cont.)

Page

TABLE OF AUTHORITIES

TABLE OF AUTHORITIES(cont.)

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REPLY TO ANSWER TO PETITION FOR REVIEW

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I. INTRODUCTION

State Farm's Answer to Policyholders' Petition highlights the important policy and legal issues raised by the Opinion. For example, while the Opinion puts the wisdom of the Board's decisions "off limits" for judicial review, State Farm defends the Opinion by arguing the merits of the Board decisions which the Opinion immunizes from Policyholder challenge.

According to State Farm, the wisdom of the Board's policy of piling up huge surpluses is shown by the fact that "State Farm today is

Policyholders have, on the contrary (*see* Ptn., p. 5), presented evidence -- based upon State Farm's own internal analysis, sworn statements to regulators in its rate filings and to Congress, and in its Annual Reports to Policyholders -- showing that State Farm went far beyond protecting its own solvency and ensuring that policyholder claims will be paid. Instead, it built up a vast "[s]urplus surplus" (the term this Court used in *20th Century Insurance Co. v. Garamendi* (1994) 8 Cal.4th 216 at 302, to describe "surplus beyond what is useful to back up premiums--inflat[ing] the [mutual] insurer's capital base and any rate set thereon to the disadvantage of its insureds"), without ever undertaking the actuarial analysis its own corporate governance expert held essential to determine whether its surplus hoard was needed to protect against its insured risks. (11AA3199.)

Far from showing that this case is unworthy of this Court's attention, therefore, State Farm's Answer starts by pointing up the importance of the question raised by this case on its facts: whether State Farm, a mutual insurer with five million policyholders in California, has wisely preserved its resources, or whether, on the contrary, State Farm's Board has, through lack of care and adequate information, allowed management to build up the kind of "surplus surplus" which this Court has condemned as not serving the interests of the policyholder-owners of mutual insurance companies.

But the implications of State Farm's policy argument go well beyond that. They also highlight the broad policy questions Policyholders raise in their Petition: whether the business judgment should be held to immunize corporate decision-making from liability for lack of care and lack of adequate information. The question of whether the care with which corporate decisions are made and the sufficiency of the information on

should be held to immunize corporate decision-making from liability for lack of care and lack of adequate information. The question of whether the care with which corporate decisions are made and the sufficiency of the information on which they are based should be subjected to more or less scrutiny has become all the more important in light of the corporate decision-making that gave rise to the "crash of the financial markets" and resulting federal bailouts.

State Farm contends that the Petition does not show that review is "necessary to secure uniformity of decision or to settle an important question of law" (Rule of Court 8.500(b)(1)), for one thing, because the Opinion supposedly deals only with Illinois law, and raises no issues of California law. (Ans., p. 21.) That is not so.

First, as pointed out in the Petition (at p. 6), *Barnes v. State Farm Mutual Automobile Insurance Co.* (1993) 16 Cal.App.4th 365, 379, n. 13 -- which the Opinion repeatedly cites (*e.g.*, Opn., pp. 5-7. 54-55, 57) -- held long ago that the law of California is the same as that of Illinois as to the business judgment rule.

Second, the Opinion directly conflicts with this Court's previously-established summary judgment jurisprudence by dramatically limiting the kinds of evidence – including expert testimony – which can be used to raise triable issues of fact in business judgment rule cases.

Third, the Opinion's discussion of the business judgment rule was written in terms that make it clear it was intended to, and will have, a material impact on the law of California, as well as that of other jurisdictions. Counsel for State Farm, in a letter to the Court of Appeal regarding the Opinion, described it as "a scholarly examination of the business judgment rule and will no doubt be cited

by courts and secondary authorities for years to come."[1] Such a decision certainly meets the requirements of review under Rule of Court 8.500(b)(1).

In fact, State Farm does not argue that the three critical issues Policyholders have identified are not appropriate for review, but that those questions are not directly raised by the *Opinion*. The rest of State Farm's argument is devoted either to (1) assertions that the Opinion does not depart from the current law in California or Illinois as Policyholders contend, or (2) attempts to distract the reader from the fact that there is nowhere in its Answer an affirmative statement of what the Opinion *does* hold, if not that the business judgment rule bars *all* corporate liability for lack of care.

In what follows, Policyholders will show that State Farm's arguments cannot defeat the evidence of the Opinion itself which, taken together with evidence in the record, make clear its holding that (1) there should be no board liability for negligence of any sort, and specifically that (2) there should be no liability for board decision-making based on inadequate information.

On the first point, the Opinion itself is absolutely clear, describing the business judgment rule as "a defense to an alleged breach of the duty of care (Opn., p. 32)," and affirming that there should be liability only where the decision-making process "was tainted by fraud, oppression, illegality, or the like." (Opn., p. 26). As to the second and third points, a review of the Opinion and the underlying record is

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[1] Letter of James R. Robie to Court of Appeal, Second District, Division Three, dated September 24, 2008.

sufficient to confirm that, despite protestations to the contrary (Opn., pp. 42-43), the Court of Appeal has, through its systematic reworking of the standard of review for summary judgment in this context, effectively barred any challenge to the Board's decisions as ill-informed.

The Opinion's expansion of the business judgment rule, and its accompanying narrowing of the evidentiary standards on summary judgment to reinforce that expansion, raise important questions of law and policy, and create conflicts within the existing law both as to the business judgment rule and summary judgment, which satisfy the requirements for a grant of review under Rule of Court 8.500(b)(1). Given the importance of the issues of corporate governance and oversight, especially in these difficult times, it is up to this Court to grant review in order to answer those questions of law, decide those issues of policy, and resolve those conflicts.

II. STATE FARM OBFUSCATES TO AVOID COMING TO GRIPS WITH THE BROAD HOLDING OF THE COURT OF APPEAL BARRING DIRECTOR LIABILITY FOR NEGLIGENCE.

State Farm insists that Policyholders have wrongly characterized the Opinion as holding that the business judgment rule "precludes liability for *any* form of negligence, ordinary or gross." (Ans., p. 22.) It goes on to assert that because the words "gross negligence" do not appear in the Opinion, no issues of gross negligence are presented by this case. (Ans., p. 23.) Paradoxically, it then proceeds to argue at length that "gross negligence" is the Illinois standard for corporate conduct. (Ans., pp. 23-26.) As will be shown below, State Farm is wrong about Illinois law.

Most significant, however, is what is *missing* from State Farm's analysis. Though asserting that Policyholders are wrong in their characterization of the Court of Appeal's holding, State Farm *nowhere* states *its* understanding of that holding. On the one hand, it suggests by its discussion of Illinois law that the Opinion adopts and applies the "gross negligence" standard to Policyholders' evidence. On the other hand, it points out that the Opinion never mentions "gross-negligence," and asserts that there is no "gross negligence" issue here. Beyond that, State Farm simply does not say.

The reason is clear. State Farm cannot articulate a plain holding on the issue other than the one Policyholders have presented: that the business judgment rule protects corporations from liability for all forms of negligence so long as the decision-making process is not tainted with fraud, illegality "or the like." This Court should grant review to decide whether California should adopt so expansive a version of that protection.

A. THE COURT OF APPEAL DOES HOLD THAT THE BUSINESS JUDGMENT RULE BARS LIABILITY FOR ANY FORM OF DIRECTOR NEGLIGENCE.

The Court of Appeal affirmatively states that the business judgment rule limits liability to instances in which the process of decision-making "was tainted by fraud, oppression, illegality, or the like," and contrasts that with cases of "a company's mistakes, errors, and mere negligence," for which liability is precluded. (Opn., pp. 26; & *see* pp. 54-55.) In other words, lack of care is not a sufficient basis for liability; there must be a "taint" of conscious wrongdoing.

In that dichotomy, all forms of negligence, "ordinary," "gross," or otherwise, fall within the category of conduct for which there is no liability. Because it takes that position, the Court of Appeal has no need to distinguish between ordinary and gross negligence, and does not do so. By way of contrast, State Farm (at p. 26) quotes a passage from *Fletcher* (3A *Fletcher Cyclopedia of the Law of Corporations,* section 505) which explicitly limits corporate liability under the business judgment rule to "fraud, bad faith, or gross negligence amounting to a breach of trust," thereby making the distinction, and placing "gross negligence" with the kinds of conduct that give rise to liability.

As pointed out in the Petition (p. 9), the Court of Appeal is by no means alone in precluding liability for any form of negligence. That is also the position taken in at least two of the cases cited by the Opinion in support of its view (at p. 32): *Radol v. Thomas* (6th Cir. 1985) 772 F.2d 244, and *Gearhart Industries, Inc. v. Smith International Inc.* (5th Cir. 1984) 741 F.2d 707). The point of the Petition is not to show that the Court of Appeal's position is categorically wrong for all jurisdictions, but rather that there is a continuum of approaches to the business judgment rule in American law, and that the Opinion would change the current law of California and Illinois by moving it very far to the end of that continuum most restrictive of corporate liability.

In sum, a principal question raised by the Opinion and this Petition is whether the business judgment rule should be held to bar corporate board liability for negligence entirely. State Farm seeks to evade that question, attempting to deflect attention from the central holding of

the Opinion to the peripheral issue of whether Illinois law limits corporate liability for negligence to cases of gross negligence.

Policyholders respectfully request that this Court look to the Opinion itself, not State Farm's fragmentary characterizations of it, to determine what its holding is and what its impact will be if allowed to stand. Policyholders are confident that the conclusion will be that the Opinion does purport to bar all corporate liability for negligence, and that such a departure from existing law compels this Court's review.

B. ILLINOIS LAW HOLDS CORPORATIONS LIABLE FOR ORDINARY NEGLIGENCE.

State Farm not only uses the issue of corporate liability for ordinary vs. gross negligence under Illinois law as a distraction from its failure to provide a clear statement of the Court of Appeal holding, it also gets the Illinois law wrong.

Specifically, State Farm claims that *Stamp v. Touche Ross* (2003) 263 Ill. App. 3d 1010 at 1016, which Policyholders cite as showing that Illinois imposes corporate liability for ordinary negligence (AOB 13), does no such thing, because it was decided upon a motion to dismiss, for purposes of which an allegation ordinary negligence is sufficient to sustain a cause of action for gross negligence. (Ans, p. 24, fn. 3.)

The language of *Stamp* flatly defeats that contention. It is true that *Stamp* was an appeal from a dismissal on the pleadings, and that the *Stamp* court reversed the dismissal on the basis that the trial court had wrongfully barred the plaintiff from bringing a negligence action, leading to a remand to allow an amended complaint sufficiently alleging negligence to be filed. However, the *Stamp* states that corporate directors must exercise "the degree of care which prudent men . . . would exercise in the management of their own affairs," and that "the shield of the business judgment rule is unavailable to directors who fail to exercise due care in their management of the corporation." Finally, it sums up the Illinois law on the issue by

stating that "the exercise of due care is a prerequisite to the applicability of the business judgment rule ... ." 263 Ill.App.3d 1010, 1015-16. That is the language of ordinary negligence, and nothing is said about "gross" negligence.

Further the Illinois court that decided *Stamp* later described it as holding that "the trial court erred in construing the business judgment rule too broadly to encompass all business judgments not involving fraud, illegality, or conflict of interest even where those judgments are the result of negligence or inattention." *Selcke v. Bove* (1994) 258 IllApp.3d 932 at 933. That is not the language of gross negligence either.

The issue of gross negligence is relevant here, but only secondarily, because of the current uncertain state of California law on the issue. (Ptn, pp. 10-11, 14.) The Opinion does not posit a gross negligence standard, but a "no liability for negligence of any sort" standard. However, in the course of reviewing that standard, this Court should also resolve the uncertainty in California law as to whether the business judgment rule allows for liability for ordinary board negligence or not.

C. STATE FARM ALSO MISREPRESENTS ILLINOIS LAW AND CALIFORNIA LAW AS TO THE EVIDENCE REQUIRED TO REBUT THE BUSINESS JUDGMENT RULE PRESUMPTION.

State Farm also attacks Policyholders' statement of the law regarding the evidence required to rebut the presumption created by the business judgment rule. State Farm asserts that, contrary to the Petition (p.17), it is not enough to present "some" evidence to rebut the presumption. There must be "enough" evidence, and the Court of Appeal rightfully found that there was not "enough." (Ans., p. 29.)

State Farm is wrong again. It is true that the relevant case, *Ferris Elevator Co., Inc. v. Neffco, Inc.* (1996) 674 N.E.2d 449, states that the trial judge found that the plaintiff had presented "enough"

evidence to go to the jury on the question of corporate liability. 674 N.E.2d at 553.

But the court there also made clear just how little evidence was "enough" to rebut the presumption. The relevant evidence only had to "suggest" that the directors were not well-informed, 674 N.E.2d at 552, and, under the Illinois "bursting bubble" rule, the presumption "vanishe[d]." 674 N.E.2d 453. Indeed, in *Lower v. Lanark Mut. Fire Ins. Co.* (1983) 114 Ill.App.3d 462, the Illinois Appellate Court held that the mere "inference" that *some* directors were inadequately informed regarding a challenged transaction was sufficient to overturn a summary judgment granted in their favor under the business judgment rule.

State Farm's insistence that Policyholders did not present "enough" evidence, in addition to being wrong as a matter of Illinois law, is doubly wrong from the perspective of California summary judgment law, under which any admissible evidence presented in opposition to the motion must be read most favorably to the party presenting it to create a triable issue of fact. *See Saelzler v. Advanced Group, supra*, 25 Cal.4th 763, 768

State Farm's position is emblematic of the Court of Appeal's approach in the Opinion, which is, contrary to the law of summary judgment, to weigh the evidence presented by the parties, and, in the name of the business judgment rule, consistently to give State Farm's evidence the greater weight.

D. THE COURT OF APPEAL'S PRECLUSION OF CONSIDERATION OF THE MERITS OF BOARD

DECISIONS IS ANOTHER MAJOR DEPARTURE FROM THE LAW GOVERNING SUMMARY JUDGMENT.

The Petition points out that the Opinion also departs from existing law in precluding consideration of the substance of corporate decisions as a means of showing negligent decision-making. (Opn., pp. 54-57.)

State Farm complains that, in doing so, Policyholders are ignoring Illinois authority which states the ultimate question in a business judgment rule case as being, not whether the court agrees with a corporate decision on the merits, but whether the decision-making process was tainted or flawed. (Ans., pp. 26-28.)

Policyholders do not ignore that statement of the law. The problem is, however, that the Court of Appeal held it proper to preclude Petitioner's expert testimony regarding the substance of board decisions as *evidence* creating a triable issue of fact on the issue.

The law of summary judgment as articulated by this Court requires courts to take into account the evidence presented in opposition to summary judgment *and* the inferences to be drawn from that evidence in deciding whether there is a triable issue of fact. *Aguilar v. Atlantic Richfield Co.* (2001) 25 Cal.4th 826, 843. Serious flaws in the decision-making process can be inferred from evidence of irrational, inconsistent and otherwise flawed results. The Court of Appeal's refusal to take such evidence into account in this context is further evidence of its determination to impose new limits on corporate liability. Indeed, Policyholders' corporate governance expert

Bebchuk's opinion that the Board's decision-making *process* was seriously flawed was based in significant part upon the substantive results of the Board's decisions,. (*See, e.g.*, 8AA020401; 8AA02044; AA02047-51; 8AA02051-54; AA02055-56.) Again, this Court should grant review to decide whether existing law should be set aside to make way for such an expansive reading of the business judgment to limit corporate liability.

III. THE OPINION ALSO EFFECTIVELY PRECLUDES SCRUTINY OF WHETHER A CORPORATE BOARD HAS INFORMED ITSELF ADEQUATELY, PROVIDED ONLY THAT THE BOARD CAN SHOW THAT IT HAD A LOT OF INFORMATION, WITHOUT REGARD TO ITS CONTENT.

State Farm points to the Opinion's accurate enunciation of the rule that directors must be sufficiently informed to take advantage of the business judgment rule's protection as a reason to reject Policyholders' showing that the Opinion effectively precludes liability for uninformed decision-making. (Ans, pp. 28-29.) The Court of Appeal, according to State Farm, simply determined that "Hill's evidence did not rebut the business judgment rule presumption that State Farm's directors were sufficiently informed...." (Ans., p. 30.)

But State Farm does not comment on the fact that the Court of Appeal found that the Board was adequately informed "as a matter of law," before considering any of the evidence *Policyholders* offered to rebut that claim, based solely on *State Farm's* evidence as to the information put before the Board. (Opn., p. 46.)

In principle, the Court of Appeal affirms that the Board must be well-informed. In practice, however, it holds that the presumption of a sufficiently informed Board is *non-rebuttable* provided only that corporate management has put a substantial *quantum* of information before the Board. As State Farm states the point, once it has been shown that the Board received "a substantial amount" of information (Ans., p. 32), the courts should pay no attention to evidence which could show that such information, though "substantial" in amount, was *qualitatively* inadequate.

Contrary to State Farm's arguments, that understanding of the presumption as non-rebuttable carries through the Court of Appeal's treatment of the questions of (1) whether the Board had adequate actuarial analysis, and the role of expert testimony in deciding that question, and whether the Board was misled about (2) its responsibilities to the policyholders, and (3) the tax consequences of dividend distributions.

In each case, the Court of Appeal, rather than reading Policyholders' evidence most favorably to Policyholders, weighs it against State Farm's evidence and finds a basis for disregarding it. The Court of Appeal's consistent rejection of Policyholders' evidence of inadequacy, ignorance, and error creates a systematic bar to qualitative scrutiny of the sufficiency of the information on which corporate decisions are based.

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A. THE COURT OF APPEAL'S REFUSAL TO CONSIDER RELEVANT EXPERT TESTIMONY REGARDING THE BOARD'S LACK OF ADEQUATE ACTUARIAL ANALYSIS FUNDAMENTALLY ALTERS CALIFORNIA SUMMARY JUDGMENT JURISPRUDENCE IN BUSINESS JUDGMENT RULE CASES.

The evidence Policyholders presented from experts in corporate governance, economics and actuarial practice, and from State Farm's own Chief Actuary, should have created a triable issue of fact as to whether the Board had the information necessary to an informed decision on dividends. (Ptn., p. 19.) State Farm attempts to defend the Court of Appeal's rejection of that evidence as appropriate under standard summary judgment law (Ans., pp. 30-32), but that attempt does not withstand scrutiny.

One key question is whether the Board lacked the actuarial analysis of State Farm's surplus needs necessary to making informed judgments about surplus and dividends.

The evidence on the issue produced by Policyholders included State Farm Chief Actuary Gary Grant's testimony that State Farm's Actuarial Deparment *never* analyzed the adequacy of State Farm's surplus to cover its risks and needs (12AA3231-3235 (pp. 7-13)), the testimony of Director James Wilson that the Board *never* discussed, directly or indirectly, whether State Farm's surplus was sufficient for its needs (12AA3325 (p. 20)), and the testimony of two of experts, the actuary Toothman and the economics and corporate governance expert Bebchuk, to the effect that a board cannot make well-informed

dividend decisions unless such analysis is produced and provided to it on a regular basis. (8AA2033, 2039-2042;9AA2496-2499.)

Dismissing that testimony, the Opinion instead focuses on Director Roger Joslin's testimony in support of the factual conclusion that "at 'many' Board meetings, there were discussions regarding the 'appropriate' level of surplus [and at] each meeting, Joslin or a member of his staff reviewed the company's surplus position," And concluding that "[a]t no time did the Board conclude that the surplus exceeded reasonable limits." (*See* Opn., p. 22.) But the insertion of the qualifier "Board" before "meetings" is not supported by Joslin's testimony cited in the Opinion. (5AA1361-01362.)

Particularly given Director Wilson's testimony, an equally reasonable inference from this testimony is that surplus adequacy was discussed only at committee meetings and dinner discussions by executives of subsidiaries. Moreover, the statement that the Board "never reached a conclusion" that the surplus retained by State Farm was in excess of reasonable limits does not support the inference that the Board actually ever deliberated on that issue. It merely indicates what the Board did *not* consider or conclude -- just as, by way of comparison, the Board also "never concluded" that the Sun rises in the East and sets in the West. Yet, consistent with its effort to rework existing summary judgment law in the service of its expansive view of the business judgment rule, the Opinion reads Joslin's testimony broadly in State Farm's favor, when a narrow reading in Policyholders' favor was equally reasonable, was consistent with the testimony of actuary Grant and director Wilson, and was required under existing summary judgment law.

State Farm also asserts that the Court of Appeal was right to reject Grant's testimony as irrelevant because, rather than testifying that his department did no actuarial analysis of the surplus at all, he testified that the actuaries left it to the Board to make "the ultimate determination as to the size and use of the surplus. (Ans., p. 30.)

State Farm's response is beside the point. Grant testified unequivocally that the actuaries did not do the actuarial analysis required to establish the level of surplus required to meet State Farm's needs (12AA3231-3235 (pp. 7-13)), and the question remains whether the Board had a sufficient basis for well-informed determinations regarding "the size and use of the surplus" without that analysis.

That is where the expert testimony becomes relevant. Both Toothman (9AA2496-2499) and Professor Bebchuk testified that such an actuarial analysis of surplus needs is essential to well-informed decision-making on dividends and surplus (8AA2039-44). State Farm defends the Court of Appeal's decision to disregard that testimony on a number of grounds, but none of them pass muster under the rules which normally govern summary judgment in California.

First, State Farm flatly asserts, as did the Court of Appeal (Opn., p. 46) and Judge Kuhl, that expert opinion as to "different or additional analyses" which a board should have received cannot create a triable issue of fact. (Ans., p. 30.) That is just another way of expressing the central point which State Farm denies: the Opinion would make corporate decisions as to what information is necessary to make important decisions invulnerable to attack.

Second, State Farm argues that the Court of Appeal did not have to accept Professor Bebchuk's "conclusory" opinion that the Board was

not sufficiently informed without an analysis of the "minimum necessary level of surplus," citing *Towns v. Davidson* (2007) 147 Cal.App.4th 461 (Ans., pp. 31-32).

But Professor Bebchuk's opinion was no mere conclusory statement of conjectural opinion. It was based on the careful analysis of an internationally recognized scholar of economics and corporate governance as to the kind of actuarial analysis necessary to a particular kind of decision. (8AA2039-40.) The same is true of Toothman's opinion, which was to the same effect. (9AA2496.)

The *Towns* court rejected the opinion of a ski instructor and safety consultant as to the plaintiff's recklessness on the basis that "the nature and risks of downhill skiing" were not sufficiently beyond common experience to warrant expert testimony, and that the expert's opinion purported to resolve, not "an ultimate factual issue," but a conclusion of law. *See Towns,* 147 Cal.App.4th at 472-73.

Here, on the other hand, Toothman and Professor Bebchuk were offering their analyses of a matter well beyond common experience: the kind of actuarial and corporate governance analysis necessary to an adequate decision-making process with respect to particular corporate decisions. Nor do Toothman and Bebchuk purport to come to "legal conclusions." Their declarations speak, not to the legal standard for claiming the protection of the business judgment rule, but to facts within their respective spheres of expertise: the actuarial and corporate governance prerequisites for sound decision-making as established in professional actuarial and corporate practice.

While the Opinion states that courts and boards should not question actuarial opinions provided by corporate management (Opn.,

pp. 38-39 & 45-46), actuaries are as much engaged in specialized professional practice and are subject to judicial scrutiny as much "as the other professionals -- lawyers, physicians and accountants, for example...," *Steiner Corp. v. Johnson & Higgins* (10th Cir. 1998) 135 F.3d 684, 690-691, and their expertise is as relevant on questions of whether the standards of the profession have been met. Under pre-existing summary judgment law, "[i]t is sufficient, if an expert declaration establishes the matters relied upon in expressing the opinion, that the opinion rests on matters of a type reasonably relied upon, and the bases for the opinion." *Sanchez v. Hillerich & Bradsby Co.* (2002) 104 Cal.App.4th 703, 718.

On summary judgment, existing law requires Policyholders to show only that Toothman's and Bebchuk's declarations, if they had been admitted, would have created a triable issue of fact as to whether the prudent management of a mutual insurance company required an actuarial analysis of surplus needs before informed dividend decisions could have been made. *Jones v. County of Los Angeles* (2002) 99 Cal.App.4th 1039, 1045. But the Opinion fundamentally alters pre-existing summary judgment law in the business judgment rule context.

Accordingly, if the Opinion here is allowed to stand, and to shape the law of California, the soundness of management judgments involving complex actuarial and corporate governance issues such as those at issue here will effectively free of challenge in *any* forum, because our courts (1) will not hold boards of directors responsible to inform themselves adequately when considering management's recommendations, as they are entitled to rely on management's "silence" as to key corporate governance issues (Opn., pp. 38-39), and

(2) will neither examine those decisions themselves for lack of care or adequate information (Opn., pp. 45-46), nor (3) allow members/shareholders to challenge them by presenting expert opinions which disagree with those of management. (Opn., pp. 45-46.)

Rejection of expert testimony on such grounds is unjustifiable under the California law of summary judgment. *See Avivi v. Centro Medico Urgente Medical Center* (2008) 159 Cal.App.4th 463, 465; *Powell v. Kleinman*, (2007) 151 Cal. App. 4th 112. The true explanation for it is that the Court of Appeal is not applying normal summary judgment rules here. Instead, it is dramatically reshaping those rules, contrary to this Court's direction in *Molko v. Holy Spirit Assn.* (1988) 46 Cal.3d 1092, 1107, to suit its new broad-ranging interpretation of the business judgment rule's protection.

This Court should grant review in order to consider whether such departures from the existing law of summary judgment are appropriate.

B. THE COURT OF APPEAL'S DISREGARD OF THE EVIDENCE AS TO THE BOARD'S MISUNDERSTANDING OF ITS RESPONSIBILITIES TO POLICYHOLDERS AND OF THE TAX CONSEQUENCES OF DECLARING A DIVIDEND FUNDAMENTALLY ALTERS CALIFORNIA SUMMARY JUDGMENT JURISPRUDENCE IN BUSINESS JUDGMENT RULE CASES.

State Farm (Ans., pp. 33-34) takes the same approach to the evidence of the Board's ignorance as to its responsibilities to the

policyholders and of the tax consequences of declaring dividends, accepting the Court of Appeal's brush-off as appropriate without attending to the fact that it could not have been accomplished under the normal rules of summary judgment.

As to the evidence that the Board was misled and confused as to its fundamental responsibilities to Policyholders, State Farm simply repeats the Court of Appeal's statement that the director who testified that he erroneously took Section 8.85 of the Illinois Business Corporation Act ("BCA") as his guide in that respect (12AA03280;11AA03203), Dr. Jaedicke, was only "one of 13 directors," and that there was no evidence that either he nor any other director ever gave it any thought in the course of decision-making. (Ans., p. 33.)

Even if those statements were accurate they would not detract from the force of this evidence in creating a triable issue of fact under the rule that requires that the evidence presented in opposition to summary judgment, and the inferences reasonably drawn from it, must be read most favorably to the party presenting it. *See, e.g., Saelzler v. Advanced Group* (2001) 25 Cal.4th 763, 768.

But they are not accurate. Jaedicke testified that he received the text of the statute as a guide to his conduct when he was elected to the Board (12AA03260), and that he consulted it while deliberating a $3 billion capital transfer to State Farm Fire & Casualty, which was certainly relevant to the surplus and dividends. (12AA03280.)

The same is true with the evidence regarding the directors' ignorance of the tax issue. State Farm claims that the Court of Appeal was not improperly weighing that evidence in dismissing it as

"isolated comments" which did not reflect directors' "real concerns," but instead provided a "correct analysis" of why it did not raise a triable issue of fact.

(Ans., p. 34.)[2] But the Opinion speaks for itself. To reject evidence as consisting of "isolated comments" which are unimportant as compared to the "real concerns" of those involved is undeniably to weigh that evidence. Again, the Court of Appeal departs from the established law of summary judgment in order to ensure that the extent of the Board's knowledge, or lack thereof, on matters affecting its dividend decisions will not be subjected to judicial scrutiny.

C. THE COURT OF APPEAL'S SYSTEMATIC DEPARTURES FROM ESTABLISHED SUMMARY JUDGMENT LAW IN FAVOR OF STATE FARM AMOUNT IN PRACTICE TO A BAR TO JUDICIAL SCRUTINY OF THE QUALITY OF THE INFORMATION UNDERLYING CORPORATE DECISION-MAKING ON IMPORTANT MATTERS.

The Court of Appeal's departures from the normal rules governing summary judgment review on the issue of whether the Board was adequately informed are too consistent and pervasive to allow State Farm to assert credibly that the Court of Appeal's decision is no more

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[2] State Farm also challenges the Policyholders' contention that *Lee v. Interinsurance Exch.* (1996) 50 Cal.App. 4th 694, 715-716, or any other decision, indicates that ignorance of relevant tax law defeats the business judgment rule. That is the clear implication of the relevant language in *Lee* (business judgment rule presumption not rebutted because, *inter alia*, "plaintiffs do not claim that the defendants failed to ascertain that federal tax savings could result from depositing surplus funds in subscriber savings accounts"); *NCR Corp. v. American Tel. & Tel. Co.* (D. Ohio 1991) 761 F. Supp. 475, 499 (business judgment rule inapplicable because of, *inter alia*, "a general unfamiliarity with the changes in tax laws and accounting rules.")

than a run-of-the-mill affirmance of a summary judgment based on its review of the facts.

Rather, they bespeak a systematic effort to fend off any judicial scrutiny of the level and quality of the information on which corporate boards base important decisions. That effort amounts in practice to a significant departure from the business judgment rule as applied either in California or Illinois, a departure which warrants this Court's review.

IV. CONCLUSION

Contrary to State Farm's unsupported assertions, a review of the Opinion demonstrates that, if allowed to stand, it will broaden the protection of the business judgment rule to the point of immunizing corporations from liability for any conduct not involving willful bad faith or conflict of interest. That is not the current law of California, or of State Farm's domicile, Illinois. So substantial a narrowing of corporate liability, enhanced by the Opinion's fundamental reworking of normal summary judgment evidentiary rules, raise important issues of law and policy which must be addressed by this Court. Review should be granted.

DATED: December 1, 2008

HENNIGAN, BENNETT & DORMAN LLP
GIANELLI & MORRIS LLP
LAW OFFICES OF ROBERT S. GERSTEIN

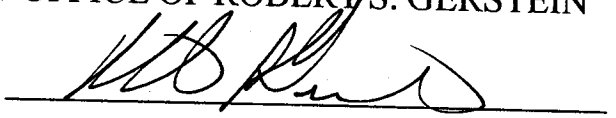
BY: _____
ROBERT S. GERSTEIN
ATTORNEYS FOR PLAINTIFFS AND PETITIONERS JERRY HILL, JOSEPHINE HILL, WILSON MALLORY AND NORENE MALLORY INDIVIDUALLY AND ON BEHALF OF PLAINTIFF CLASS

CERTIFICATE OF WORD COUNT

THE UNDERSIGNED CERTIFIES, PURSUANT TO CALIFORNIA RULES OF COURT, RULE 14(C)(1), THAT THIS BRIEF CONTAINS 5,553 WORDS, INCLUDING FOOTNOTES, AS COUNTED BY MICROSOFT WORD 2003, THE WORD PROCESSING PROGRAM USED TO PREPARE THE BRIEF.

DATED: DECEMBER 1, 2008

LAW OFFICE OF ROBERT S. GERSTEIN

BY: 

ROBERT S. GERSTEIN

PROOF OF SERVICE

STATE OF CALIFORNIA)
) ss.
COUNTY OF LOS ANGELES)

I am employed in the County of Los Angeles, State of California. I am over the age of 18 years and not a party to the within action. My business address is 12400 Wilshire Blvd., Suite 1300, Los Angeles, California 90025.

On December 1, 2008, I served the foregoing document described as **REPLY ANSWER TO PETITION FOR REVIEW** on parties interested in this action by enclosing true copies thereof in sealed envelopes with postage thereon fully prepaid, and by providing for their deposit in the United States Mail at Los Angeles , California, follows:

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Plaintiffs Jerry Hill, Josephine Hill, Wilson & Norene Mallory
[Address Withheld]

Honorable Carolyn B. Kuhl
Los Angeles Superior Court
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Los Angeles, CA 90012

Court of Appeal, Second District
Division 3
300 S. Spring St.
Los Angeles, CA 90014

I am "readily familiar" with the firm's practice of collection and processing correspondence for mailing. Under that practice it would be deposited with the U.S. postal service on that same day at Los Angeles, California, in the ordinary course of business. I am aware that on motion of the party served, service is presumed invalid if the postal cancellation date or postage meter date is more than one day after the date of deposit for mailing in affidavit.

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

Executed December 1, 2008 at Angeles , California.

Patsy W. Herron