IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION

RAUL FOJAS, Derivatively On Behalf of ALLSTATE CORP., Plaintiff, vs. F. DUANE ACKERMAN, JAMES G. ANDRESS, ROBERT D. BEYER, W. JAMES FARRELL, JACK M. GREENBERG, RONALD T. LEMAY, EDWARD M. LIDDY, J. CHRISTOPHER REYES, H. JOHN RILEY, JR., JOSHUA I. SMITH, JUDITH A. SPRIESER, MARY ALICE TAYLOR, THOMAS J. WILSON, Defendants, -and- ALLSTATE CORP., a Delaware corporation, Nominal Defendant.	Civil Action No. 08-cv-00423 Judge William T. Hart

PLAINTIFF'S MEMORANDUM OF LAW IN OPPOSITION TO DEFENDANTS' MOTION TO DISMISS FOR FAILURE TO ADEQUATELY PLEAD DEMAND FUTILITY

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Plaintiff Raul Fojas ("Plaintiff") respectfully submits this Memorandum of Law in opposition to the Director Defendants'[1] and Nominal Defendant Allstate Corp.'s ("Allstate" or the "Company") Motion to Dismiss.

I. INTRODUCTION

The Complaint[2] details the defendants' systemic bad faith litigation strategy, which resulted in the Company expending considerable sums to defend this strategy and the loss of billions of dollars in business. In 1992, Allstate hired McKinsey & Co. ("McKinsey") to redesign the Company's claim handling process. ¶35. By 1995, Allstate adopted McKinsey's Claims Core Process Redesign plan and began a three pronged assault on its policy holders: arbitrary denial of claims; random delay in processing and litigating claims; and unfounded reduction of payments to injured policy holders. ¶¶25, 35-36, 45.

Not surprisingly, by 2001, well after nine of the thirteen individual defendants were elected as active members of the Board,[3] these systemic and arbitrary bad faith practices were being regularly attacked in both judicial and regulatory proceedings across the country. ¶¶36-40, 42-43. In the actions against, and investigations of, the Company, the Board approved or acquiesced to the strategy to conceal certain documents, including the McKinsey reports that outlined the claims processing procedures. This decision has had dire effects on the Company.

Notably, the strategy of noncompliance with subpoenas from the Florida Office of Insurance Regulation ("FOIR") has cost the Company millions, if not billions, of business in the State of Florida. In fact, because the Director Defendants caused or allowed Allstate to stonewall its discovery obligations in a regulatory proceeding in Florida the Company is banned from writing new policies in Florida. Yesterday, on May 14, 2008, the First District Court of Appeals in Florida upheld the FOIR's suspension of Allstate from writing new policies in the

[1] The "Director Defendants" consist of the thirteen members of Allstate's board of directors ("Board"), namely, F. Duane Ackerman ("Ackerman"), James G. Andress ("Andress"), Robert D. Beyer ("Beyer"), W. James Farrell ("Farrell"), Jack M. Greenberg ("Greenberg"), Ronald T. LeMay ("LeMay"), Edward M. Liddy ("Liddy"), J. Christopher Reyes ("Reyes"), H. John Riley, Jr. ("Riley"), Joshua I. Smith ("Smith"), Judith A. Spreiser ("Spreiser"), Mary Alice Taylor ("Taylor"), and Thomas J. Wilson ("Wilson"). Together, the Director Defendants and Allstate are referred to herein as "Defendants."

[2] All references herein to the "Complaint" are to Plaintiff's Verified Shareholder Derivative Complaint for Breach of Fiduciary Duty, Abuse of Control, Gross Mismanagement, Waste of Corporate Assets, and Unjust Enrichment,, and all references to "¶__," are to the corresponding paragraphs thereof.

[3] By 1999, defendants Ackerman, Andress, Farrell, LeMay, Liddy, Riley, Smith and Spreiser were members of the Board. Defendant Taylor joined just one year later. ¶¶7-8, 10, 11-12, 15-18.

State of Florida ("Florida Appeal Order"). The Court of Appeals called the Company's practices "***willful, indeed potentially criminal***" and noted that its failure to comply with its statutory disclosure requirements prevented the FOIR from adequately investigating its belief that Allstate is systematically defrauding its policyholders. *See* Florida Appeal Order at 17 (emphasis added), attached hereto as Exhibit A. To make matters worse, Allstate is also liable for millions of dollars in fines for being held in contempt of court in other judicial proceedings and for untold millions to defend, settle or satisfy judgments in the civil litigation stemming from its failure to produce documents regarding the Company's claims processing practices. ¶¶50, 54.

Contrary to Defendants' mischaracterization of the Complaint, this action is not about Allstate merely adopting a discovery strategy in an isolated lawsuit. Rather, the Complaint alleges that under the Board's active guidance, the Company (i) adopted or ratified a bad faith litigation strategy in multiple judicial and regulatory proceedings across the country (ii) designed to conceal and perpetuate the arbitrary denial, delay and reduction of payments to injured policy holders (iii) which has already subjected the Company to judgments, civil fines for contempt, potential criminal liability and suspension of Allstate's ability to write policies in Florida.

The sole issue before this Court is whether Plaintiff has sufficiently pleaded that pre-suit demand on the Board is excused. Defendants argue that such pre-suit demand was not excused and that Plaintiff should have demanded that the Board – consisting of the very people within Allstate who approved the bad faith litigation strategy – sue themselves. It simply defies common sense to expect the Director Defendants to make independent and disinterested decisions regarding the viability of the claims asserted in the Complaint, given their explicit approval of the strategy which has now injured Allstate and subjected each of them to a substantial likelihood of personal liability. Accordingly, Defendants' Motion to Dismiss should be denied.

II. STATEMENT OF FACTS

A. Background

Allstate is a Delaware corporation that, through its subsidiaries, provides property-liability insurance, in addition to other lines of insurance, throughout the nation. ¶6. In 1992, Allstate retained McKinsey to redesign the Company's claim handling process. ¶35. In 1995, McKinsey issued a report which contained its proposed plan to redesign Allstate's claims processing procedures. *Id.*

The Complaint alleges that Allstate's arbitrary claims processing practices came under attack in numerous judicial and regulatory proceedings across the country, including in Kentucky, Missouri, New Mexico and Louisiana. ¶¶36-40, 42-43, 48-54. In each of these proceedings Allstate risked fines for civil contempt and the entry of default judgments for their calculated non-compliance with discovery orders requiring, *inter alia*, the production of the McKinsey reports. ¶¶37-40, 42. In one such proceeding, Allstate was held in contempt and ordered to pay $25,000 per day for each day the Company defies the court's discovery orders. To date, Allstate is still accruing fines in this matter which have amassed to over $3 million. *Id.*

Government agencies have also sought the McKinsey reports pursuant to their investigations of the Company's price-fixing schemes and claims handling process. ¶¶42-54. In 2007, the FOIR subpoenaed the Company for documents and ordered witnesses to appear in January 2008 in hearings before the agency. ¶43. Allstate, with the approval of the Board, refused to fully answer the subpoena, did not produce the McKinsey reports and failed to provide the appropriate witnesses in connection with the investigation. Due to this refusal and uncooperative behavior the FOIR took the unprecedented step of prohibiting Allstate from writing new policies in Florida, a state in which the Company wrote over $1.9 billion in auto policies in 2006 alone. ¶¶50, 54. This suspension was upheld just yesterday by the Florida Court of Appeals. *See* Florida Appeal Order.[4]

In flagrant disregard of orders emanating from numerous judicial and regulatory authorities, including FOIR, the members of the Board adopted or implicitly approved a strategy of concealment no matter the dire consequences to the Company and its shareholders. This harmful "strategy" has subjected Allstate to millions of dollars in fines for contempt of court,

[4] In upholding the lower court's decision the Florida Court of Appeals detailed the numerous discovery abuses that led to FOIR's suspension:

> [FOIR] issued subpoenas and subpoenas *duces tecum*, and scheduled a hearing. Allstate never requested an extension of time. The hearing was held. Allstate appeared at the hearing without the requested documents, and without the required witnesses. At the hearing, Allstate frustrated the Commission's efforts to conduct the required investigation….The record supports the [FOIR] allegation that Allstate's conduct is likely to continue, based on its representations at the hearing, and its history of choosing to incur millions of dollars in fines rather than comply with court-ordered production.

Florida Appeal Order at 16.

potential criminal liability, and the loss of over $1.9 billion dollars of auto insurance business alone in Florida alone due to the FOIR's suspension. ¶¶50, 54.

III. LEGAL STANDARDS GOVERNING THIS MOTION

A. Applicable Legal Standards For Evaluating Demand Futility

The parties agree that both Federal Rule of Civil Procedure 23.1 and Delaware law are applicable to the demand futility analysis. *See Kamen v. Kemper*, 500 U.S. 90, 108-09 (1991). Federal Rule 23.1 and Delaware law require Plaintiff to allege with particularity the reasons demand would be futile, but Plaintiff is ***not*** required to plead facts sufficient to support a judicial finding of demand futility nor a reasonable probability of success on the merits. *See McCall v. Scott*, 239 F.3d 808, 816 (6th Cir. 2001), citing *Grobow v. Perot*, 539 A.2d 180, 186 (Del. 1988). When deciding a motion to dismiss, the court must assume the truth of all facts alleged in the complaint, construing the allegations liberally and viewing them in the light most favorable to the plaintiff. *Jones v. Gen. Elec. Co.*, 87 F.3d 209, 211 (7th Cir.1996); *Wilson v. Formigoni*, 42 F.3d 1060, 1062 (7th Cir. 1994).

1. Demand is Futile Under the *Aronson* Test

Under Delaware law, it is well-settled that a pre-suit demand on a corporate board of directors need not be made if the facts alleged tend to demonstrate such a demand would have been futile. *Aronson v. Lewis*, 473 A.2d 805, 806-07 (Del. 1984), overruled in part on other grounds *sub nom.*, *Brehm v. Eisner*, 746 A.2d 244 (Del. 2000). In the landmark *Aronson* case, the Delaware Supreme Court established a two-pronged test for assessing demand futility in a shareholder derivative action. Under *Aronson*, pre-suit demand is excused where, under the facts alleged, there is either a reasonable doubt: (1) "the directors are disinterested and independent"; or (2) "the challenged transaction was otherwise the product of a valid exercise of business judgment." *Id.* at 814. The demand futility test enunciated in *Aronson* is disjunctive.[5]

(a) Interest

Delaware courts have recognized that directors are sufficiently "interested" to render demand futile where they face a "substantial likelihood" of liability for the wrongful conduct

[5] Thus, "[i]f a derivative plaintiff can demonstrate a reasonable doubt as to the first or second prong of the *Aronson* test, then he has demonstrated that demand would have been futile." *Seminaris v. Landa*, 662 A.2d 1350, 1354 (Del. Ch. 1995); *see also Grobow v. Perot*, 539 A.2d 180, 188-89 (Del. 1988), *overruled in part on other grounds sub nom. Brehm*, 746 A.2d 244 (demand excused where allegations raise reasonable doubt as to either *Aronson* prong).

alleged in the complaint. *See Rales v. Blasband*, 634 A.2d 927, 936 (Del. 1993). Such director liability may arise in two distinct situations: (a) from a board decision that results in a loss because the decision was ill advised (*i.e.* malfeasance); or (b) from an unconsidered failure of the board to act in circumstances in which due attention might have prevented the loss (*i.e.* nonfeasance). *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 967 (Del. Ch. 1996).

(b) Independence

Independence, on the other hand "means that a director's decision is based on the corporate merits of the subject before the board ***rather than extraneous considerations or influences***." *Aronson*, 473 A.2d at 816 (emphasis added). A director may lack independence rendering demand futile where he or she is "beholden" to interested directors ***or*** "so under their influence that [his or her] discretion would be sterilized." *Rales*, 634 A.2d at 935-37 (citations omitted). Among other situations, a lack of independence has been found where a director holds a position as an employee of the corporation. *Id.* at 937 ("there is a reasonable doubt that [an employee-director] can be expected to act independently considering his substantial financial stake in maintaining his current offices.").

(c) Business Judgment Rule

Under the business judgment rule, directors are presumed to act in the best interests of the company. *Aronson*, 473 A.2d at 812. To invoke the rule's protection, however, directors must act on an informed basis, in good faith, and with the requisite care in the discharge of their duties. *Id.* A reasonable doubt sufficient to rebut the business judgment rule and render demand futile is created where a petition alleges that the board knowingly and intentionally decides to "exceed the shareholders' grant of express (but limited) authority," or where the complaint "alleges bad faith and, therefore a breach of the duty of loyalty." *Ryan v. Giffford*, 918 A.2d 341, 357 (Del. Ch. 2007). Bad faith may be shown where "the fiduciary intentionally acts with a purpose other than that of advancing the best interests of the corporation, where the fiduciary acts with the intent to violate applicable positive law, or where the fiduciary intentionally fails to act in the face of known duty to act, demonstrating a conscious disregard of this duties." *Stone v. Ritter*, 911 A.2d 362, 369 (Del. 2006).

Other examples of bad faith "include any action that demonstrates a faithlessness or lack of true devotion to the interests of the corporation and its shareholders." *Id.* Under these circumstances, the board's conduct is deemed to be so "egregious on its face that board approval

cannot meet the test of business judgment, and a substantial likelihood of director liability therefore exits" rendering demand futile. *Ryan*, 918 A.2d at 356. Importantly, however, any such determination "applies only with respect to demand futility" and should "reflect[] no opinion as to the truth of the allegations or the outcome of the claims on the merits." *Abbott Labs.*, 325 F.3d at 809.

In the present case, the second prong of the *Aronson* test is applicable to the demand futility analysis because the Complaint challenges the decision of the Board to authorize litigation practices which have subjected Allstate to considerable damage. More particularly, Plaintiff alleges that a majority of the Board – at least 9 out of 13 directors – affirmatively approved, or made a conscious decision not to act in the face of Allstate's utter and complete disobedience with various judicial and regulatory orders. The Director Defendants' affirmative approval of this indefensible litigation strategy and/or conscious failure to act to correct it, satisfies the second prong of the *Aronson* test and renders the Director Defendants incapable of considering a pre-suit demand. In other words pre-suit demand is excused in this case because: ratification of these practices could never have been the valid exercise of the Director Defendants' business judgment. *See Desimone v. Barrows*, 924 A.2d 908, 934-935 (Del. Ch. 2007).

2. In The Alternative, Demand is also Futile Under The *Rales* Test

Where a complaint does not challenge a specific action or decision of the board or where the plaintiff is not challenging a decision of the board in place at the time the complaint is filed, only the first prong of the *Aronson* test is relevant to the demand futility analysis. In such situations, demand is excused if the plaintiff "create[s] reasonable doubt that, as of the time the complaint is filed, the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand." *Rales*, 634 A.2d at 933.

The *Rales* test is applicable where the directors' liability is "'predicated upon ignorance of liability creating activities'" and the complaint challenges a board's "'unconsidered' failure to act." *In re Abbott Labs. Derivative S'holder Litig.*, 325 F.3d 795, 805 (7th Cir. 2001) *quoting Caremark*, 698 A.2d at 968.

In this action, under either the first prong of the *Aronson* test or the *Rales* test, the Complaint raises a reasonable doubt as to the ability of a majority of the Board to fairly, independently and disinterestedly consider a pre-suit demand.

B. The Court Must Apply Delaware's "Reasonable Doubt" Standard

In assessing demand futility this Court must examine each allegation of the Complaint taken as a whole[6] to determine whether Plaintiff has raised a ***reasonable doubt*** as to the Board's disinterestedness, independence, or exercise of business judgment. The term "reasonable doubt," as applied by the Delaware courts, can be said to mean "reason to doubt" that the board is capable of making an independent or disinterested decision or that the Board's actions are shielded by the business judgment rule. *Grimes v. Donald*, 673 A.2d 1207, 1217 (Del. 1996) *overruled in part on other grounds sub nom. Brehm*, 746 A.2d 244. In *Rales*, the Delaware Supreme Court expressly rejected a request for a more stringent standard much like that requested by Defendants in this action, holding:

> [W]e ***reject*** the defendants' proposal that, for purposes of this derivative suit and future similar suits, we adopt either a universal demand requirement or a requirement ***that a plaintiff must demonstrate a reasonable probability of success on the merits.***

634 A.2d at 934 (emphasis added). *See also Grobow*, 539 A.2d at 186-87 (rejecting the more stringent "judicial finding" standard for pleading director interest).

This reasonable doubt standard promotes a strong public policy, since "the derivative suit ... [is a] potent tool [] to redress the conduct of a torpid and unfaithful management." *Rales*, 634 A.2d at 933. It is further particularly appropriate in derivative suits, because plaintiffs typically have not had the benefit of discovery. *Id*. at 934 (requiring a reasonable probability of success on the merits would be "an extremely onerous burden to meet at the pleading stage without the benefit of discovery").

Under this "reasonable doubt" standard, Plaintiff is not obliged to prove at the pleading stage that the Director Defendants were interested or that the transaction was not shielded by the business judgment rule. Instead, Plaintiffs must allege, with particularity, facts that would give a reasonable shareholder reason to doubt the ability of the Board to consider a demand. *Rales*, 634 A.2d at 933 (endorsing reasonable doubt standard); *Grimes*, 673 A.2d at 1217 n.17 ("the concept

[6] The allegations of the Complaint may not be parsed and read in isolation, but must be read as a whole. *See Harris v. Carter*, 582 A.2d 222, 229 (Del. Ch. 1990) ("the question is whether the accumulation of all factors creates the reasonable doubt to which *Aronson* refers"); *In re Cendant Corp. Derivative Litig.*, 189 F.R.D. 117, 128 (D.N.J. 1999) ("the trial court must not rely on any one factor but examine the totality of the circumstances and consider all of the relevant factors").

of reasonable doubt is akin to the concept that the stockholder has a 'reasonable belief' that the board lacks independence or that the transaction was not protected by the business judgment rule").

Plaintiff amply meets this burden by raising a reasonable doubt not only as to the ability of each of the thirteen Director Defendants to independently and disinterestedly evaluate the claims asserted in Plaintiff's Complaint, but also by alleging facts which demonstrate that the Director Defendants' approval of indefensible litigation tactics and/or conscious decision not to remedy the same were not the product of a valid exercise of business judgment. Accordingly, pre-suit demand was excused in this action.

IV. THE COMPLAINT ADEQUATELY PLEADS THE FUTILITY OF DEMAND

A. The Board's Actions are Not Shielded by the Business Judgment Rule

Plaintiff details facts in the Complaint which demonstrate that the Director Defendants acquiesced in or deliberately ignored Allstate's sustained and systematic defiance of court orders arising from its refusal to disclose the McKinsey reports. *See, e.g.* ¶¶ 23, 27, 37, 40, 42, 43, 47-54, 58. This conduct is not a valid exercise of business judgment and, therefore, such a decision is not protected under the business judgment rule.

As noted above, under the second prong of *Aronson*, demand is excused where the alleged facts raise a reasonable doubt that "the challenged transaction was otherwise the product of a valid exercise of business judgment." *Aronson*, 473 A.2d at 814. The business judgment rule presumes directors are acting in the best interests of the company, unless they abuse their discretion.[7] *Aronson*, 473 A.2d at 812. Illegal activities, whether a violation of statute or comparable expression of public policy, even if such a violation is undertaken in the corporation's best interests, can never constitute the exercise of valid business judgment. *See Desimone*, 924 A.2d at 934-35 ("it is utterly inconsistent with one's duty of fidelity to the corporation to consciously cause the corporation to act unlawfully); *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 67 (Del. 2006) ("A failure to act in good faith may be shown ... where [a] fiduciary acts with intent to violate applicable positive law.").

Here, Defendants adopted or approved a scheme to repeatedly and systematically violate and defy court orders and regulatory subpoenas despite the harm that would be inflicted on the

[7] The business judgment rule only applies to directors free of self-interest in the challenged transaction. *Grobow*, 539 A.2d at 187.

Company as a result. Indeed, by approving these practices, the Director Defendants have exposed themselves and the Company to potential criminal liability. *See* Florida Appeal Order at 17. These practices have also cost the Company considerable amounts in legal fees to defend this "strategy" before judicial and regulatory authorities. ¶¶ 40, 50. Most recently, the Director Defendants' misconduct has caused Allstate to lose its privilege to issue new insurance policies in Florida at a significant financial loss to the Company.

Nine of the thirteen current Board members were on the Board when the actions contesting Allstate's claims processing detailed in the Complaint began. ¶¶ 7-19. Despite the disastrous consequences of the Board's scheme, these Director Defendants have not taken any action to halt these damaging litigation practices or have, in fact, acquiesced in their continued application.

As recently stated by the Delaware Supreme Court in finding that plaintiffs had adequately alleged demand futility based on allegations of "bad faith":

> [T]he concept of ***intentional dereliction of duty, a conscious disregard for one's responsibilities***, is an appropriate (although not the only) standard for determining whether fiduciaries have acted in good faith. Deliberate indifference and inaction *in the face of a duty to act* is ... conduct that is clearly disloyal to the corporation. It is the epitome of faithless conduct.

Walt Disney, 906 A.2d at 62.

Plaintiff makes a nearly identical allegation - that the Director Defendants were aware of the risk of sanctions being imposed as a result of the Company's defiant litigation tactics – yet approved such practices or simply decided to do nothing to remedy them. In fact, Plaintiff here also alleges the Director Defendants actively, knowingly, and consciously made decisions to conceal the McKinsey reports and avoid any true inquiry into the issue by judicial and regulatory officials. ¶¶ 23, 25, 27, 39-40, 50-52. Stated simply, the Board chose to evade scrutiny, leading directly to the sanctions, both potential and actual, and losses complained of in the Complaint.

The Third Circuit was presented with remarkably similar facts in *Stanziale v. Nachtomi (In re Tower Air, Inc.)*, 416 F.3d 229 (3d Cir. 2005).[8] The *Tower Air* complaint alleged that the

[8] *Tower Air* was not a derivative action, but rather an action brought by a bankruptcy trustee. 416 F.3d at 232. *Tower Air* therefore does not directly address demand futility but nevertheless, contains an expansive analysis of the protections afforded directors by Delaware's business judgment rule. *Id.* at 238-42. This same analysis is applicable to the evaluation of whether Plaintiff has raised a "reason to doubt business judgment protection" of the Board's actions here. *Walt Disney*, 825 A.2d at 289

directors of an airline ignored warnings regarding inadequacies in aircraft maintenance and repair work. *Id.* at 239. The Third Circuit noted that ignoring such safety concerns was particularly egregious, since "[l]ives are on the line." *Id.* 239. Consequently the Third Circuit held that such conduct could never be the product of the board's valid exercise of business judgment, since "[t]he officers' alleged passivity in the face of negative maintenance reports seems so far beyond the bounds of reasonable business judgment that its only explanation is bad faith." *Id.* 239, *citing Parnes v. Bally Entm't Corp.*, 722 A.2d 1243, 1246 (Del. 1999). Similarly, in this action, the Board approved of, and failed to remedy, the Company's litigation tactics which have led to its present problems.

Here, the Director Defendants approved, or failed to remedy, a scheme to repeatedly violate court orders and regulatory subpoenas to conceal the Company's claims handling practices. The blatant disregard of valid court orders and subpoenas could never constitute the exercise business judgment. Thus, demand is excused as futile under the second prong of the *Aronson* test.

1. Demand is Futile under the Theory Articulated by the Seventh Circuit in *Abbott Labs*.

In *Abbott Labs*, the plaintiffs alleged that for six years, Abbott Labs' board of directors ***knew that the company had been accused of committing numerous violations of FDA rules and regulations***, but the board took no action to correct the problems or exercise reasonable oversight over the company's operations. *Abbott Labs.*, 325 F.3d at 802-803. The plaintiffs commenced a derivative action against Abbott's directors and alleged that pre-suit demand was excused because the board:

> knew of the continuing pattern of noncompliance with FDA regulations and knew that the continued failure to comply with FDA regulations would result in severe penalties and yet ignored repeated red flags raised by the FDA and in media reports ***and chose not to bring a prompt halt to the improper conduct causing the noncompliance, nor to reprimand those persons involved, nor to seek redress for Abbott for the serious damages it has sustained***. . . .

Id. at 803-804. The Seventh Circuit Court of Appeals reversed the district court's decision that the plaintiffs' allegations were insufficient to excuse demand, holding:

> [t]he facts support a reasonable assumption that there was a 'sustained and systematic failure of the board to exercise oversight', in this case intentional in that ***the directors knew of the violations of law, took no steps in an effort to prevent or remedy the situation, and that failure to take any action for such an***

> ***inordinate amount of time resulted in substantial corporate losses, establishing a lack of good faith***. We find that six years of noncompliance, inspections, 483s, Warning Letters, and notice in the press, all of which resulted in the largest civil fine ever imposed by the FDA . . ***.indicate that the directors' decision to not act was not made in good faith and was contrary to the best interests of the company.***
>
> ***With respect to demand futility based on the directors' conscious inaction, we find that the plaintiffs have sufficiently pleaded allegations, if true, of a breach of the duty of good faith*** to reasonably conclude that the directors' actions fell outside the protections of the business judgment rule.

Id. at 810.

Indeed, just as in *Abbott Labs.*, Allstate has been subjected to fines for civil contempt in state judicial proceedings (¶50), judicial action by the State of Louisiana (¶40), regulatory action ultimately resulting in suspension by the FOIR (¶54), potential criminal liability (Florida Appeal Order at 17) as well as numerous public studies and negative reports in the media. Defendants cannot credibly argue that the directors fulfilled their fiduciary duties to oversee the Company, yet simultaneously, were totally ignorant of the ultimate negative impact that resulted from Allstate's attempts to foreclose widespread legal scrutiny of the Company's claims handling practices.[9]

[9] Defendants repeated reliance upon *McSparron v. Larson*, 2006 U.S. Dist. LEXIS 53773 (N.D. Ill. May 3, 2006) is misplaced. Unlike either this action or *Abbott Labs.*, the plaintiffs in *McSparron* were unable to plead the long term systemic violations and disregard for judicial or regulatory orders, but instead were only able to plead "two instances of ex-employees making salacious claims that were repeated in a class action complaint and investigated by the SEC." *Id*. at *15. On this basis, this Court in *McSparron* held that "[i]f this gave rise to the type of extreme indifference and failure to act that *Abbott* says creates enough of a likelihood of board member liability to justify a finding of demand futility, any board of any company with multiple operating units would constantly face liability." *Id.* *15-*16. Such concerns about the ease of pleading demand futility simply are not present here. The Board's approval of, or failure to remedy, the tactic of noncompliance with discovery obligations systematically put the Board on notice because of contempt orders imposing millions of dollars in fines and suspension from issuing new insurance policies in Florida – at a loss of ***billions of dollars*** in business. The defendants' reliance upon *In re IAC/InterActive Corp. Secs. Litig.*, 478 F. Supp. 2d 574 (S.D.N.Y. 2007), which action is currently on appeal before the Second Circuit Court of Appeals, is also misplaced. In *IAC*, the gravamen of derivative plaintiffs' demand futility allegations was that demand was futile because the directors lacked independence. Moreover, in *IAC* the federal court had already dismissed the class action complaint which contained the same allegations underlying the derivative case. *Id.* at 596. In contrast, this case does not involve the dismissal of related actions or focus solely on the Director Defendants' lack of independence. Quite the opposite is true. The Florida Court of Appeals upheld the suspension by the FOIR costing the Company billions of dollars in potential revenue because of the Board's scheme to withhold information from judicial and regulatory authorities. Further, Plaintiff here has pled the futility of pre-suit demand by alleging that the Director Defendants both lack independence and disinterestedness and that their conduct is not protected by the business judgment rule.

B. Plaintiff has Created a Reason to Doubt the Disinterest and Independence of A Majority of the Board Under Either the *Aronson* or the *Rales* Test

Even if the Court does not find that pre-suit demand was futile because the Board failed to exercise valid business judgment, demand is still excused as futile under the *Rales* test. One means by which Plaintiff may raise such a reasonable doubt regarding the disinterestedness of the Board is by demonstrating that at least one-half of the members of the Board are subject to a substantial likelihood of liability. *Cendant*, 189 F.R.D. at 129 (demand futile where 16 of 23 directors faced a substantial likelihood of liability). Under Delaware law, "[d]irectors who are sued for failure to oversee subordinates have a disabling interest for pre-suit demand purposes when 'the potential for liability is not a 'mere threat' but instead may rise to a 'substantial likelihood.'" *In re Baxter Int'l, Inc. S'holders Litig.*, 654 A.2d 1268, 1269 (Del. Ch. 1995) (quoting *Rales*, 634 A.2d at 936). In such situations:

> Director liability for a breach of the duty to exercise appropriate attention may, in theory, arise in two distinct contexts. First, such liability may be said to follow ***from a board decision*** that results in a loss because that decision was ill advised or "negligent." Second, liability to the corporation for a loss may be said to arise from an ***unconsidered failure of the board to act*** in circumstances in which due attention would, arguably, have prevented the loss. (emphasis in original)

Abbott Labs., 325 F.3d at 805 (quoting *Caremark*, 698 A.2d at 967). As explained by the Delaware Chancery Court in *Caremark*, a violation of duty exists if the directors "either lack good faith in the exercise of their monitoring responsibilities or permit a known violation of law by the corporation to occur." *Caremark*, 698 A.2d at 972.

1. A Majority of the Directors are Interested Because they Face a Substantial Likelihood of Liability

Delaware courts have held that the substantial likelihood test is satisfied where a plaintiff alleges facts to support the inference that a majority of the directors on a board should have known that the corporation was engaging in imprudent or unlawful conduct and breached their fiduciary duty of good faith by failing to take corrective action. *See Ash v. McCall*, 2000 Del. Ch. LEXIS 144, *55-57 (Del. Ch. Mar. 15, 2000). Under this reasoning, "a sustained or systematic failure of the board to exercise oversight – such as an utter failure to attempt to assure a reasonable information and reporting system exits – will establish the lack of good faith that is a necessary condition to liability" sufficient to render demand futile. *Caremark*, 698 A.2d 959, 971 (Del. Ch. 1996); *see also In re Oxford Health Plans, Inc.*, 192 F.R.D. 111, 117 (S.D.N.Y. 2000).

Defendants, apparently with a straight face, claim that the Complaint "contains no particularized allegations regarding what the board knew about these cases, if anything, when they knew it, or what the board failed to do." Def. Mem. at 11. Defendants are wrong. The Complaint details the litigation, regulatory action and published studies that provided the Allstate Board with knowledge of the Company's litigation in connection with bad faith claims handling processes and the Florida regulatory proceedings. ¶¶37-40, 42-54. The Complaint further details the manner in which Allstate steadfastly disregarded valid orders of one court after another and flaunted its disobedience to regulatory subpoenas in a strategy to stonewall legal authorities in these actions, all in a wide-ranging and orchestrated fashion in an effort to conceal the McKinsey reports. ¶¶35-54. Contrary to defendants' characterization these were substantial legal issues which subjected Allstate to recurring fines for civil contempt, potential criminal liability and suspension of the Company's ability to operate in Florida's lucrative insurance market. Allstate has had to expend considerable funds to defend, appeal and settle with judicial authorities due to its failure to comply with its discovery obligations. *See, e.g.*, ¶¶50, 54. This Company-wide strategy, with its dire consequences, could not have been developed, deployed and paid for without either the Board's active or implicit approval.

Nevertheless, even if this Court declines to find that the Director Defendants had express knowledge of these practices, Plaintiff's particularized allegations are more than sufficient to render demand futile under the *Rales* test. Namely, Plaintiff's Complaint raises a reasonable doubt as to the Director Defendants' disinterestedness because an overwhelming majority of the Board faces a substantial likelihood of liability for its intentional ignorance of, or willful blindness to, "red flags" which should have alerted the Director Defendants to Allstate's reckless litigation strategy. The Director Defendants blindness to the "red flags" has subjected the Company to significant fines, potential criminal liability and loss of Allstate's ability to write new insurance in the state of Florida. Indeed, director liability may arise not only from considered inaction, such as discussed above, but also from an unconsidered failure of the board to act to prevent losses to the corporation. *Caremark*, 698 A.2d at 971 (where there is a "sustained or systematic failure of the board to exercise oversight" and where the directors have willfully ignored obvious signs of wrongdoing the lack of good faith upon which to condition liability is established).

If the Court finds that Plaintiff's allegations are "predicated upon ignorance of liability creating activities," *McCall v. Scott* is instructive. 239 F.3d 808; *Caremark*, 698 A.2d at 971-72. In *McCall*, the court held that the plaintiffs' claims did not involve a "conscious Board decision to refrain from acting" and therefore applied the *Rales* test to evaluate demand futility. *McCall*, 239 F.3d at 816. In this vein, the *McCall* court held that the plaintiffs had sufficiently alleged demand futility with respect to their claims for intentional or reckless breach of the duty of care because the board had ignored warning signs of potentially unlawful practices at the company. *McCall*, 239 F.3d at 819.[10]

In this case, Plaintiff has made strikingly similar allegations and has pointed to numerous "red flags" which should have alerted the Director Defendants to the dire consequences of the Company's flagrant disregard for court orders and defiance of regulatory bodies. Such red flags include, *inter alia*,: (i) the judicial and regulatory proceedings commenced in 2001, regarding Allstate's arbitrary bad faith claims processing practices in Kentucky, Missouri, New Mexico and Louisiana (¶¶36-38, 40, 42); (ii) the 2001 ruling in *Geneva Hager v. Allstate Ins. Co.*, 98-cl-2482, Fayette Circuit Court Kentucky, that the McKinsey reports were not trade secrets (¶38); (iii) the FOIR investigation commenced in October 16, 2007 for which the Company was subpoenaed for information and asked to produced witnesses (¶43); (iv) the suspension of Allstate's certificate of authority to write new insurance in Florida for non-compliance with a subpoena issued in the FOIR investigation (Florida Appeal Order); and (v) the fine, amounting to $25,000 per day beginning September 12, 2007, levied against the Company by a Missouri court in an action styled *Dale Deer v. Allstate Ins.*, Case No. 0516-CV24031, for Allstate's ongoing failure to comply with its discovery obligations, including production of the McKinsey reports (¶40). In light of these "red flags," it is clear that the Director Defendants' failure to act was reckless and willful, subjecting them to a substantial likelihood of liability for the "unconsidered inaction." Accordingly, demand is excused.

[10] The *McCall* court inferred that the defendants' failure to act was reckless and willful in light of *qui tam* actions which had been brought against the company, extensive investigations into the company's unlawful practices, a *New York Times* investigation and that the company had previously been "investigated for and settled allegations of questionable billing, cost reporting, and marketing practices" for $475,000 plus $1.1 million in reimbursement for unsupportable or questionable expenditures. *Id.* at 819-21.

2. Plaintiffs' Remaining Allegations Also Demonstrate Demand Futility

In addition to demonstrating that demand is futile because the Director Defendants are interested or because their conduct is not shielded by business judgment rule, demand is also excused because Plaintiff has pleaded that certain Director Defendants lack independence.

Defendants Liddy and Wilson could have not have fairly considered a demand on its merits, because one "extraneous consideration or influence" that destroys director independence is the financial reward that accrues to him by virtue of his position as an executive of the Company.[11] Hence, the fact that a director receives substantial financial compensation from his employment is sufficient to raise a reasonable doubt regarding the director's independence from others who have the ability to control his employment and compensation. *See Rales*, 634 A.2d at 937 ("there is a reasonable doubt that [a director] can be expected to act independently considering his substantial financial stake in maintaining his current offices"); *In re The Student Loan Corp. Derivative Litig.*, No. 17799, 202 WL 75479, *3 (Del. Ch. Jan. 8, 2002) (allegations that a director owes their livelihood to their employer, without elaboration on the exact compensation, sufficient to show lack of independence).

These allegations, when coupled with each Director Defendants' substantial likelihood of liability, bolster Plaintiff's demand futility allegations.[12]

V. CONCLUSION

For all the foregoing reasons, Plaintiff respectfully requests that the Court deny defendants' Motion to Dismiss in its entirety, and grant such other relief as appropriate.[13]

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[11] At the time this action was commenced, defendant Wilson's principal professional occupation was as CEO and President of Allstate. ¶¶19, 58(b). Similarly, Liddy was President and CEO for much of the relevant period. ¶¶13, 58(b). In fact, for fiscal year 2006, Allstate paid Liddy $24 million and Wilson $8 million in salary, stock awards and other compensation. Accordingly, Plaintiff has pled reasonable doubt regarding the independence of defendants Wilson and Liddy, rendering them incapable of impartially considering a demand to commence and vigorously prosecute this action.

[12] *See Harris*, 582 A.2d at 229 (noting that no single factor is dispositive because "the question is whether the accumulation of all factors creates the reasonable doubt to which *Aronson* refers.").

[13] Plaintiff respectfully requests leave to amend if the Court is inclined to grant defendants' motion to dismiss. A district court should freely grant leave to amend. *Vance v. Gallagher*, No. 02 C 8249, 2004 WL 1510016 (N. D. Ill. Jul. 7, 2004). If granted such leave, Plaintiff would include allegations concerning, *inter alia*, the confirmation by Florida Governor Charlie Crist that in an April 24, 2008 article in *tampabay.com* that Allstate quietly offered Florida $10 million to let the Company "off the hook" and retract the order that would prevent Allstate from selling new policies in Florida. The details provided in the Florida Appeal Order will also be included in the amended complaint.

Dated: May 15, 2008

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EXHIBIT A

IN THE DISTRICT COURT OF APPEAL
FIRST DISTRICT, STATE OF FLORIDA

ALLSTATE FLORIDIAN INSURANCE COMPANY; ALLSTATE INDEMNITY COMPANY; ALLSTATE PROPERTY & CASUALTY INSURANCE COMPANY; ALLSTATE INSURANCE COMPANY; ALLSTATE FLORIDIAN INDEMNITY COMPANY; ALLSTATE FIRE AND CASUALTY INSURANCE COMPANY; ENCOMPASS INSURANCE COMPANY OF AMERICA; ENCOMPASS INDEMNITY COMPANY; ENCOMPASS FLORIDIAN INSURANCE COMPANY; and ENCOMPASS FLORIDIAN INDEMNITY COMPANY,

Appellants,

v.

OFFICE OF INSURANCE REGULATION,

Appellee.
_____/

CASE NO. 1D08-0275

Opinion filed May 14, 2008.

An appeal from an order of the Department of Insurance.

Elizabeth McArthur, Harry O. Thomas, and David A. Yon of Radey, Thomas, Yon & Clark, P.A., Tallahassee, for Appellants.

Susan Dawson, Deputy General Counsel, Steven H. Parton, Anoush Arakalian Brangaccio and Jim L. Bennett, Office of Insurance Regulation, Tallahassee, for Appellee.

ON MOTION FOR REHEARING, REHEARING EN BANC, AND CERTIFICATION

HAWKES, J.

This cause is before us on Allstate's motion for rehearing, rehearing en banc, and certification. We deny the motion in its entirety. On the merits, our opinion remains unchanged. We write only to clarify our opinion. Therefore, we withdraw our previous opinion and substitute this opinion in its place.

The Allstate Companies appeal an Immediate Final Order (IFO) issued by the Department of Insurance, Office of Insurance Regulation (OIR). The IFO immediately suspended Allstate's Certificates of Authority to transact new insurance business in Florida. The suspension would terminate upon Allstate producing documents OIR previously subpoenaed in an investigation of Allstate's insurance practices. The question we must answer is whether OIR can suspend Allstate's Certificates of Authority as a consequence of Allstate's refusal to comply with its

statutory obligation to comply with OIR's investigation in order to conduct insurance business in Florida. Under the unique facts of this case, they can. We affirm.

The Subpoenas

On October 16, 2007, OIR served investigative subpoenas and subpoenas duces tecum on each of the Allstate Companies. The information sought was in connection with OIR's investigation of Allstate's relationship with risk modeling companies, insurance rating organizations, trade associations and compliance with House Bill 1A. The subpoenas informed Allstate that OIR was holding a hearing on these issues in Tallahassee three months later on January 15-16, 2008.

The subpoenas duces tecum required Allstate's corporate representatives with knowledge of identified subject matter to appear and testify at the public hearing. Each subpoena and subpoena duces tecum contained a notice that "Failure to comply with this subpoena may result in the initiation of enforcement proceedings pursuant to the Florida Insurance Code."

The Hearing

The hearing was held as scheduled. At the onset of the hearing, the Commission observed that, although Allstate produced "thousands of documents," it had not complied with the subpoenas. Specifically, Allstate had labeled every one of the approximately 30,000 documents it had produced as "trade secret." Some of these

"trade secret" documents were public records posted on OIR's website. Many of the documents had pages removed. Most of the required documents were withheld. Some of the documents subpoenaed from Allstate had been ordered produced by courts of other states, and Allstate had refused to comply. The Commission observed Allstate was currently being held in contempt of court in Missouri with a $25,000.00 per day fine for its failure to produce documents and, as of the date of the hearing, those fines exceeded $2 million.

Allstate's counsel "regret[ted]" Allstate's production had not met OIR's investigative needs, and he asserted Allstate would continue to cooperate in consultation with OIR to produce documents responsive to the subpoenas. Counsel acknowledged that marking every document "trade secret" was "an irritation," and stated that, in Allstate's "next wave" of production, it would make sure that the "trade secret" designation was raised "in only the most appropriate circumstances."

When asked if Allstate was prepared to produce "the McKinsey documents," counsel replied "subject to the appropriate protections" . . . "privileges." Counsel stated Allstate did not produce witnesses to respond to questions regarding Allstate's claims handling practices as contained in the McKinsey report or documents made by Allstate in that regard, despite being requested to do so. Instead, counsel referred the

Commission to the witnesses Allstate did provide, indicating they were "very knowledgeable."

Allstate's counsel was asked whether anyone was present to testify about communications and reasons for non-renewals from 2005 to the present, as requested by subpoena. Counsel replied "No." Counsel was asked if anyone was present to testify about the item requiring production of "documents and communications that evaluate, discuss, analyze or otherwise refer or relate in any way to your non-renewal or cancellation of policies identified in the previous response." Counsel referred the Commissioner to the witnesses present, and reiterated the topics upon which they were qualified to testify. In response, the Commission questioned whether, by Allstate selecting the witnesses and documents that would be produced, it was Allstate's intent to limit the Commission's area of inquiry. Counsel replied "These are the witnesses we have produced, yes," and the witnesses could testify about these "general topics."

The record shows Allstate produced three witnesses, none of whom produced any documents. The witnesses answered some general questions in part, but were unable to answer probing questions about the subjects required by the subpoenas. For example, the Commission attempted to question the witness produced to answer questions related to Allstate's relationship with trade associations. However, that witness testified he: had not reviewed any document responsive to that topic; had no

knowledge regarding what documents had been produced relative to that topic; did not bring documents responsive to that topic; and did not have with him documents provided to OIR relative to that topic.

Allstate's counsel represented it was not possible to produce the requested documents in the time allotted, but acknowledged Allstate did not request an extension of time. The Commission noted it was impossible to ask penetrating questions without the subpoenaed documents, and it would "happily" provide an extension of time to provide the documents if Allstate would comply with the subpoenas. However, based on counsel's representations and blanket objections, the Commission did not believe Allstate would ever produce the subpoenaed documents.

The recurring theme throughout the hearing was that OIR's requests were "breathtakingly broad," document production was incomplete, Allstate intended to provide the documents "necessary" for OIR's review subject to Allstate's objections and privileges "in a way that respects each party's interests," and the witnesses Allstate produced were unable to answer any but the most general of questions.

At the conclusion of the hearing, Senator Atwater opined Allstate decided to narrow the focus of the questions by choosing what witnesses to produce, and what was "breathtakingly broad" was Allstate's "dance" to avoid answering questions, not the questions Allstate was asked. The hearing was continued for the Commission to

"look at the array of options, which are quite limited," to take "appropriate enforcement actions."

The IFO

The next day, OIR entered the IFO at issue, which detailed the subpoena requests, Allstate's 51 pages of "frivolous" objections, Allstate's failure to produce, and Allstate's representations at the hearing. The IFO discussed Allstate's failure to produce the "McKinsey Report," the significance of which was based on complaints OIR had received and information contained in J. Robert Hunter's July 18, 2007 report titled "*The 'Good Hands' Company or a Leader in Anti-Consumer Practice? Excessive Prices and Poor Claims Practices at the Allstate Corporation.*"

In essence, Hunter's report, addressed in detail in the IFO, alleges Allstate used a computer program which "immediately reduce[s] the size of bodily injury claims by up to 20 percent." Any insurer who buys a license to use the program is able to calibrate the amount of "savings" it wants the program to meet. If the program does not generate "savings" to meet the insurer's goals, the insurer "adjusts" the benchmark values until the program reaches the desired result. The program is designed to systematically reduce payments to policyholders without adequately examining the validity of each individual claim.

The IFO asserted Allstate was ordered by a Missouri circuit court to produce a document similar to the "McKinsey Report." Allstate failed to produce the report, and chose instead to incur a $25,000 per day fine until the documents were produced. At the time the IFO was entered, Allstate had incurred approximately $2.4 million in court fines for failure to comply with court-ordered production.

The IFO discussed, in detail, applicable insurance code provisions, OIR's statutory obligations and available enforcement mechanisms, and the statutory requirements with which Allstate must comply to transact insurance in Florida. Specifically, the IFO referenced the following statutes:

- Section 624.307(1), Florida Statutes - Mandating OIR enforce the insurance code.
- Section 627.031(1)-(2), Florida Statutes - Stating the purpose of the insurance rating law is to "promote the public welfare" by regulating insurance rates to ensure they are not excessive, inadequate or unfairly discriminatory, and to "protect policyholders and the public against the adverse effects of excessive, inadequate, or unfairly discriminatory insurance rates . . ."
- Section 624.11(1), Florida Statutes - Providing that "*[n]o* person[1] shall transact insurance in this state . . . without complying with the applicable provisions of this code." (emphasis added).
- Section 624.15(1), Florida Statutes - Providing "*[e]ach willful violation of this code* . . . as to which a greater penalty is not provided by another provision of this code . . . or by other applicable laws of this state is a

[1]"Person" is defined, in part, to include "insurer." *See* § 624.04, Fla. Stat.

misdemeanor of the second degree and *is*, *in addition to* any prescribed applicable denial, *suspension, or revocation of certificate of authority*, . . ., *punishable as provided in s. 775.082 or s. 775.083.* Each . . . violation shall be considered a separate offense." (emphasis added).

- Section 627.031(2), Florida Statutes - Mandating that, if OIR has reason to believe any rate is excessive, inadequate or unfairly discriminatory, "*it is directed to take the necessary action*" to cause the rate to comply with Florida law.

- Section 624.317, Florida Statutes - Mandating that, if OIR has reason to believe any person has violated or is violating any provision of the code, or upon the written complaint by any interested party indicating any such violation may exist, OIR *shall* conduct such investigation of the person's accounts, documents, and transactions as OIR deems necessary.

- Section 624.318(2), Florida Statutes - Requiring that "*[e]very person being* examined or *investigated, and its* officers, *attorneys*, employees, agents, and representatives, *shall make freely available* to [OIR] . . . the accounts, records, documents, files, information, assets, and matters in their possession or control relating to the subject of the examination or investigation." (emphasis added).

- Section 624.321(1)(b), Florida Statutes - Granting OIR, when conducting an investigation "the power to subpoena witnesses, compel their attendance and testimony, and require by subpoena the production of books, papers, records, files, correspondence, documents, or other evidence which is relevant to the inquiry."

- Section 624.418,(2)(a)-(b), Florida Statutes - Providing as an enforcement mechanism, that "[OIR] *may, in its discretion, suspend or revoke the certificate of authority* of an insurer *if it finds that the insurer*: (a) Has violated . . . any provision of this code. (b) *Has refused to be examined or to produce its accounts, records, and files for examination, or if any of its officers have refused to give information with respect to its affairs or to perform any other legal obligation as to such examination, when required by [OIR].*" (emphasis added).

The IFO asserted that, without full and complete information, OIR was unable to protect the public by documenting Allstate's claims handling procedures; improper claims handling practices harm Allstate's Florida customers and are a continuing violation of Florida's Unfair Insurance Trade Practices Act; and Allstate's failure to produce documents violated the insurance code and constituted a willful, ongoing crime pursuant to section 624.15(1), Fla. Stat. The IFO found Allstate's continuing failure to provide lawfully requested documents, and its continuous criminal violations of Florida law constituted an immediate danger to the public.

Finally, the IFO asserted, in essence, that based on Allstate's representations at the hearing it would not respond in good faith to OIR's subpoena, but would instead continue its extensive, "frivolous" objections. Allstate's representations, coupled with its choice to incur millions of dollars in fines rather than comply with a Missouri circuit court order requiring production of similar documents, led OIR to conclude the better enforcement option was to issue the IFO instead of pursuing the apparently futile course of seeking enforcement of its subpoenas in circuit court.

IFO Requirements

An IFO must contain facts sufficient to demonstrate: (1) Immediate, serious danger to the public health, safety, or welfare; (2) The order takes only that action necessary to protect the public considering the emergency (i.e., the remedy is tailored

to the harm); and, (3) Procedural fairness under the circumstances (the procedure provides at least the same procedural protection given by other statutes, or the state or federal Constitutions). *See* § 120.60(6), Fla. Stat. (2007); *Bio-Med Plus, Inc. v. Dep't of Health*, 915 So. 2d 669 (Fla. 1st DCA 2005); *Premier Travel Int'l v. Dep't of Agric. & Cons. Servs.*, 849 So. 2d 1132 (Fla. 1st DCA 2003). These elements, which are necessary to an IFO's validity, must appear on its face. *See e.g., Bio-Med Plus,* 915 So.2d at 669; *Commercial Consultants Corp. v. Dep't of Bus. Reg., Div. of Land Sales & Condo.*, 363 So. 2d 1162, 1164 (Fla. 1st DCA 1978).

IFO Compliance

Allstate's willful failure to comply with its statutory disclosure requirements made it extremely difficult, if not impossible, for OIR to provide the degree of specificity this court may ordinarily require for an IFO. Essentially, Allstate created the difficulty about which they now complain and attempt to use to seek relief. Consequently, we require a somewhat lesser demonstration of specificity here than what the court may ordinarily find necessary. Applying this relaxed standard, our review of the IFO reveals OIR met each requirement, and every element necessary to the IFO's validity appears on its face.

Immediate Danger to Public Health, Safety or Welfare

The IFO provided facts sufficient to demonstrate an immediate danger to the public health, safety or welfare. Two allegations in the IFO satisfy this element.

First, it alleged monetary loss to policy holders and beneficiaries. OIR received complaints regarding Allstate's claims handling practices, and information indicating Allstate's claims handling practices arbitrarily reduced bodily injury claim payments to its policyholders and beneficiaries by up to 20%. This allegation of widespread personal monetary loss is sufficient to meet the danger requirement of section 120.60, Florida Statutes. *See Premier Travel*, 849 So. 2d at 1134 (holding personal monetary losses can be the type of danger to the public health, safety or welfare addressed by section 120.60); *Stock v. Dep't of Banking & Finance,* 584 So. 2d 112 (Fla. 5th DCA 1991); *Saviak v. Gunter,* 375 So. 2d 1080 (Fla. 1st DCA 1979).

Second, the IFO alleged ongoing criminal activity. The Legislature made failure to cooperate with an OIR investigation a crime. *See* § 624.15(1), Fla. Stat. Allstate's criminal conduct prevented OIR from protecting the public by fully investigating the complaints and information it had received.

When the Legislature enacts penal statutes, it does so under the State's police power, which is limited to protection of the public's health, safety and welfare. *See e.g., In re Forfeiture of 1969 Piper Navajo, Model PA-31-310, S/N-31-395, U.S.*

Registration N-1717G, 592 So. 2d 233 (Fla. 1992); *State v. Saiez,* 489 So. 2d 1125 (Fla. 1986); *Hamilton v. State,* 366 So. 2d 8 (Fla. 1978); *Carroll v. State,* 361 So. 2d 144 (Fla. 1978). Thus, the IFO assertion that Allstate's failure to comply with the subpoenas, each offense of which constitutes a separate criminal violation, poses a danger to the public health, safety or welfare, has merit. Ongoing criminal violations constitute a danger to the public health, safety and welfare.

Remedy Tailored to Address Harm

In at least three ways, the IFO showed the immediate suspension of Allstate's certificate of authority to transact new insurance in Florida until it complied with the subpoenas was narrowly tailored to address the harm.

First, the IFO was limited in scope. Pursuant to statute, OIR could have suspended Allstate from conducting *any* insurance business in Florida for its failure to comply with the insurance code by its refusal to produce the documents, and to make the documents requested by OIR "freely available." *See* § 624.11(1), Fla. Stat.; § 624.318(2), Fla. Stat.; § 624.418(2)(a)-(b), Fla. Stat. In limiting the scope to suspension of new business, OIR's action mitigates the potential harm from Allstate's alleged insurance practices while still allowing Allstate to service existing policies.

Second, the IFO was tailored to address Allstate's continued obstruction of OIR's investigation. For instance, the IFO alleged and the record showed Allstate

marked approximately 30,000 documents, including public records, "trade secret" and objected to *every* document requested, asserting, in part, that the requested documents were irrelevant, burdensome to produce, vague, overbroad, etc. OIR found the 30,000 pages of documents produced "non-responsive" and the 51 pages of objections "frivolous." Although Allstate complained of the extensiveness of the request, it never requested an extension of time to produce the documents, and gave extremely ambiguous caveats as to the extent to which they would ever produce the documents. The witnesses Allstate produced in response to the subpoenas duces tecum were unable to address in meaningful detail any of the subjects set forth in the subpoenas. Competent, substantial evidence from the hearing supports OIR's conclusion that additional time, further negotiations or utilizing the circuit court option to enforce the subpoenas would have been futile in assisting OIR to obtain the required documents from Allstate. Allstate's responses at the hearing support OIR's concern that Allstate, through obstruction and delay, hoped to define the scope of OIR's investigation. Clearly, Allstate lacks this authority.

Third, the IFO was tailored to the harm by allowing Allstate to determine the duration of the suspension. OIR exercised its discretion to temporarily suspend Allstate's certificates of authority to transact new business for failing to produce the requested records. *See* § 624.418(2)(b), Fla. Stat. Allstate may lift the suspension at

any time by simply producing the documents it is required by statute to "freely" produce in order to conduct insurance business in Florida. OIR places no extra burden on Allstate than the one Allstate voluntarily accepted when choosing to transact insurance in Florida. *See* § 624.11(1), Fla. Stat.; § 624.318(2), Fla. Stat.; § 624.418(2)(a)-(b), Fla. Stat.

Allstate argues OIR's decision to issue the IFO instead of seeking to enforce its subpoenas in circuit court prevents Allstate from obtaining judicial review to determine the reasonableness of the subpoenas, and requires Allstate to waive its right to withhold documents protected by attorney-client privilege. We reject this argument. Nothing prevented *Allstate* from *timely* filing a privilege log and seeking a protective order in circuit court, specifically identifying any of the requested documents they believed were privileged.

Procedural Fairness

Courts must consider the facts of the particular case to determine whether the parties have been accorded the procedural due process state and federal constitutions demand. *See Hadley v. Dep't of Admin.*, 411 So. 2d 184, 187 (Fla. 1982) (citing *Mathews v. Eldridge*, 424 U.S. 319, 334 (1976)). Formalities requisite in judicial proceedings are not necessary to meet due process requirements in the administrative process. *See id.* It is sufficient if the accused is informed of the charges against him,

has reasonable opportunity to defend against attempted proof of such charges, and the proceedings are conducted in a fair and impartial manner. *See id.*

Additionally, in determining whether to affirm or reverse an IFO, courts consider whether the pattern of conduct is likely to continue. *See Premier Travel Int'l*, 849 So. 2d at 1135; *Saviak,* 375 So. 2d at 1080; *Stock,* 584 So. 2d at 115.

Here, OIR provided procedural fairness and entry of the IFO was fair under the circumstances. OIR issued subpoenas and subpoenas duces tecum, and scheduled a hearing. Allstate never requested an extension of time. The hearing was held. Allstate appeared at the hearing without the requested documents, and without the required witnesses. At the hearing, Allstate frustrated the Commission's efforts to conduct the required investigation. Although Allstate claims it intended eventual compliance with the subpoenas, it did so in such ambiguous terms and with such extensive caveats as to render these assertions meaningless. The record supports the IFO allegation that Allstate's conduct is likely to continue, based on its representations at the hearing, and its history of choosing to incur millions of dollars in fines rather than comply with court-ordered production.

OIR's decision to forgo futile attempts to enforce its subpoenas in circuit court, issue the IFO to temporarily suspend Allstate's ability to transact new insurance business, and provide for a formal administrative hearing to determine whether the

suspension should be permanent, met the statutory "procedural fairness under the circumstances" requirement.

Conclusion

The facts of this case are unique. In order to conduct insurance business in Florida, Allstate is statutorily required to comply with OIR's investigation and make "freely available" documents sought by OIR. Allstate's willful, indeed potentially criminal, failure to comply with its disclosure obligations has prevented OIR from adequately investigating its reasoned belief that Allstate is systematically defrauding its policyholders. To the extent Allstate believed any documents OIR sought were privileged, *Allstate* was required to *timely* seek a protective order in circuit court.

In attempting to conduct its investigation, OIR was faced with Allstate's representations that it would decide which documents it would produce, and Allstate's history of incurring millions of dollars in court-ordered fines rather than comply with court-ordered production. The scope of OIR's investigation cannot be limited by Allstate's unilateral actions. Suspension of Allstate's Certificates of Authority was one of OIR's statutorily available options when Allstate refused to cooperate in the investigation. Because the IFO meets the requirements of section 120.60(6), Florida Statutes, it is AFFIRMED and the stay is lifted.

BROWNING, C.J., and LEWIS, J., CONCUR.