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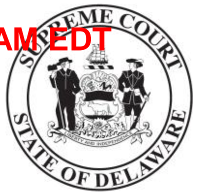

IN THE SUPREME COURT OF THE STATE OF DELAWARE

REBECCA CLARK and JAMES SMITH, on behalf of themselves and all others similarly situated,	)	No. 167, 2015
Plaintiffs below/appellants,	)	On Appeal From the Superior Court of the State of Delaware in and for New Castle County
v.	)	C.A. No. N14C-02-188 JRJ [CCLD]
STATE FARM MUTUAL AUTOMOBILE INSURANCE COMPANY,	)	
Defendant below/appellee.	)	

APPELLANTS' OPENING BRIEF ON APPEAL

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August 7, 2015

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NATURE OF PROCEEDINGS

Plaintiffs Rebecca Clark and James Smith commenced this proposed class action on February 20, 2014. Their original complaint challenged State Farm's practice of deducting statutory interest penalties, incurred by the company pursuant to 21 *Del. C.* § 2118B, from its insureds' limits of liability for Personal Injury Protection (or "PIP") coverage. However, as Ms. Clark and Mr. Smith explained below, State Farm's record-keeping practices made it practically impossible to either prove or disprove the offending conduct:

> Regarding the contents of the Clark and Smith claim files, [defense counsel] candidly admitted in a recent email that "State Farm doesn't contend that the production has any effect on the summary judgment motion one way or the other." Our review of the Clark and Smith files confirms that point: since the files contain no rolling tally of the diminution of PIP limits — no document that records, for example, that the limits were $15,000 on such-and-such a date, and then reduced by payment to $14,500 on such-and-such a date — there would seem to be no efficacious way to either prove or refute our original theory of the case by resort to State Farm's business records.
>
> Taking all this into account, we have decided to abandon the "deduction from PIP limits" theory. Whether State Farm has actually deducted statutory interest payments from its Delaware policyholder's PIP limits is something known to State Farm alone; but as a practical matter, State Farm's record-keeping practices make it difficult (if not impossible) for an objective outsider to make that determination.

> We believe that Delaware consumers (and perhaps State Farm as well) would be better served by a change in State Farm's record-keeping practices. Were State Farm to stop distributing payment logs that show statutory interest under the heading "Coverage Description," it could avoid the confusion that (apparently) led to this lawsuit. In addition, common sense dictates that an insurer keep reliable and transparent records regarding the periodic diminution of a policy's limits of liability. These observations, however, are not enough to justify continued litigation of the issue.

A93-95.

Prior to this development — that is, prior to the plaintiffs' determination that State Farm's business records would not permit a fair opportunity to either prove or disprove the allegations of the original complaint — the plaintiffs served State Farm with written discovery in the form of a single interrogatory: "State the total number of PIP claim files with respect to which you made any payment of statutory interest during the period February 20, 2011 to the present." A41.[1] State Farm's response disclosed that the company incurred interest penalties for the late payment of covered Delaware PIP claims on ***6,349 claim files*** since February

---

[1] Pursuant to the definitions that accompanied the plaintiffs' interrogatory, the interrogatory was limited to Delaware PIP claims only:

> The term "PIP claims" (as used in Interrogatory No. 1 below) refers to claims, requests or demands for payment of Personal Injury Protection benefits pursuant to 21 *Del. C.* § 2118, and under any policy of automobile insurance issued by State Farm. As used in Interrogatory No. 1, the term "PIP claims" shall not include claims submitted under the laws of any state other than Delaware.

A40-41.

2011. A42. Note that according to State Farm's own interrogatory response, this figure relates not to individual payments of statutory interest, but to the number of ***files*** on which such payments have been made. When one considers that (as shown below) State Farm incurred 59 separate interest payments on Ms. Clark's file alone, it appears likely that State Farm is violating Delaware's 30-day standard for the payment of covered PIP claims tens of thousands of times each year.[2]

Accordingly, in August 2014 Ms. Clark and Mr. Smith moved to amend their complaint to address the conduct revealed by State Farm's interrogatory response. More specifically, the proposed amendment sought declaratory relief on a classwide basis, seeking to effectively end State Farm's routine and purposeful violation of the 30-day deadline under 21 *Del. C.* § 2118B(c):

> 35. Under 21 *Del. C.* § 2118B(c), and under the obligations imposed by State Farm's insurance contracts with members of the proposed class, State Farm must pay or deny claims for Personal Injury Protection coverage within 30 days of receipt of the claim.

---

[2] Section 2118B(c) provides, in pertinent part:

> When an insurer receives a written request for payment of a claim for benefits pursuant to § 2118(a)(2) of this title, the insurer shall promptly process the claim and shall, no later than 30 days following the insurer's receipt of said written request for first-party insurance benefits and documentation that the treatment or expense is compensable pursuant to § 2118(a) of this title, make payment of the amount of claimed benefits that are due to the claimant or, if said claim is wholly or partly denied, provide the claimant with a written explanation of the reasons for such denial.

> 36. Under 21 *Del. C.* § 2118B(c), and under the obligations imposed by State Farm's insurance contracts with members of the proposed class, State Farm must fully investigate claims for Personal Injury Protection coverage within 30 days of receipt of the claim.
>
> 37. Under 21 *Del. C.* § 2118B(c), and under the obligations imposed by State Farm's insurance contracts with members of the proposed class, State Farm must communicate to its insured a coverage determination for Personal Injury Protection claims within 30 days of receipt of the claim.
>
> 38. State Farm has adopted the practice of failing and refusing to either pay or deny a PIP claims within the statutorily-required 30-day period under 21 *Del C.* § 2118B(c). Instead, State Farm routinely and consciously incurs statutory interest penalties for overdue PIP benefits under section 2118B(c), treating its payment of such penalties as a mere cost of doing business.
>
> 39. State Farm's practice of failing and refusing to comply with section 2118B's 30-day requirement is inconsistent with and in violation of Delaware law and public policy.

A81 (excerpt from proposed amended complaint at ¶¶35-39, setting forth the sought-after judicial declaration).

On March 30, 2015 the Superior Court denied the plaintiffs' motion to amend the complaint, holding that the proposed amendment stated no case or controversy and the plaintiffs therefore lacked standing to sue — despite the fact that the plaintiffs are actually owners of State Farm; despite the fact that State Farm's conduct could potentially constitute criminal conduct, or otherwise damage

the company's brand; and despite the fact that such conduct diminishes the value of the insurance product for which the plaintiffs paid substantial premiums. *Clark v. State Farm Mut. Auto. Ins. Co.*, 2015 WL 1518662 (Del. Super. Ct. March 30, 2015), Op. at *4 (Ex. A). On June 23, 2015 the Superior Court granted State Farm's motion for summary judgment with respect to the original ("deduction-from-PIP-limits") theory of the case, which the plaintiffs had already abandoned. *Clark v. State Farm Mut. Auto. Ins. Co.*, 2015 WL 388-2528 (Del. Super. Ct. June 23, 2015), Order at *2.

Ms. Clark and Mr. Smith filed a timely Notice of Appeal, which the Prothonotary docketed on July 8, 2015. They appeal from the Superior Court's March 30, 2015 ruling on their motion for leave to amend the complaint. This is their opening brief on appeal.

SUMMARY OF ARGUMENT

1. The policyholders of a mutual company are the equivalent of stockholders in a stock corporation. Where a policyholder disputes the handling of his or her individual insurance claim, the mutual company owes no fiduciary duty to the policyholder. However, when policyholders act in their capacity as owners — that is, by challenging the mutual company's widespread institutional conduct (as opposed to its handling of an individual claim) — the company owes policyholders a fiduciary duty; and such policyholders have standing to sue.

2. The plaintiffs paid substantial premiums to State Farm in return for the promise of PIP coverage. The very essence of PIP coverage is speed; hence the PIP statute's 30-day claims-handling deadline. By adopting a widespread practice of ignoring the statutory 30-day deadline, State Farm has deprived the plaintiffs of the benefit of their bargain; and the contract rights for which they paid have been diminished. This constitutes an actual case or controversy.

3. The fact that State Farm paid statutory interest for overdue PIP claims — whether such interest was paid to the plaintiffs or to absent class members — does not change the fact that the company is engaging in a widespread and continuing pattern of unlawful conduct. Nor does it relieve State Farm of the fiduciary duty it owes to its owner/policyholders, or undo the resulting diminution in value of State Farm's insurance product. Under the doctrine of voluntary cessation, therefore,

State Farm's payment of interest penalties does not moot its dispute with the plaintiffs.

STATEMENT OF FACTS

A. The Parties

Plaintiff Rebecca Clark is a resident of Hockessin, Delaware, while plaintiff James Smith resides in Smyrna, Delaware. Both are current State Farm auto policyholders. State Farm is a mutual company headquartered in Illinois. It derives substantial profits from the sale of automobile insurance products in Delaware.

B. The Litigation History

i. The *Womack* Case

In April 2006 the undersigned counsel commenced a class action against State Farm styled *Womack v. State Farm*. In *Womack* the plaintiff sought recovery of statutory interest under 21 *Del. C.* § 2118B for PIP benefits that were paid, but paid late. This Court ultimately approved a $1.1 million settlement in *Womack* for the benefit of roughly 13,000 class members. *See generally Womack v. State Farm Mut. Auto. Ins. Co.*, Del. Super., C.A. No. 06C-04-013 RFS, Stokes, J. (Aug. 21, 2008) (Final Order Approving Class Action Settlement and Final Judgment) (Ex. B). The settlement provided for pro rata payments to each class member of approximately $90. Certification of John S. Spadaro ¶3 (A92).

ii. State Farm's Interrogatory Response

As noted above, State Farm's interrogatory response below admitted that from February 2011 through June 2014, the company incurred interest penalties for the late payment of covered Delaware PIP claims on 6,349 separate claim files. A42. Note again that according to State Farm's response, this figure relates not to individual payments of statutory interest, but to the number of ***files*** on which such payments have been made. According to the company's own payment logs, meanwhile, State Farm incurred 59 separate interest penalties on Ms. Clark's file alone, and seven more such penalties on Mr. Smith's file. *See* A16-20; A36-39 (payment logs). It thus appears likely that State Farm is violating the 30-day standard tens of thousands of times each year — despite section 2118B's unequivocal 30-day mandate, and despite the seven-figure class settlement in *Womack*.

iii. State Farm's Defense of Its Conduct

At a hearing below, State Farm made clear its essential position. According to State Farm, section 2118B's statutory interest provision is not a penalty, and not intended to either punish or deter. State Farm has thus arrogated to itself the right to routinely delay payment of covered PIP claims as a matter of general business practice, so long as it pays the required statutory interest; and such interest

payments, it argues, are merely the cost of doing business in the Delaware auto insurance market:

> One last point I want to make — and I think it's very important to what the Court thinks is happening here today — is that 2118B is not part of the original no-fault statute, which was enacted either in 1968 or 1972. It was actually added in 1993. It's a payment statute. And all it simply says – and the legislature decided that this is what it wanted to do. All it simply said is if you don't pay the bill in 30 days, for a period of time after you pay one and a half percent interest, for another period of time you pay two percent interest, and for another period of time you pay two and a half percent interest.
>
> Interest is simply some charge for the use of money. It is not a punishment, it is not a penalty. It is not something that if State Farm can't or doesn't pay in 30 days, if it pays interest to the providers, as the statute requires — it's not a statute that requires anybody to be punished or penalized. It's simply the General Assembly's assessment of what a reasonable charge is for the use of that money.

Transcript of July 16, 2014 hearing at 17-18 (A59-60).

But this displays an almost willful ignorance of Delaware's no-fault scheme. The PIP statute's purpose "is to remove the expense and uncertainty of automobile accident litigation, allowing the insured to receive prompt payment for medical expenses and lost wages regardless of who was at fault." *Selective Ins. Co. v. Lyons*, 681 A.2d 1021, 1024 (Del. 1996). The express purpose of section 2118B is to deter auto insurers from delay:

> The purpose of this section is to ensure reasonably prompt processing and payment of sums owed by insurers to their policyholders and other persons covered by their policies . . . and to prevent the financial hardship and damage to personal credit ratings that can result from the unjustifiable delays of such payments.

21 *Del. C.* § 2118B(a). In addition, both this Court and the Superior Court have expressly characterized section 2118B(c)'s interest provision as a ***penalty*** — that is, something specifically intended to punish and deter. Not incidentally, both cases involved State Farm.

In *State Farm Mut. Auto. Ins. Co. v. Davis*, 80 A.3d 628 (Del. 2013), this Court characterized section 2118B(c)'s interest provision thusly: "Davis also alleged claims of breach of contract, bad faith, and violations of 21 *Del. C.* § 2118B, which addresses penalty interest on claims that go unpaid for more than 30 days." *Davis*, 80 A.3d at 631. In *Spine Care Delaware, LLC v. State Farm Mut. Auto. Ins. Co.*, 2007 WL 495899 (Del. Super. Ct. Feb. 5, 2007), the Superior Court observed that

> [t]he purpose of PIP insurance is to protect policyholders from the financial difficulties that can result from unpaid or overdue bills. To achieve this purpose, the PIP statute imposes on insurance carriers specific obligations, as well as penalties for failing to comply with those obligations in a timely fashion.

Spine Care Delaware, Op. at *1 (citing section 2118B(a)).[3]

It should also be noted that under 18 *Del. C.* § 2303, "[n]o person shall engage in this State in any trade practice which is defined in this chapter as, or determined pursuant to this chapter to be, an unfair method of competition or an unfair or deceptive act or practice in the business of insurance." Subdivision 16 of section 2304 defines fourteen specific unfair claims handling practices, including "[f]ailing to affirm or deny coverage of claims within a reasonable time after proof of loss statements have been completed," and "[n]ot attempting in good faith to effectuate prompt, fair and equitable settlements of claims in which liability has become reasonably clear . . . ." 18 *Del. C.* § 2304(16)(e) and (f). State Farm's routine delay in processing PIP claims necessarily violates these provisions.

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[3] As noted in *Spine Care Delaware*, "the New York PIP statute imposes the same obligations on carriers" as does Delaware's PIP statute. *Spine Care Delaware*, Op. at *2. It is thus instructive that New York's courts have characterized an identical interest provision in New York's PIP statute as a penalty, meant to have deterrent effect. *Dermatossian v. New York City Transit Auth.*, 67 N.Y.2d 219, 224 (N.Y. 1997) ("A claimant to receive [no-fault] payment need only file a 'proof of claim' . . . and the insurers are obliged to honor it promptly or suffer the statutory penalties") (citation omitted); *East Acupuncture, P.C. v. Allstate Ins. Co.*, 873 N.Y.S.2d 335, 341-42 (N.Y. App. Div. 2009) ("The interest which accrues on overdue no-fault benefits at a rate of two percent a month . . . is a statutory penalty designed to encourage prompt adjustments of claims and inflict a punitive economic sanction on those insurers who do not comply") (citations omitted).

iv. The Proposed Amendment

Superior Court Civil Rule 23(b)(2) contemplates declaratory relief that "corresponds to" injunctive relief; or, as the Advisory Committee has described it, relief that "as a practical matter . . . affords injunctive relief or serves as a basis for later injunctive relief." Fed. R. Civ. P. 23(b)(2) advisory committee's note.

The plaintiffs' proposed amended complaint seeks declaratory relief only. As to State Farm's practice of violating the PIP statute's 30-day deadline thousands (or tens of thousands) of times each year, the amended pleading would seek a judicial declaration that "State Farm routinely and consciously incurs statutory interest penalties for overdue PIP benefits . . . treating its payment of such penalties as a mere cost of doing business," and "State Farm's practice of failing and refusing to comply with section 2118B's 30-day requirement is inconsistent with and in violation of Delaware law and public policy." A81. Such a judicial declaration would clearly have the practical effect of enjoining State Farm's misconduct, while also having the legal effect of supporting "later injunctive relief," should the latter prove necessary.

ARGUMENT

I. THE SUPERIOR COURT ERRONEOUSLY FAILED TO RECOGNIZE AND GIVE EFFECT TO THE PLAINTIFFS' STATUS AS OWNERS OF STATE FARM

A. Question Presented

Does the proposed amended pleading present an actual case or controversy, where Ms. Clark and Mr. Smith are proceeding in their capacity as owners of State Farm, and challenging the company's widespread institutional conduct (as opposed to its handling of an individual claim)? *See* A98-99 (asserting at oral argument below that "[t]he question before the Court is whether these two plaintiffs who are actual State Farm policyholders, and because State Farm is a mutual company happen to be owners of the company to boot, even have standing to mount a legal challenge to State Farm's practice of systematically violating the 30-day standard and failing to give to their policyholders what they paid for . . ."); A83-88 (arguing, in opening brief below, that the plaintiffs have standing to challenge State Farm's treatment of statutory interest penalties as a cost of doing business).

B. Scope of Review

This Court reviews *de novo* a trial court's grant of a motion to dismiss. *Sagarra Inversiones, S.L. v. Cementos Portland Valderrivas*, S.A., 34 A.3d 1074, 1078 (Del. 2011). In addition, under Superior Court Civil Rule 15(a), leave to amend a pleading "shall be freely given when justice so requires." Super. Ct. Civ. R.

15(a). The latter standard is a liberal one, and so "freely allows amendment in all but the most limited circumstances." *Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.*, 714 A.2d 96, 103 (Del. Ch. 1998) (citations omitted). Thus, "[i]n the absence of prejudice to another party, the trial court is required to exercise its discretion in favor of granting leave to amend." *Mullen v. Alarmguard of Delmarva, Inc.*, 625 A.2d 258, 263 (Del. 1993) (citing *Ikeda v. Mollock*, 603 A.2d 785, 787-88 (Del. 1991)).

C. Merits of Argument

It is black letter law that "'[t]he policyholders in a mutual [insurance company] are equivalent to stockholders in a stock corporation in so far as rights and remedies are concerned.'" *Heritage Healthcare Serv., Inc. v. The Beacon Mut. Ins. Co.*, No. 02-7016, 2004 WL 253547, slip op. at *4 (R.I. Super. Ct. Jan. 21, 2004) (quoting 3 Lee R. Russ, *Couch on Insurance* 3d § 39:15 (1995)). Surveying the existing case law, the court in *Heritage Healthcare* summarized the matter thus:

> The case law suggests that whether a mutual insurance company owes a fiduciary duty to its policyholders hinges on the claim involved. Specifically, the insurance company does not owe a fiduciary duty requiring it to act with the utmost good faith where the insured is disputing the treatment of the insured's claim to the company. However, when dealing with claims involving policyholders who are acting in their capacity as owners, courts generally treat policyholders as being entitled to the same fiduciary duty as owed to stockholders.

Heritage Healthcare, slip op. at *5.

It should be manifest that in their effort to reform State Farm's institutional conduct, Ms. Clark and Mr. Smith are acting as owners of the company. They do not challenge the company's handling of this individual claim or that, but rather its routine, systemic and continuing violation of section 2118B's 30-day standard.

As noted above, the very essence of PIP coverage is speed; and the express legislative purpose of section 2118B is to deter the precise conduct in which State Farm is now engaged. *See* 21 *Del. C.* § 2118B(a) (stating the statute's purpose "to prevent the financial hardship and damage to personal credit ratings that can result from the unjustifiable delays of [PIP] payments.") By selling insurance products in Delaware on a massive scale, and actively defeating the purpose of such products on a similarly massive scale, State Farm is arguably in violation of a variety of criminal laws, including 18 U.S.C. § 1341 (regarding mail fraud), 18 U.S.C. § 1342 (regarding wire fraud), and state and federal RICO statutes. *See generally* 11 *Del. C.* § 1501 *et seq.* (identifying predicate crimes for criminal liability under Delaware's RICO statute).

The company's management has thus invited criminal liability, placed the company's brand at risk, and generally betrayed the interests of its owners. To hold that in the face of such conduct, those owners have no legal recourse whatever would be a startling departure from settled principles of fiduciary duty. *Cf. Rieff v.*

Evans, 630 N.W.2d 278, 291 (Iowa 2001) ("Clearly, [Allied] Mutual's directors owe a fiduciary duty to its policyholders.")

II. BY ADOPTING A WIDESPREAD PRACTICE OF UNLAWFUL DELAY, STATE FARM HAS CAUSED A DIMINUTION IN VALUE OF THE PLAINTIFFS' AUTO POLICIES

A. Question Presented

Has State Farm's adoption of widespread unlawful practices operated to diminish the value of the insurance products it sold to Ms. Clark and Mr. Smith? *See* A83-88 (arguing the existence of standing by virtue of diminished value).

B. Scope of Review

This Court reviews *de novo* a trial court's grant of a motion to dismiss. *Sagarra Inversiones, S.L. v. Cementos Portland Valderrivas*, S.A., 34 A.3d 1074, 1078 (Del. 2011). In addition, under Superior Court Civil Rule 15(a), leave to amend a pleading "shall be freely given when justice so requires." Super. Ct. Civ. R. 15(a). The latter standard is a liberal one, and so "freely allows amendment in all but the most limited circumstances." *Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.,* 714 A.2d 96, 103 (Del. Ch. 1998) (citations omitted). Thus, "[i]n the absence of prejudice to another party, the trial court is required to exercise its discretion in favor of granting leave to amend." *Mullen v. Alarmguard of Delmarva, Inc.*, 625 A.2d 258, 263 (Del. 1993) (citing *Ikeda v. Mollock*, 603 A.2d 785, 787-88 (Del. 1991)).

C. Merits of Argument

A litigant seeking declaratory relief "need not have suffered actual harm . . . ." *Hoechst Celanese Corp. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA*, 623 A.2d 1133, 1137 (Del. Super. Ct. 1992) (citations omitted). Rather, it is enough that one party alleges an invasion, erosion or deprivation of legal rights, while the other party disputes the allegation:

> This case clearly fits both the letter and the spirit of the Declaratory Judgment Act. By their complaint and by the position they have taken in this lawsuit, the plaintiffs have created an "uncertainty" with respect to the defendants' "rights, status and other legal relations" as owners of [the disputed parcel of land]. A purpose of the Act is to afford relief from such uncertainty.

Heathergreen Commons Condo. Ass'n v. Paul, 503 A.2d 636, 642 (Del. Ch. 1985).

In *Heathergreen Commons* the owners of a parcel of land announced plans to build a motel and restaurant on the property. Alleging that the disputed parcel was subject to certain easements and deed restrictions, a neighboring group of condominium owners sued to enjoin the owners from developing the planned motel and restaurant. The defendant property owners counterclaimed for declaratory judgment, alleging that they had purchased the disputed parcel free and clear of the alleged easements and restrictions. *Heathergreen Commons*, 503 A.2d at 637-38. The condominium owners moved to dismiss the counterclaim, arguing that because the defendants had yet to obtain the zoning variance necessary for

construction of the motel and restaurant, the dispute was unripe. The Chancery Court denied the motion, finding that the central issue was "whether the defendants received the title they claim to have paid for when [they] purchased Parcel A . . . in 1984." *Id.* at 640.

To be sure, this lawsuit involves insurance products, and not the presence or absence of deed restrictions on real property. But the Chancery Court's analysis in *Heathergreen Commons* confirms a crucial point: when a party alleges that it purchased rights that an adverse party should recognize, but (by word or deed) is refusing to recognize, that party may properly resolve the uncertainty through declaratory judgment. By ignoring the basic distinction between contractual rights (on the one hand) and contractual performance (on the other), the Superior Court missed the mark. *And see Warth v. Seldin*, 422 U.S. 490, 500 (1975) ("The actual or threatened injury required by Art[icle] III may exist solely by virtue of statutes creating legal rights, the invasion of which creates standing") (internal quotation omitted).

To begin, State Farm cannot dispute that Ms. Clark and Mr. Smith paid substantial insurance premiums in return for valuable contract rights, including the rights to (i) timely coverage determinations on PIP claims, and (ii) prompt payment of covered claims. Nor can State Farm dispute that time is of the essence where PIP is concerned — a point that is underscored by the statutory 30-day standard, the

Superior Court's "preclusion" ruling in *Spine Care Delaware*, and the Delaware Supreme Court's discussion of "prompt payment" in *Lyons*. Similarly, State Farm cannot dispute that if the plaintiffs' allegations are taken as true — if State Farm has adopted a widespread practice of ignoring the statutory 30-day deadline — then the plaintiffs have been deprived of the benefit of their bargain, and the contract rights for which they paid have been diminished.

This constitutes a legally cognizable injury. For example, in *Boswell v. Liberty Nat'l Life Ins. Co.*, 643 So.2d 580 (Ala. 1994) the plaintiffs were insured under a cancer policy. While the policy was still in place, the insurance company's agents urged the plaintiffs to purchase a (supposedly) newer and better cancer policy, offering more complete coverage albeit at greater cost. The plaintiffs purchased the newer, more expensive policy, but eventually discovered that it actually offered less coverage than their original policy. The plaintiffs therefore sued the insurer for breach of contract and other claims.

On appeal to Alabama's highest court, the insurer argued that since the plaintiffs never had occasion to file a claim under either cancer policy, they suffered no actual injury. The Alabama Supreme Court disagreed:

> When a person, such as [the plaintiffs] in this case, buys cancer insurance, he hopes that she will never have to "use" it. That does not mean that she cannot be injured by the loss of, or a deduction in, those benefits that could be claimed, should that very event against which she sought to be insured ever occur and she was forced to

> "use" the policy. An insurer has already weighed the risk that that event will occur and has contractually expressed its willingness to take that risk for a price, *i.e.*, the premium. *** However, when an insurer disturbs this negotiated balance, through fraudulent misrepresentation or fraudulent suppression of material facts, the insured should be allowed to recover in order to counterbalance the damage or injury thereby done to her. ***Make no mistake, even if the insured files no claim, the loss of what the insured paid for constitutes legal damage or a legal injury.*** The insurer cannot be allowed to profit from its fraud simply because the insured is "lucky" enough never to have to "use" the coverage.

Boswell, 643 So.2d at 582 (emphasis added).

Similarly, in *Gooch v. Life Investors Ins. Co. of Amer.*, 264 F.R.D. 340 (M.D. Tenn. 2009) a health insurer unilaterally changed its method of calculating the level of payment for covered chemotherapy charges. The insured brought a proposed class action, including within the class not only those who had arguably lost money under the new payment regime, but all persons insured under the same type of policy. *Gooch*, 264 F.R.D. at 344-46. In granting both class certification and the plaintiff's summary judgment motion, the court identified the harm suffered by policyholders generally:

> The Defendants' interpretation [of its contractual duties] nullifies the purpose of the policy to provide supplemental coverage that is in addition to what the primary insurors (*sic*) agreed to pay. In the Defendants' scenario, Defendants accept premiums without any meaningful contractual obligations to pay benefits.

Gooch, 264 F.R.D. at 358-59.[4]

The Third Circuit employed a similar analysis in *Horvath v. Keystone Health Plan East, Inc.*, 333 F.3d 450 (3d Cir. 2003). In *Horvath* the plaintiff brought an ERISA class action against her HMO. She claimed that the HMO failed to disclose the details of cost-control incentives that it offered to participating care providers. On this basis she sought both injunctive relief and monetary relief (in the form of restitution and disgorgement of insurance premiums). *Horvath*, 333 F.3d at 452-53. Notably, however, Horvath "[did] not allege that she ha[d] been personally affected by the existence of incentives or that the care she received from the Keystone HMO was defective or substandard in any way." *Id.* at 453. Rather, she complained of the HMO's adoption of the incentive program generally.

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[4] Following the district court's class certification ruling in *Gooch*, a competing state-court class action was approved for settlement. Because the state-court settlement mooted the claims of many (but not all) of the absent class members in *Gooch*, the district court later decertified the *Gooch* class. On appeal, the Sixth Circuit "recognize[d] that Gooch may still be able to represent those class members who have certifiable claims and that most of [the insurer's] other objections to certification would not foreclose this possibility." *Gooch v. Life Investors Ins. Co. of Amer.*, 672 F.2d 402, 433 (6th Cir. 2012). The Sixth Circuit therefore remanded the case to district court for consideration of traditional Rule 23 factors, including "whether differences in state law preclude class certification . . . ." *Id.* at 433-34. The class representative's standing in *Gooch* was thus explicitly endorsed by the district court, and (at a minimum) implicitly acknowledged by the Sixth Circuit.

The Third Circuit found that Horvath had standing to pursue injunctive relief, but no standing to pursue monetary relief. The Court noted that with respect to injunctive relief, a plaintiff's standing may rest solely upon a defendant's invasion of legal rights (or, as in *Horvath*, statutory rights). *Horvath* at 456. Thus, the court concluded, "Horvath need not demonstrate actual harm in order to have standing to seek injunctive relief requiring that Keystone satisfy its statutorily-created disclosure or fiduciary responsibilities." *Id.* (citations omitted). *See also Warth*, 422 U.S. at 500 ("The actual or threatened injury required by Art[icle] III may exist solely by virtue of statutes creating legal rights, the invasion of which creates standing") (internal quotation omitted).

These cases show persuasively that an insurer's systematic dilution of contract rights may properly form the basis for declaratory relief (which, under the circumstances here, "corresponds to" injunctive relief for purposes of Rule 23(b)(2)). Indeed, one must ask what position State Farm would take if an insurance company reached an internal decision to withhold ***all rights*** under existing policies — essentially pretending that the policies had never been sold and did not exist. Apparently, State Farm's view would be that no policyholder would have standing to challenge such conduct absent a pending claim for insurance benefits. But this result is absurd on its face. *Cf. Hoechst*, 623 A.2d at 1136-37 (a dispute may merit declaratory relief where a "claim of right or other legal interest is

asserted against one who has an interest in contesting the claim . . . .")[5]

It is important, too, that the plaintiffs here seek relief under Superior Court Civil Rule 23(b)(2). As the Ninth Circuit has observed,

> Although common issues must predominate for class certification under Rule 23(b)(3), no such requirement exists under 23(b)(2). It is sufficient if class members complain of ***a pattern or practice*** that is generally applicable to the class as a whole. ***Even if some class members have not been injured by the challenged practice, a class may nevertheless be appropriate.***

Walters v. Reno, 145 F.3d 1032, 1047 (9th Cir. 1998) (citing, *inter alia*, 7A Charles Alan Wright, Arthur R. Miller & Mary Kay Kane, *Federal Practice & Procedure* § 1775 (2d ed. 1986) for the proposition that "All the class members need not be aggrieved by or desire to challenge the defendant's conduct in order for some of them to seek relief under Rule 23(b)(2)") (emphasis added).

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[5] As noted in *Hoechst*, a claim for declaratory relief must satisfy four requirements:

> (1) [I]t must be a controversy involving the rights or other legal relations of the party seeking declaratory relief; (2) it must be a controversy in which the claim of right or other legal interest is asserted against one who has an interest in contesting the claim; (3) the controversy must be between parties whose interests are real and adverse; and (4) the issue involved in the controversy must be ripe for judicial declaration.

Hoechst, 623 A.2d 1137-38 (citing, *inter alia*, *Marshall v. Hill*, 93 A.2d 524, 525 (Del. Super. Ct. 1992)). For the reasons shown above, all four requirements are met by the plaintiffs' proposed amended pleading.

In short, Ms. Clark and Mr. Smith are entitled to the benefit of their bargain — in this case, the full bundle of rights (including PIP-related coverage determinations within the statutory 30-day window, and prompt payment of covered claims) for which they paid. Having been deprived of that "full bundle," the plaintiffs have standing to seek declaratory relief.

III. THE DOCTRINE OF VOLUNTARY CESSATION SUPPORTS THE PLAINTIFFS' CLAIM TO STANDING

A. Question Presented

Does the fact that State Farm is treating interest penalties as a cost of doing business relieve it of the obligation to comply with the statutory 30-day standard, and deprive the plaintiffs of standing? *See* A88-90 (arguing the existence of standing by virtue of the doctrine of voluntary cessation).

B. Scope of Review

This Court reviews *de novo* a trial court's grant of a motion to dismiss. *Sagarra Inversiones, S.L. v. Cementos Portland Valderrivas*, S.A., 34 A.3d 1074, 1078 (Del. 2011). In addition, under Superior Court Civil Rule 15(a), leave to amend a pleading "shall be freely given when justice so requires." Super. Ct. Civ. R. 15(a). The latter standard is a liberal one, and so "freely allows amendment in all but the most limited circumstances." *Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.*, 714 A.2d 96, 103 (Del. Ch. 1998) (citations omitted). Thus, "[i]n the absence of prejudice to another party, the trial court is required to exercise its discretion in favor of granting leave to amend." *Mullen v. Alarmguard of Delmarva, Inc.*, 625 A.2d 258, 263 (Del. 1993) (citing *Ikeda v. Mollock*, 603 A.2d 785, 787-88 (Del. 1991)).

C. Merits of Argument

State Farm contends that once it pays statutory interest on a particular PIP-related expense, the insured is deprived of standing to challenge State Farm's conduct — even if that conduct is part of a larger and continuing pattern or practice. Meanwhile, as shown by State Farm's argument below, the company continues to defend the legality of its actions: section 2118B, it says, is not intended to deter late payment, and neither the General Assembly nor this Court would (or should) care if State Farm purposely delayed payment on ***every*** covered PIP claim, so long as it also paid interest on the claim.

This being State Farm's position, a useful comparison can be made to cases involving "voluntary cessation" — that is, cases in which the defendant argues that by voluntarily ceasing its misconduct, it has mooted the dispute. In such cases, courts hold that a defendant's voluntary cessation of wrongful conduct does not moot a case or controversy:

> It is well settled that "a defendant's voluntary cessation of a challenged practice does not deprive a . . . court of its power to determine the legality of the practice." "[I]f it did, the courts would be compelled to leave '[t]he defendant . . . free to return to his old ways.'"

Friends of the Earth, Inc. v. Laidlaw Envtl. Serv., 528 U.S. 167, 189 (2000) (quoting *City of Mesquite v. Alladin's Castle, Inc.*, 455 U.S. 283, 289, 289 n.10 (1982); other internal citations omitted). Accordingly, a defendant that voluntarily

ceases a challenged practice can establish mootness only by meeting a "stringent" test: "'A case might become moot if subsequent events made it absolutely clear that the allegedly wrongful behavior could not reasonably be expected to recur.'" *Friends of the Earth*, 528 U.S. at 189 (quoting *United States v. Concentrated Phosphate Export Assn.*, 393 U.S. 199, 203 (1968)). The U.S. Supreme Court elsewhere describes this showing as a "heavy burden." *Parents Involved in Community Schools v. Seattle School Dist. No. 1*, 551 U.S. 701, 719 (2007).

A recent decision of the First Circuit shows the relevance of the "voluntary cessation" doctrine to this lawsuit. In *Cooper v. Charter Comm. Entertainments, I, LLC*, 760 F.3d 103 (1st Cir. 2014) the plaintiffs sued a cable provider that initially failed to issue credits after a cable outage. The cable provider argued that by ultimately accepting the sought-after credits, the plaintiffs forfeited their standing to sue for declaratory judgment. The issue was whether the plaintiffs could seek declaratory relief regarding their rights in the event of a future outage. After the district court dismissed the case as moot, the First Circuit reversed.

In finding that the issue was "live and proper for judicial consideration," the First Circuit cited United States Supreme Court precedent for the proposition that "a defendant 'bears the formidable burden of showing that it is absolutely clear the allegedly wrongful behavior could not reasonably be expected to recur . . . .'" *Cooper*, 760 F.3d at 107-08 (quoting *Already, LLC v. Nike, Inc.*, 133 S.Ct. 721,

727 (2013)). The First Circuit likewise relied on U.S. Supreme Court precedent in finding that a claim was not moot where (as here) the defendant "'continues to defend the legality' of its action, making it 'not clear why the [defendant] would necessarily refrain from [the same conduct] in the future.'" *Cooper* at 108 (quoting *Knox v. Service Employees Int'l Union, Local 1000*, 132 S.Ct. 2277, 2287 (2012)).

As shown above, State Farm continues to defend its purported right to delay covered PIP claims, and to incur statutory interest penalties, more than 50 times on a single PIP file. Not only is it "not clear" why State Farm would refrain from similar conduct going forward — thereby diluting the statutory and contractual protections that should properly be afforded to all its Delaware policyholders — it is abundantly clear that State Farm intends to continue its misconduct. Under these circumstances, cases like *Nike*, *Knox* and *Cooper* clearly establish Ms. Clark's and Mr. Smith's standing to sue for declaratory judgment.

CONCLUSION

For the reasons set forth above, plaintiffs/appellants Rebecca Clark and James Smith respectfully request that this Court reverse the Superior Court's March 30, 2015 ruling on their motion for leave to amend the complaint.

Respectfully submitted,
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