

REGULATION AND THE ROLE OF THE COURTS: DRAWING A LINE IN A SANDSTORM

by

Peter A. Bisbecos

Lawmakers, regulators, and the courts must ensure that markets function freely, and that the laws governing those markets are reliable. They accomplish this in ways that reflect their role and authority in making and enforcing laws. As lawmaking is more art than science, refinements are frequently required after a law is enacted. Courts refine laws through the resolution of individual disputes. They also ensure that laws comply with constitutional requirements. Because the court system is driven by individual disputes with widely varying fact patterns, a precise line cannot be drawn between these two branches. However, general parameters were well articulated in a recent North Carolina Supreme Court decision:

The General Assembly is the “policy-making agency” because it is a far more appropriate forum than the courts for implementing policy-based changes to our laws. This Court has continually acknowledged that, unlike the judiciary, the General Assembly is well equipped to weigh “all the factors surrounding a particular problem,” ... “balanc[e] competing interests,” ... “provide an appropriate forum for a full and open debate,” ... and “address all of the issues at one time.” *Rhyne v. Kmart*, 358 N.C. 160, 594 S.E. 2d 1 (2004).

As judicial determinations are insulated from public input, courts may not engage in the kinds of public debate and interaction necessary in making public policy. See Peter A. Bisbecos, *Regulator or Juries: Who Can Best Protect Insurance Consumers?*, Wash. Lgl. Found. LEGAL BACKGROUNDER, Aug. 23, 2002.

While most courts take care to respect legislative public policy decisions, some have strayed from this principle. Unlike traditional lawmaking, decisions that fail to honor legislative public policy determinations are “imposed on people who were not parties to the litigation: without notice, public debate, or consideration of broader public policy implications. In some instances, state officials charged with enforcing the laws are not even parties to the lawsuit that over-rules their regulatory determination.” Peter A. Bisbecos and Victor E. Schwartz, *The Damaging Effect of Regulation of Insurance by the Courts*, Nat’l Assoc. of Mutual Ins. Co’s, 2003, available at www.namic.org/policy/papers.asp. When courts are not faithful to the public policy decisions made by the other branches of government, “their intervention creates a void, an absence of law, for which there is currently no solution.” *Id.*

A Case Study

One case that illustrates the problems created when courts make public policy determinations is *Avery v. State Farm Mut. Auto Ins. Co.*, No. 97-L-114, 1999 WL 1022134 (Ill. Cir. Ct. Oct. 8, 1999). In *Avery*, an Illinois

Peter A. Bisbecos, Esq. is Director, Legislative and Regulatory Affairs, of the National Association of Mutual Insurance Companies.

court certified a 49-state class action lawsuit founded on alleged violations of an Illinois consumer fraud law. Ultimately, State Farm was found to be liable for its use of non-original equipment manufacturer (non-OEM) parts. See Victor E. Schwartz & Leah Lorber, *State Farm v. Avery: State Court Regulation Through Litigation Has Gone Too Far*, 33 CONN. L. REV. 1215 (2001).

Avery remade public policy without the benefits of public involvement, and in so doing, created a series of problems for law-abiding insurers:

It applied Illinois law to 49 other states, effectively reversing their public policy determinations. The use of non-OEM parts is an issue with a long history, evidenced by the fact that most states had laws governing their use. Not surprisingly, the states' public policy determinations vary widely. Some require notice to consumers before non-OEM parts are used; some require prior consent; some have provisions regarding the use of these parts in their unfair claims practices law; and, importantly, some don't. Generic Auto Crash Parts, May 2003, The Insurance Information Institute, ("III Report") available at www.iii.org/hottopics/insurance/genericauto. (This report contains an excellent chart reflecting the general characteristics of laws governing the use of non-OEM parts in each state.). Yet, the *Avery* court certified a national class action lawsuit that applied the Illinois law to the other states represented in the class.

Auto insurers are now uncertain about the legality of their activities in those states. Post-*Avery*, many auto insurers determined that it was wiser to discontinue the use of non-OEM parts. *Id.* Consider that in 2000, a lawsuit was filed in California asking the California courts to rule that *Avery* didn't apply in their state. Kathy McKinney, *State Farm Verdict Draws Lawsuit; Parts Dealer Cites Loss of Business*, THE PANTAGRAPH BLOOMINGTON IL., Aug. 12, 2000. In particular, it was argued that this decision should not apply because California allows the use of these parts. Joseph Treaster, *Makers of Generic Car Parts Wage War on Insurance Ruling*, THE CLEVELAND PLAIN DEALER, Aug. 2, 2000. In February 2003, courts in three separate states denied class certification on similar lawsuits, "giving insurers hope that they might finally be getting control over the long-running parts nightmare." III Report, *supra*. While this is encouraging, it reflects the fact that insurers have to fight this battle on a state-by-state basis, despite the fact that the states have established laws addressing the use of these parts.

Avery effectively nullified the oversight authority of insurance regulators in the other states. As of May 2003, Lee Covington, who was Ohio's insurance regulator, had filed *amicus* briefs in lawsuits in ten other states "citing the need to preserve Ohio's regulatory authority and not to impose another state's insurance laws ... on Ohio insurance consumers." III Report, *supra*.

Avery negatively impacted insurance markets causing increases in the cost of auto repair. "A number of consumer advocates, including Ralph Nader, have sided with State Farm, saying that without generic parts, the auto manufacturers would have a monopoly on replacement parts. ... The price difference is substantial. Ford charges \$192 for a fender for a 1995 Explorer; the generic fender costs \$79. ... insurers say that to assemble a 1997 Ford Taurus from factory spare parts would cost \$72,000. The cost of the car new was \$19,000." Treaster, *supra*.

Unlike legislatures, courts cannot correct errors in when new information comes to light. A February 19, 2000 report issued by the Insurance Institute for Highway Safety concluded that "[t]here essentially was no difference in crashworthiness performance." See *Cosmetic Repair Parts Irrelevant to Safety*, Status Report, Vol. 35 No 2., Feb. 19, 2000, available at www.iihs.org. Had the Illinois Legislature banned non-OEM parts, this evidence could subsequently have been presented to them with a request for corrective action. But, because the decision was made by a court, there is no remedy other than filing a new lawsuit.

Motivated by the belief that law-abiding insurers should be able to rely on each state's laws, the National Association of Mutual Insurance Companies (NAMIC) endorsed the "Fair Notice and Market Stability Model Act." This model was also recently adopted by the American Legislative Exchange Council and is being promoted to state legislatures. It provides answers to the problems created by decisions like *Avery*.

The Fair Notice and Market Stability Model Act

Legislative Findings

(1) The law must be predictable so that people may order their behavior. This fundamental concept is a cornerstone of any democratic society. (2) When people cannot rely on the written law, they cannot plan and conduct their daily activities with the assurance that their legal conduct will not subsequently be the source of punishment. This state of disorder destroys an individual's ability to enter into contracts and a market's ability to structure and regulate business conduct in an orderly, reliable, and fair manner. (3) To prevent this from happening, the legislative, executive, and judicial branches of government have well-defined roles that are critically important to ensuring that the law remains predictable and reliable. (4) When courts step outside their assigned role, and laws are changed without notice, without consideration of the consequences of the change, and without the opportunity for the appropriate parties to defend their positions or the law, the law becomes unreliable and unpredictable. (5) Courts must be required to operate within their traditional role as an arbiter of disputes. This will not limit an aggrieved party's access to the courts, or their ability to obtain judgments that redress their grievances or compensate them for their injuries.

Definitions

1. *Aggrieved party*: Any person or business that has a contractual relationship with a regulated party, and believes that the regulated party has violated a statute, regulation, order or finding detrimental to the aggrieved party.
2. *Appropriate government authority*: The official or agency of government having the responsibility of interpreting or enforcing laws, or regulating parties under state law. For purposes of representing the state in litigation, but not in promulgating regulations, it may also include the State Attorney General or Chief Legal Officer.
3. *Judgment*: A final order by a court of competent jurisdiction. (If the state has a definition of judgment, consider citing it.)
4. *Litigation*: For purposes of this Act, litigation means a lawsuit brought in a court of competent jurisdiction, in which individual disputes are resolved, or the legality, constitutionality, or application of a statute, regulation, order or finding is in question.
5. *Regulated Party*: Any person, corporation, or other business entity licensed and regulated by an appropriate government authority of this state.

Permissible Scope of a Judgment

1. A judgment against a regulated party may only extend to the regulated party's conduct as defined in the litigation.
2. Judgments may not affect a statute, regulation, finding, or order, unless the validity of that statute, regulation, finding or order was raised as part of the litigation.
3. The appropriate government entity may, at its discretion, intervene as a party in litigation to defend a statute, regulation, finding or order.
4. The judgment of a court in another state may only extend to a regulated party in this state if the party attempting to apply the judgment shows that:
 - a. Application of the foreign judgment would not be inconsistent with, or nullify, a statute, regulation, finding or order in this state that governs the conduct being challenged, and;
 - b. The facts of the foreign judgment do not differ materially from the facts being alleged in the cause in question, and;
 - c. Compliance with the foreign judgment will not require a regulated party to violate a domestic statute, regulation, finding or order.

(Note: this is intended to prevent a party from challenging one state's valid legislative or regulatory determinations without joining the state. This provision is not intended to prevent a foreign party from directly challenging a state's law, nor would it nullify any state laws allowing for the enforcement of foreign judgments.)

 - d. The court may not consider conduct of a regulated party outside of this state except as it may be relevant in proving the regulated party's intent in the conduct alleged in litigation.

(Note: This may not be appropriate in states where the rules of evidence are established by the courts.)

Remedies

1. If the validity of a statute, regulation, order or finding is an issue in the litigation, a court may consider and rule on whether the statute, regulation, finding, or order is unconstitutional or invalid.
2. An aggrieved party, who is not engaged in litigation of a grievance, may pursue a remedy of the grievance through an administrative procedure with the appropriate government authority. The appropriate government authority's ruling shall be final, but may be appealed to a court of competent jurisdiction. If, before a final ruling, any party to an administrative action under this section enters into litigation on the matter being heard by the appropriate government entity, the administrative proceeding shall terminate immediately. *(Note: in some states, the legislature may also have to enact enabling legislation before an appropriate government authority may create and employ this administrative process.)*
3. If, after an administrative hearing, the appropriate government authority finds in favor of the aggrieved party, the appropriate government entity may:
 - a. Order the regulated party to amend its conduct so that it complies with the statute, regulation, order or finding;
 - b. Order the regulated party to pay actual damages;
 - c. Order attorneys' fees for the prevailing party.

Regulatory Authority and Duties

If a court of final jurisdiction has ruled that a statute, regulation, order or finding is invalid or unconstitutional, the appropriate government authority shall take the following actions:

1. For regulations, orders, or findings, the appropriate government authority shall immediately amend the regulation, finding, or order to comply with the judgment.
2. For statutes, if the legislature is out of session or concludes without addressing the court's ruling, the appropriate government authority shall immediately promulgate an emergency regulation which identifies problems created by the court's ruling, and provides regulated parties with a prescribed method of conduct until the issues set out in the emergency regulation are resolved by the legislature. The emergency regulation shall remain in effect until the legislature addresses and resolves the issues set out in the emergency regulation.
(Note: a regulator could not issue emergency guidelines if the statute in question was nullified on constitutional grounds. Further, if the judgment finds that the statute, finding, regulation or order, is unconstitutional in a particular application, amended or emergency regulations will not be necessary, in that the state law remains valid.)

Defenses

If a court properly determines that a statute, regulation, finding, or order is illegal:

1. It shall be a defense that a regulated party relied on the law, regulation, finding or order.
2. It shall be an absolute defense for conduct occurring between the time that a statute, regulation, finding, or order is found invalid, and the promulgation of a corrective or emergency regulation, or the enactment of a corrective statute, that the regulated party altered its conduct to comply with the court's ruling.
3. It shall be a defense that a regulated party relied upon and complied with an emergency regulation.

Conclusion

This Act will achieve and sustain a healthy judiciary while ensuring market stability by: requiring that public policy decisions be made in open public proceedings with considerations of a broad range of concerns and interests; limiting the impact of individual disputes to those named individuals; providing a mechanism for defining appropriate conduct when a court overturns a statute or regulation; clarifying that a state court judgment has no force or effect in other states; and providing a defense from damages for legal conduct.