

THE STATE OF TEXAS,
Plaintiff,

IN THE DISTRICT COURT OF

v.

TRAVIS COUNTY, TEXAS

HOME STATE COUNTY MUTUAL
INSURANCE COMPANY,
Defendant

201st JUDICIAL DISTRICT

ASSURANCE OF VOLUNTARY COMPLIANCE

This Assurance of Voluntary Compliance ("AVC") is made and entered into this _____ day of March, 2004, by and between the State of Texas, acting through its Attorney General Greg Abbott, and HOME STATE COUNTY MUTUAL INSURANCE COMPANY (also referred to as "Defendant" or "Home State").

I. RECITALS

1.1 Home State is chartered as a county mutual insurance company pursuant to TEX. INS. CODE ANN. Art. 17, and it writes auto insurance in the State of Texas.

1.2 This action was commenced by the State of Texas on February 14, 2000, with Plaintiff's Original Petition complaining of Home State, and alleging violations of the Texas Deceptive Trade Practices - Consumer Protection Act, TEX. BUS. COM. CODE ' ' 17.41, *et seq.*, and violation of TEX. INS. CODE Art. 21.21, and TEX. ADMIN. CODE ANN. ' 21.1, *et seq.* The State of Texas complained in its Petition of the practice of deducting an amount for depreciation or

betterment on certain first party claims under the Texas Private Passenger Automobile Policy of Insurance, alleging that such practice was not allowed under the policy language in the Limit of Liability Provision, Part D - Coverage for Damage to Your Auto. In its petition, the State of Texas sought injunctive relief, restitution to insureds, civil penalties and attorney's fees and costs.

1.3 From January 1, 1996, to the present, Home State accepted and processed Texas personal auto insurance policies and adjusted claims through its “Direct” program. In addition, pursuant to TEX. INS. CODE ANN. 21.07-3, Home State entered into agreements with Texas-licensed Managing General Agents (“MGA=s”) whereby Home State authorized the MGA=s to conduct field operations on its behalf, including accepting and processing insurance policies produced by other agents and adjusting claims. From January 1, 1996, to the present, Home State had contracts with a total of 31 MGA=s which conducted field operations on Home State=s behalf with respect to the sale of Texas personal auto policies and the adjustment of claims. Attached hereto as **Exhibit A** is a list of the MGA programs with which Home State contracted.

1.4 In response to the Attorney General=s investigation and lawsuit, Home State investigated the practices of its “Direct” program with regard to deducting an amount for depreciation or betterment on first party auto repair claims since 1996 and conducted audits of its books and records. It also requested that the MGA=s with which it had contracts determine their practices with regard to deducting an amount for depreciation or betterment on first party auto repair claims since 1996 and conduct audits of their books and records. Home State determined that its “Direct” program never deducted for depreciation or betterment on first party auto repair claims and

has provided an affidavit so stating this. Sworn affidavits have been provided for Home State's MGA's as follows:

(a) Fourteen MGA's did not deduct for depreciation or betterment on first party auto repair claims.

(b) Fifteen MGA's conducted audits and determined that depreciation or betterment had been deducted on first party auto repair claims. Three of these MGA's conducted a complete audit and twelve conducted partial audits and projected what the additional depreciation or betterment would have been.

(c) One MGA (Esurance Insurance Services) had a policy not to deduct depreciation or betterment on first party auto repair claims. However, during a complete audit of its claims, it discovered that depreciation or betterment had been deducted in three instances. It immediately reimbursed the depreciation and betterment amount to its insureds.

(d) One MGA (Midland Risk Insurance Co.) had previously provided information stating that it did deduct for depreciation or betterment on first party auto repair claims. However, since the company is no longer in business and no personnel could be located to sign the sworn affidavit, the affidavit was signed by Christopher A. McClellan, General Counsel for Home State, using the information previously provided.

(e) No records could be located for the Eagle Insurance Company/Freedom General Agency program.

The three MGA's that conducted a complete audit of their books and records stated that a total of \$44,258.33 was deducted for depreciation or betterment on first party auto repair claims

since 1996. In addition to this amount, although Reliant General Agency conducted a complete audit of its records, a number of records were missing. Reliant General Agency estimated that a total of \$1,403.38 depreciation or betterment would have been found in these missing files.

The eleven MGA's that conducted a sample audit of their books and records estimated that a total of \$350,091.17 was deducted for depreciation or betterment on first party auto repair claims since 1996.

As stated previously, it was Esurance Insurance Services' policy not to deduct depreciation or betterment on its claims. However, during a complete audit of its books and records, it learned that a total of \$1,627.03 for depreciation or betterment had been deducted on three of its claims. This amount was immediately reimbursed to its insureds.

1.5 In providing the information and data on which this AVC is based, Home State relies on its own records and the sworn affidavits of the MGA's with which it has contracts. In Christopher A. McClellan's affidavit attached as **Exhibit B**, Home State attests that the spread sheet attached to **Exhibit B** is an accurate summation of the information and data gathered from its own records and provided to it by the MGA's.

1.6 The practice of deducting for betterment or depreciation on first party claims has been a common practice of automobile insurers in Texas for many years and at least since adoption of the current Texas Personal Auto Policy in 1981.

1.7 The Texas Department of Insurance ("TDI") is the state agency authorized by the Texas legislature to regulate the business of insurance in Texas. TDI promulgated the standard and uniform Texas Personal Auto Policy in 1981. Although aware of insurers' practice of deducting

betterment or depreciation for first party collision or comprehensive claims under the Texas Personal Auto Policy, TDI did not formally object to the practice until February 24, 2000, through Commissioner's Bulletin No. B-0014-00.

1.8 Home State alleges that it and the MGA's with which it had contracts ceased the practice of deducting for betterment or depreciation on first party auto repair claims by no later than May 1, 2000.

1.9 Home State **and its agents** deny any and all liability for the claims asserted and contends that they properly and timely paid all amounts due insureds under the policy terms. Home State and its agents deny any violation of the Texas Deceptive Trade Practices - Consumer Protection Act, TEX. BUS. COM. CODE ' ' 17.41 *et seq.*, deny any violation of TEX. INS. CODE Art. 21.21, and deny any violation of 28 TEX. ADMIN. CODE ' 21.3 (b) or 21.1 *et seq.*

1.10 The Parties are desirous of entering into, and obtaining approval of this AVC, pursuant to TEX. BUS. COM. CODE ' 17.58 in order to fully and finally resolve the State's claims and disputes related to the practice of deducting an amount for depreciation or betterment on first party repair claims under the collision and comprehensive coverages of the Texas Personal Auto Policy.

1.11 Home State and its agents intend that the payment provisions of this AVC offer full and complete restitution for Home State's and its agents' alleged violations of the DTPA and Texas Insurance Code.

II. AGREEMENT

2.1 In consideration of the mutual promises and covenants herein contained, the State of Texas and Home State and its agents agree as follows:

2.2 Home State and its agents will pay each and every insured, whether a current policyholder or not, according to the procedures set forth in this AVC, the total amount deducted as depreciation or betterment (“the deduction amount”), if any, from each first party comprehensive or collision coverage claim (where the covered auto was not adjusted as a total loss) made by the insured against a Texas personal auto policy issued by Home State where the claim was paid, in whole or in part, on or after January 1, 1996. Home State and its agents shall also pay to the insured 10% per annum simple interest on the deduction amount with such interest to be calculated from the date the claim was originally paid.

2.3 Based on information and data provided by the MGA=s from their audits, Home State has identified 651 insureds who may be entitled to payment under paragraph 2.2. Home State and its agents will mail to each of these presently identified insureds (unless the insured has already recovered or been paid the full deduction amount), and to any insureds who subsequently request and are identified as being entitled to payment under paragraph 2.2 of the AVC, a check or draft in the amount of the deduction amount, plus 10% per annum interest on such amount, calculated from the date the claim was originally paid. Home State and its agents will make their best efforts to mail payment to presently identified insureds entitled to payment under paragraph 2.2 within sixty (60) days of the effective date of this AVC. Home State and its agents presently estimate the total amount of such payment to the presently identified insureds to be approximately \$183,909.05, including interest.

2.4 Other than presently identified insureds, Home State and its agents have been unable to identify, through searches of their electronic records, those first party auto repair claims in which

betterment or depreciation was deducted. Home State and its agents have estimated, by extrapolating figures from the MGA audits for each calendar year since 1996, that approximately 1,688 presently unidentified insureds may be also be entitled to payment under paragraph 2.2 above. Home State and its agents will set aside and hold, for a period of two years after the effective date of this AVC, the amount of \$498,339.42 (Athe set-aside@) for payment of claims to the presently unidentified policyholders who qualify under paragraph 2.2 of this AVC and whose first party comprehensive or collision coverage claim was paid, in whole or in part, before May 1, 2000, but after December 31, 1995. Home State acknowledges that it will have to establish a claims process under this AVC. Two years after the effective date of this AVC, the claims process will terminate and any and all unpaid amounts from the set-aside shall be paid within 60 days to the Office of the Attorney General for deposit to the State of Texas=general revenue fund. The payments to insureds under this paragraph shall be made as follows:

(a) Within forty-five (45) days after the effective date of this AVC, Home State and its agents will mail the Home State Notice and Claim Form in the form attached hereto as **Exhibits C and D** to its Texas policyholders who were paid on a comprehensive or collision claim (excluding those claims adjusted as a total loss) before May 1, 2000, but after December 31, 1995, and whose names and addresses are known to Home State from either its own records or whose names and addresses were made known to Home State by the MGA-s. In addition, no later than forty-five (45) days after the effective date of this AVC, Home State and its agents shall also send, via electronic mail, **Exhibits C and D** (the Home State Notice and Claim Form) to any Home State policyholder who was paid on a comprehensive or collision claim (excluding those claims adjusted as a total loss)

before May 1, 2000, but after December 31, 1995, whose e-mail address is available to Home State from either its own records or were made known to Home State by its MGA-s.

(b) No later than forty-five (45) days after the effective date of this AVC, Home State shall publish notice of this AVC, and the claims process described herein, in newspapers of general and daily circulation in Texas cities having a population of 500,000 or more, as determined by the most recent U.S. census. The newspaper notice shall be in the form and have the content of **Exhibit E**, and shall be published in the newspapers=section for legal notices for a period of seven (7) seven consecutive days. In addition, no later than forty-five (45) days after the effective date of this AVC, Home State shall publish notice of this AVC and the claims process described herein for a continuous period of two (2) years on any website it maintains. The website notice shall also be in the form and have the content of **Exhibit E**, and shall be clearly and conspicuously displayed. Home State shall maintain a log with the name and addresses of persons who have contacted it in response to the published notice. Home State represents that publication in newspapers of general and daily circulation in Texas cities having a population of 500,000 or more, as determined by the most recent U.S. census, will result in publication in cities and those counties immediately adjacent to those cities in which approximately ninety percent (90%) of Home States' insureds reside. If publication in such cities results in less than ninety percent (90%) coverage, then Home State will publish the notice in the next largest cities as necessary to achieve at least ninety percent (90%) coverage. Home State will provide to the Attorney General an affidavit regarding publication to support its representation of ninety percent (90%) coverage.

(c) After Home State and its agents mail a claim form, the policyholder must return by mail the claim form (**Exhibit D**) to Home State within 90 days of the date of the mailing to initiate the claims review process.

(d) Following the receipt of a timely-returned claim form, Home State and its agents will review the original claim file, and if there is an indication anywhere in the claim file that betterment or depreciation was deducted, the policyholder is entitled to the deduction amount plus interest pursuant to this AVC unless (i) there is clear and unequivocal documentation in the claim file that betterment or depreciation was ultimately not deducted on the claim or (ii) Home State-s and its agents' records clearly and unequivocally reflect that the betterment or depreciation amount has already been refunded.

(e) After the claims review process, if Home State and its agents determine from the criteria set forth in this AVC that the policyholder is entitled to payment under paragraph 2.2 of this AVC, then within (60) days of the date the claim form is received, Home State and its agents shall mail directly to each such policyholder a check or draft for the deduction amount plus interest as provided in this AVC.

2.5 Each check or draft may also include on the back of the check or draft a release as follows: "I release Home State County Mutual Insurance Company and its agents from any and all liability related to or arising out of any betterment or depreciation deducted on this claim."

2.6 Each check or draft issued to a policyholder pursuant to the terms of this AVC shall be accompanied by a letter in the form attached hereto as **Exhibit F**. If a policyholder is not entitled

to payment pursuant to the terms of this AVC, Home State and its agents shall notify the policyholder by a letter in the form attached hereto as **Exhibit G**.

2.7 Each check or draft will be mailed by first class mail, with address correction requested, to the most current address available to Home State and its agents. All such payments returned to Home State and its agents with a corrected address will be forwarded to such corrected address. Any checks or drafts returned to Home State and its agents that are undeliverable shall be subject to TEX. PROP. CODE ANN. ' 72.001, *et seq.* Home State and its agents shall pay all costs in connection with making payments under this AVC.

2.8 Thirty-two (32) months after the Effective Date, Home State and its agents shall file with the Attorney General a verified report under oath, which shall state:

(a) the total dollar amount of payments, including interest, mailed to policyholders pursuant to this AVC;

(b) the total number of policyholders to whom checks or drafts were mailed;

(c) the total number and dollar amount of negotiated checks or drafts;

(d) the total number and dollar amount of returned checks or drafts;

(e) a list of policyholders to whom notice was sent;

(f) the total number policyholders who, pursuant to paragraphs 2.3 or 2.4 hereof, were determined to be entitled to payment under paragraph 2.2 of this AVC; and

(g) the total number policyholders who, under paragraph 2.3 or 2.4 hereof, request payment of the deduction amount but who are determined by Home State not to be entitled to payment under paragraph 2.2 of this AVC.

2.9 On or before the effective date of this AVC, and continuing thereafter, until and unless the Limit of Liability section of Part D coverage under the standard Texas personal auto policy is amended to specifically permit deduction for depreciation or betterment on collision or comprehensive claims where the covered auto is not adjusted as a total loss, Home State and its agents shall cease and desist from: (a) deducting amounts for betterment or depreciation on first party collision or comprehensive coverage auto insurance claims covered under a Texas personal auto policy where the covered auto has not been adjusted as a total loss; and (b) representing to any person making a first party collision or comprehensive coverage auto insurance claim covered under a Texas personal auto policy, where the covered auto has not been adjusted as a total loss, that deduction for betterment or depreciation on such claim is legal, required, or otherwise permitted.

2.10 Within 10 days of the effective date of this AVC, Home State and its agents shall pay \$67,370.87 to the Office of the Attorney General as its attorneys' fees, expenses, and costs of investigation. Failure to pay within the designated time period shall be a material breach of this agreement.

2.11 Home State further agrees that it:

(a) will not cancel or refuse to renew the insurance coverage of any Home State insured because that insured has filed a claim form or received a payment under this AVC; provided, however, that such agreement shall not prevent Home State from canceling or non-renewing any insurance policy, or coverage under any insurance policy (including a policy held by an insured who receives a payment hereunder), for any other legitimate reason; and

(b) will not consider payments made to policyholders or to the Attorney General pursuant to this AVC in projecting future rate needs, for purposes of setting the rates Home State charges for motor vehicle insurance policies issued by Home State in Texas; provided, however, that this agreement is not intended to supersede any requirement imposed by law, or by regulation, order, or directive of the Texas Department of Insurance, on the reporting of data or the setting of rates for Texas motor vehicle insurance.

III. COURT APPROVAL

3.1 The parties agree that they will submit this AVC to a court of competent jurisdiction in Travis County and request that the court approve and enter this AVC pursuant to the terms set forth in this AVC and TEX. BUS. & COM. CODE ' 17.58.

3.2 This agreement shall be deemed to be finally approved and effective only after the Court has entered an order approving this AVC. If the court does not approve the terms of this AVC, this AVC shall become null and void.

3.3 The parties hereto agree that this is a compromise of a disputed claim, and that this AVC is entered into without admitting any liability, which liability is expressly denied, and without agreement by any party to any of the allegations made by another party. Nothing contained herein shall be deemed an admission of liability or wrongdoing of any kind.

3.4 The parties hereto agree to release and discharge each other and their agents and representatives (including reinsurers) from any and all claims for damages or other relief, other than as provided herein, arising out of Home State-s and its agents' practice of deducting for betterment or depreciation on first party collision or comprehensive coverage auto damage insurance claims

(where the covered auto has not been adjusted as a total loss) that may exist as of the effective date of this AVC, whether or not asserted by the parties, in their pleadings in this case or otherwise.

3.5 The parties represent and warrant, each to the other, that each has the authority to enter into and make this AVC, and to bind themselves to this AVC. Home State and the Attorney General agree that nothing in this AVC shall create any private rights, causes of action or remedies of any other party against Home State and/or its agents.

3.6 This AVC shall be governed by TEX. BUS. & COM. CODE ' 17.58.

3.7 Any and all taxable costs of court are taxed against Home State.

IV. MISCELLANEOUS PROVISIONS

4.1 No modification of this AVC may be made, except by written agreement of both the Plaintiff and Home State.

4.2 This AVC may be executed in any number of counterparts and each of which when so executed shall be deemed an original and all of which taken together shall constitute one and the same AVC.

EXECUTED AND EFFECTIVE this _____ day of _____, 2004.

GREG ABBOTT
Attorney General of Texas

BARRY R. McBEE
First Assistant Attorney General

EDWARD D. BURBACH
Deputy Attorney General for Litigation

PAUL CARMONA

Chief, Consumer Protection Division

By: _____
RAY OLAH
State Bar No. 00794391
Assistant Attorney General
Consumer Protection Division
Insurance Practices Section
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ATTORNEYS FOR THE STATE OF TEXAS

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Austin, Texas 78768-2212
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Facsimile: (512) 322-0301

By: _____
Larry Parks, TBA No. 15524800
For the Firm

ATTORNEYS FOR DEFENDANTS

EXHIBIT A

HOME STATE COUNTY MUTUAL INSURANCE COMPANY -- LIST OF MGA'S

AGM Insurance Services, Inc.
Aerostar Insurance Agency, Inc.
Amco Insurance Agencies, Inc.
AmTrust General Agency
American Recreational Markets
Arrowhead General Agency
Absolute Bargain Insurance
Beacon Insurance Group
Benchmark General Agency
Bankers Ins. Group, Inc.
Centurion (formerly Paramount)
Concord Ins. Services, Inc. (now Mercury)
Esurance Ins. Services, Inc.
Eagle Insurance Co./Freedom General Agency
Fred Loya Insurance
Germania General Agency
Insurance Depot
Integon (also National General)
AAbana Insurance Services, Inc. (a Louis A. Williams & Associates' company)
Physical Damage Specialists, Inc.
Midland Risk Insurance Co.
Paragon Ins. Managers
Reliant General Agency/Coast National Ins. Co.
Rodney D. Young
Safeco Insurance Co. of America
Southern Ins. Underwriters
Spartan Insurance Agencies
Statewide General Agency
Texas Colonial General Agency
Texas State Low Cost, Inc.
Titan Insurance Services, Inc.

EXHIBIT C

Date: _____, 2004

Home State County Mutual Insurance Company (AHome State®) and the Texas Attorney General, Greg Abbott, have recently come to an agreement regarding deductions for depreciation or betterment on certain collision or comprehensive coverage auto insurance claims. Despite the fact that this was a common practice among insurance companies, Home State has elected to avoid the additional time and expense of litigation with the Attorney General by settling the issue and avoiding the potential of increased costs which could result in raising automobile insurance rates.

Home State has agreed to return to eligible Home State policyholders the amount deducted for depreciation or betterment on their claims. Home State has also agreed to pay to the insured 10% per annum simple interest on the deduction amount with such interest to be calculated from the date the claim was originally paid. You may be an eligible policyholder if:

- (1) You presented a collision or comprehensive claim for damages to an auto covered under your Home State policy (other than a total loss), AND
- (2) Your claim was paid between January 1, 1996, and May 1, 2000, AND
- (3) A betterment or depreciation amount was noted on your estimate, or you believe it was deducted, and a deduction for betterment or depreciation can be verified by your own records or a presently existing claim file.

Enclosed with this notice is a claim form for you to complete in order to determine whether you are eligible for a return of the amount deducted for depreciation or betterment in accordance with the above eligibility requirements. If you believe you meet the above criteria, please complete the attached form and return it by first class mail to the following:

Home State Claims Administrator
(address)

YOU MUST COMPLETE AND MAIL THE ATTACHED CLAIM FORM WITHIN 90 DAYS OF THE DATE OF THIS LETTER.

If you have any questions concerning this form, please contact _____
at 1-800_____.

EXHIBIT D

POLICYHOLDER SETTLEMENT CLAIM FORM

RETURN THIS FORM BY MAIL ONLY IF A BETTERMENT OR DEPRECIATION AMOUNT WAS NOTED ON YOUR VEHICLE ESTIMATE, OR IF YOU BELIEVE BETTERMENT OR DEPRECIATION WAS DEDUCTED AND A DEDUCTION CAN BE VERIFIED BY YOUR OWN RECORDS OR A PRESENTLY EXISTING CLAIM FILE.

Named Insured: _____

Current Address: _____

Current Home Phone: _____

Home State Auto Policy Number (at time of loss): _____

Claim Number (if available; please refer to any correspondence received with your claim): _____

Date of Loss (if known): _____

Signature

Date

YOU MUST COMPLETE AND MAIL THIS CLAIM FORM WITHIN 90 DAYS OF THE DATE IT WAS MAILED TO YOU.

EXHIBIT E

**NOTICE OF SETTLEMENT AND CLAIMS PROCEDURE FOR
HOME STATE COUNTY MUTUAL INS. CO. POLICYHOLDERS**

Home State County Mutual Insurance Company (“Home State”) and the Texas Attorney General, Greg Abbott, have recently come to an agreement regarding deductions for depreciation or betterment on certain collision or comprehensive coverage auto insurance claims. Home State has agreed to return to eligible Home State policyholders the amount deducted for depreciation or betterment on their claims. Home State has also agreed to pay to the insured 10% per annum simple interest on the deduction amount with such interest to be calculated from the date the claim was originally paid. You may be an eligible policyholder if:

- (1) You presented a collision or comprehensive claim for damages to an auto covered under your Home State policy (other than a total loss), AND
- (2) Your claim was paid between January 1, 1996, and May 1, 2000, AND
- (3) A betterment or depreciation amount was noted on your estimate, or you believe it was deducted, and a deduction for betterment or depreciation can be verified by your own records or a presently existing claim file.

IF YOU BELIEVE THAT YOU MEET THE ABOVE CRITERIA, YOU MAY REQUEST A CLAIM FORM BY CALLING 1-800-____-____ OR BY CONTACTING HOME STATE VIA E-MAIL AT _____.COM. You must complete and return the claim form to the address below and the Home State Claims Administrator will determine whether you are eligible for a return of the amount deducted for depreciation or betterment, in accordance with the above eligibility requirements.

Home State Claims Administrator
(address)

YOU MUST COMPLETE AND MAIL THE CLAIM FORM WITHIN 90 DAYS OF THE DATE YOU RECEIVE IT.

If you have any questions concerning the settlement between the Attorney General and Home State or this claim procedure, please contact _____ at 1-800-____-_____.

EXHIBIT F

Date: _____

Policyholder Name and Address: _____

Policy No. _____

Claim No. _____

Home State County Mutual Insurance Company (“Home State”) acknowledges receipt of your completed claim form in connection with your above loss. After reviewing company records, Home State has determined that you meet the eligibility requirements for reimbursement of betterment or depreciation on your claim. Home State is pleased to provide you with the enclosed check representing the amount deducted for betterment or depreciation on your claim, along with 10% per annum simple interest on the deduction amount calculated from the date the claim was originally paid.

Please note that, if you accept this payment, this check must be negotiated no later than six (6) months from the date of its issuance. Additionally, if you negotiate this check, you shall be deemed to have released Home State and its agents and representatives from any and all liability relating to the deduction of betterment or depreciation on this claim.

If you have any questions regarding the enclosed check or this letter, please contact Home State at: 1-800-_____.

EXHIBIT G

Date: _____

Policyholder Name and Address: _____

Policy No. _____

Claim No. _____

Home State County Mutual Insurance Co. (“Home State”) acknowledges receipt of your completed claim form in connection with your above loss. After reviewing company records, Home State has determined that you do not meet the eligibility requirements for reimbursement of betterment or depreciation on your claim because either: (1) betterment or depreciation was never deducted on your claim; or (2) betterment or depreciation has already been refunded on your claim.

If you have any questions regarding this letter, please contact Home State at 1-800-_____.
_____.