IOWA SUPREME COURT AFFIRMS MUTUAL POLICYHOLDER RIGHT TO BRING DERIVATIVE SUIT

John C. Schachterle, Esq.
(515) 288-8208

The Supreme Court of Iowa recently resurrected a policyholder lawsuit against two insurance companies, Allied Mutual Insurance Company ("Mutual") and Allied Group, Incorporated ("Group"), along with numerous individual defendants who were directors of Allied Mutual.

The suit, filed by Mary Rieff, was originally brought on behalf of Mutual by its policyholders as a *quasi*-shareholder's derivative suit. The suit was later amended to include a class action claim of "de facto demutualization." The basic premise of both suits is that the directors of Mutual essentially "looted" the value of the company through their interaction and association with Group. The Polk County District Court granted a motion to dismiss and held, among other things, the policyholders lacked standing to proceed with the lawsuit.

While the case dealt with numerous substantive and procedural issues, the analysis for the purposes of this article will be limited to just one: Whether a policyholder has standing to bring a derivative suit. Below are the facts set out by the Court as alleged by the policyholders in their pleading:

> Allied Mutual Insurance Company (Mutual) incorporated Allied Group, Inc. (Group) in 1974. Mutual primarily operated as a private citizen insurer for home and automobile. Group engaged in the casualty and life insurance business. Until 1985, Group was a totally dependent subsidiary of Mutual. Group had no employees of its own, and Mutual provided for all of Group's services. Many of the directors of Mutual were also the directors of Group. Prior to 1985, Mutual owned 100% of Group's stock. In 1985, the directors, who are most of the defendants in this proceeding, offered 21% of Group's stock publicly. Rather than Mutual receiving the benefits of this sale, the proceeds totaling $16.4 million went to Group's subsidiaries. This transaction began the process that would ultimately result in a role reversal between Mutual and Group.
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> A pool had always existed between Mutual and Group and its subsidiaries containing the assets, profits, and premiums of their business. Initially, Mutual controlled the pool and Group received 15%. The defendant directors began to slowly increase Group's share in 1985, first to 38%, in 1987 to 41%, in 1990 to 53%, in 1992 to 60%, and in 1993 to 64%. Thus, in 1985 Mutual received 85% of the benefits from the joint pool, but by 1993 Mutual's share had decreased to 36%. Finally, in January of 1993, Mutual gave up all control of the pool to a subsidiary of Group for no consideration.
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> By 1989, all Mutual employees had been reclassified as Group employees, in turn making Mutual completely dependent on Group for its workforce. Eventually, in February of 1993, Mutual sold off all of Group's remaining common stock, giving up any possibility of sharing in Group's growth and success. As a result of the sell-off of Mutual's control to Group, the policyholders allege that the directors have allowed themselves several generous grants since 1985 worth many millions of dollars.
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> From 1985 to 1993, Mutual slowly restructured itself, which the policyholders allege benefitted the individual directors, Group, and its shareholders, and was to Mutual's detriment. In all, the policyholders conclude the defendants exchanged assets worth more than $900 million at the time of the original petition for consideration of only $126 million. Further, because Mutual was essentially subsumed under Group, the policyholders argue, what in fact occurred was a demutualization.[1]
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> In December 1997, Rieff filed a derivative suit against the individual directors/officers of Mutual and Group and Group individually. She later amended her petition in June 1998 to include class claims and a class of injured policyholders. The amended petition asserts eight counts against all named defendants. The

> petition alleges five derivative claims and three class action claims, the main one being de facto demutualization. The petition requests relief for Mutual and its policyholders.[2]
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> Nationwide intervened as a defendant in 1998 following its purchase agreement with and for Allied and its subsidiaries. The policyholders sought to enjoin this sale from going through pending their litigation. In July 1998, a hearing was held on the policyholders' motion for temporary and permanent injunction against the sale of all Allied companies to Nationwide. This motion was denied. The directors/officers, together with Group, also filed a motion to dismiss the policyholders' amended petition. They argued policyholders have no standing to bring a derivative suit, the statute of limitations bars the basis for the claims, and the policyholders have otherwise failed to state a cognizable claim for which relief can be granted.
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> The district court agreed with each argument made by the defendants. It granted the motion to dismiss in its entirety. The district court's opinion has caused quite a stir among those in the insurance and legal communities. Six *amicus curiae* briefs have been filed since the policyholders took their appeal to our court.[3]

In reviewing this case, the Court addressed the issue of policyholder standing to bring a derivative suit by analyzing prior case law which had assumed standing on the part of policyholders as well as statutory authority regarding "shareholders" derivative suits.

In the *Rowen* cases, the Court had previously allowed policyholder derivative suits but had never addressed the issue of standing to bring such a suit.[4] However, the Court could have raised the issue on its own motion if it was concerned about lack of jurisdiction because of standing.[5]

In *Rowen I*, the Court "concluded that when the corporation is a public franchise, its policyholders own it and are permitted to seek redress for wrongs done to it on behalf of the company.[6] Even though "the right to seek derivative relief is subject to abuse, it is essential as a means to permit correction of intracorporate wrongs."[7]

The right of a shareholder to bring a derivative suit on behalf of their corporation is specifically set out in state statute.[8] Iowa Code Section 490 generally governs "Business Corporations" in Iowa. In addition, § 490.1701 (2) specifically forbids the applicability of Chapter 490 to mutual insurance companies.[9] Section 490 was enacted in 1989, 14 years after *Rowen I.* The defendants argued that since the language of § 490.740 is limited to "shareholders," it effectively overruled the earlier *Rowen* line of jurisprudence.[10] The policyholders, on the other hand, argued the right to bring a policyholder derivative suit, as granted by the *Rowen* cases, cannot be taken away by the legislature with clear legislative language.[11] "Statutes will not be construed as taking away common law rights existing at the time of enactment unless the result is 'imperatively' required by the language of the statute."[12]

In its analysis, the Court relied on several things. First, " the predecessor to § 490.740 was essentially identical to it, also naming only shareholders."[13] Therefore, the *Rowen* Courts gave this right to policyholders even though this "shareholder only" language was present in the statute in existence prior to the enactment of § 490.740.

Secondly, the Court used the precedent established in the *Rowen* line of cases. Although § 490.740 does not provide policyholders derivative rights, this section is not the "exclusive provider of derivative remedy for every corporate context."[14] Instead the authority to bring such a derivative suit comes from *Rowen* jurisprudence.[15]

Thirdly, the Court summarily reviewed the national treatment of policyholder standing and found "(p)olicyholder standing to sue derivatively is a right much recognized by other jurisdictions."[16] "The United States Supreme Court has also recognized that the derivative suit is available to policyholders because of their similarity to shareholders."[17] As a result of this analysis, the Court held for the policyholders and reversed the dismissal of the derivative claims for lack of standing. They found nothing in § 490 prohibits such a derivative suit, or overrules the *Rowen* precedent.[18] Moreover, the Court held derivative suits provide a court the necessary "leeway to address issues that would not ordinarily be available to policyholders" without such suits.[19]

As indicated earlier, this case "caused quite a stir among those in the insurance and legal communities."[20] In the end,

however, the Court followed a long line of cases allowing policyholder derivative suits, much to the objection of the insurance industry.

Endnotes

1. *Rieff v. Evans*, 630 N.W.2d 278, 282 (Iowa 2001).

2. *Id*. at 283.

3. *Id*.

4. *Id*. at 285 [*citing Rowen v. LeMars Mut. Ins Co*., 230 N.W.2d 905 (Iowa 1975)] [*Rowen I*] and [*Rowen v. LeMars Mut Ins. Co*., 282 N.W.2d 639 (Iowa 1979)][*Rowen II*].

5. *Id*. (*citing Troester v. Sisters of Mercy Health Corp*., 328 N.W.2d 308, 311 (Iowa 1982)).

6. *Id.* (*citing Rowen I*, 239 N.W.2d at 915-916).

7. *Id*.

8. *Id*. at 283 (*citing* Iowa Code § 490.740).

9. *Id*. at 285.

10. *Id*. at 286.

11. *Id*. at 285.

12. *Id*. at 286 (*citing Collins v. King*, 545 N.W.2d 310, 312 (Iowa 1996)).

13. *Id*. (*citing* Iowa Code § 496A.43 (1973)).

14. *Id*. at 287.

15. *Id*.

16. *Id.* (*citing* Theodore Allegaert, Comment, *Derivative Actions by Policyholders on Behalf of Mutual Insurance Companies*, 63 U. Chi. L Rev. 1063, 1070-71 (1996)).

17. *Id*. (*citing Koster v. (Am.) Lumbermens Mut. Cas. Co*., 330 U.S. 518, 522 (1947)).

18. *Id.* at 288.

19. *Id*. (*citing Koster,* 330 U.S. at 522).

20. *Id*. at 283.