

U.S. INSURANCE AND REINSURANCE INDUSTRY FACES SCRUTINY FOR ANTICOMPETITIVE PRACTICES

(FORC Journal: Vol. 18 Edition 4 - Winter 2007)

Michael T. Griffin, Esq.
(860) 541.7764

Alan J. Levin, Esq.
(860) 541-7747

U.S. insurers and reinsurers have recently come under increased scrutiny from state attorneys general for alleged anticompetitive behavior. Attorneys general in several states, including Connecticut, Florida, Illinois and Ohio, have issued subpoenas to insurers and reinsurers to investigate whether state antitrust laws have been violated, while Connecticut, Louisiana and Oregon have brought antitrust lawsuits against insurers, reinsurers and brokers. This all comes at a time where Congress is considering bills to repeal the McCarran-Ferguson Act.

This article examines the aggressive posture taken by state attorneys general to investigate and prosecute anticompetitive behavior in the U.S. insurance and reinsurance industry. It begins with a brief overview of the McCarran-Ferguson Act. It next provides an overview of some of the more noteworthy antitrust lawsuits and investigations involving the U.S. insurance and reinsurance industry brought this year by state attorneys general. Finally, it discusses recent legislative proposals aimed at repealing McCarran-Ferguson.

1. McCarran-Ferguson

The McCarran-Ferguson Act was passed in direct response to the Supreme Court's 1944 decision in *United States v. South-Eastern Underwriters' Association*, which held that insurance rate setting constitutes interstate commerce and therefore could violate the Sherman Act. Congress responded the following year by enacting the McCarran-Ferguson Act, which, generally speaking, left regulation of insurance to the states. The Act includes an exemption from federal antitrust enforcement for "the business of insurance" to the extent that the insurance business is regulated by state law, and as long as the challenged conduct does not constitute "boycott, coercion or intimidation." Under the protection of the McCarran-Ferguson exemption, insurance companies enter pooling agreements, exchange risk information and participate in collaborative rate setting without fear of antitrust attack.

McCarran-Ferguson is not a blanket exemption for all participants in the insurance industry. Rather, it exempts only "the business of insurance," a concept that the courts have narrowly drawn to cover conduct that:

- Has the effect of transferring or spreading policyholders' risk; or
- Is an integral part of the policy relationship between insurer and insured; and
- Is limited to entities within the insurance industry.

Reinsurance is generally considered to be within the "business of insurance" for purposes of the federal exemption. While the cases in recent years have been uniformly strict in narrowly interpreting the McCarran-Ferguson exemption, its mere existence has deterred plaintiffs and prosecutors from bringing antitrust claims against insurers and reinsurers.

FEDERATION OF REGULATORY COUNSEL, INC.

2. State Antitrust Enforcement Actions

McCarran-Ferguson exempts the insurance industry only from federal antitrust regulation. McCarran-Ferguson intentionally left regulation of the insurance industry to the states, and insurers and reinsurers are subject to state antitrust laws. Over the last several years, the insurance and reinsurance industry has come under increased scrutiny from state attorneys general alleging violations of state antitrust laws by insurers, reinsurers and brokers. This trend started with the lawsuits brought by former New York Attorney General Elliot Spitzer against Marsh & McLennan Companies, Inc. ("Marsh") and various insurance companies based on allegations of bid-rigging and price fixing and the resulting settlements.

Connecticut

Connecticut Attorney General Richard Blumenthal recently filed a lawsuit against the world's second-largest reinsurance broker and Marsh subsidiary, Guy Carpenter & Company, LLC ("Guy Carpenter"), alleging the company conspired with reinsurance companies to fix rates, eliminate competition and generate increased fees. The 107 page complaint, dated October 4, 2007 and filed in Connecticut Superior Court in Hartford (the "Complaint"), is based on violations of Connecticut's Antitrust and Unfair Trade Practices Acts. The Complaint, which may be viewed at <http://www.ct.gov/ag/lib/ag/antitrust/reinsurancecomplaint.pdf>, also names another Marsh subsidiary, Philadelphia based Excess Reinsurance Company, as a defendant in the lawsuit. Numerous reinsurers participating in reinsurance facilities managed by Guy Carpenter are alleged in the Complaint to be co-conspirators, but have not been named as defendants in the lawsuit.

The Complaint alleges "Guy Carpenter traded exclusive access to a lucrative book of business in exchange for excessive fees and other benefits by creating a series of reinsurance 'facilities' aimed at a large block of its smallest clients. Guy Carpenter created what was essentially a closed market for certain categories of business and then, rather than seeking competitive quotes on behalf of its clients, funneled business to the reinsurers participating in the facilities." The Complaint further alleges that "[r]einsurers, in order to gain access to this closed market, agreed not to compete on the prices and terms set by either Guy Carpenter or another 'lead' reinsurer and instead agreed to be bound by the same prices and terms as the other reinsurer participants." For a more comprehensive summary of the Connecticut Attorney General's allegations, please go to <http://www.insurereinsure.com/BlogHome.aspx?entry=238>.

Guy Carpenter responded to the Complaint in a press release by stating:

"The Connecticut Attorney General's complaint is based on a fundamental misunderstanding of reinsurance facilities that have been in operation for the benefit of small-and mid-sized clients for as long as 50 years. As many of our clients have confirmed during this investigation, these facilities result in improved availability and terms of reinsurance and ultimately benefit insurance buyers. Simply put, there is no basis for the Attorney General's lawsuit and we intend to defend ourselves vigorously."

By all accounts, it appears that more lawsuits are likely to follow, as attorneys general around the country continue to investigate the practices of insurers, reinsurers and brokers. "Thousands of consumers in Connecticut and many more in most states across the country paid premiums up to 40 percent higher, costing them potentially hundreds of millions of dollars," Attorney Blumenthal has stated. "We are drawing back the cloak of secrecy on industry practices that inflated prices and profits at the expense of 170 insurance companies and their customers. Our investigation is active and ongoing." Over the last several months, Attorney General Blumenthal's office has also issued subpoenas to numerous insurers and reinsurers.

Florida

FEDERATION OF REGULATORY COUNSEL, INC.

On October 16, 2007, the Florida Office of Insurance Regulation (the "Office") issued a subpoena to several subsidiaries of the Allstate Corporation which have requested rate increases in Florida "to appear in a public hearing in Tallahassee [on January 15, 2008] to testify before the Office about: the companies' reinsurance program, their relationships to risk modeling companies, insurance rating organizations or companies and insurance trade associations." The Office is investigating whether insurers may have colluded on rates on homeowner's insurance and/or violated legislation passed earlier this year requiring insurers to lower rates on homeowner's insurance. The subpoena may be viewed at <http://www.floir.com/pdf/allstatesubpoena.pdf>.

Multi-State Settlement

On October 26, 2007, Oregon Attorney General Hardy Myers announced a settlement with ACE Group Holdings, Inc. and its subsidiaries ("ACE") over allegations of improper, fictitious quoting and steering of insurance businesses. The \$4.5 million monetary settlement will be divided among jurisdictions participating in a multi-jurisdiction task force, including the District of Columbia, Florida, Hawaii, Maryland, Massachusetts, Michigan, Oregon, Texas and West Virginia. Under the terms of the settlement, ACE will be required to abide by certain reforms and, in addition, disclose the actual amount of payments made to insurance brokers upon request from its customers and prospective policyholders. ACE entered into a settlement in 2006 with attorneys general from Connecticut, Illinois and New York stemming from the same anticompetitive practices.

Louisiana

On November 8, 2007, Louisiana Attorney General Charles C. Foti, Jr. announced that his office filed a petition in New Orleans Civil District Court against Allstate Insurance Company, Lafayette Insurance Company, Xactware, Inc., Marshall & Swift/Boeckh, LLC, Insurance Services Office, Inc., State Farm Fire and Casualty Company, USAA Casualty Insurance Company, Farmers Insurance Exchange, Standard Fire Insurance Company and McKinsey & Company for alleged violations of the Louisiana Monopolies Act.

According to Attorney General Foti's press release, the petition alleges that the defendants participated in "an on-going scheme to rig the value of property damage claims paid by insurance companies to their insureds" and used "damage-estimating software programs to engage in horizontal price-fixing as well. The combination allegedly artificially held down property damage claim payouts with the intended goal of increasing the profits of each company involved."

3. Proposals to Repeal McCarran-Ferguson

The onslaught of state antitrust investigations and claims involving alleged anticompetitive activities of insurers, reinsurers and brokers comes at a time when some industry observers are calling for Congress to repeal McCarran-Ferguson.

In February, Senator Patrick Leahy (D-Vt.), Chairman of the Judiciary Committee, introduced the "Insurance Industry Competition Act of 2007," (S. 618), a bipartisan measure that would amend McCarran-Ferguson to give the Department of Justice and the Federal Trade Commission authority to apply Federal antitrust laws to the insurance industry. In March, companion legislation was introduced in the House of Representatives as H.R. 1081. Although these bills will not be acted upon this year, Congress will likely continue deliberations next year regarding repeal of McCarran-Ferguson. Further fueling these discussions will be a report issued in September by the European Commission questioning the need for the Block Exemption which, like McCarran-Ferguson, provides insurers with a limited exemption from European Union competition laws.

4. Conclusion

FEDERATION OF REGULATORY COUNSEL, INC.

The lawsuits and investigations of state attorneys general alleging violations of state antitrust laws by insurers, reinsurers and brokers will likely trigger other lawsuits by attorneys general, as well as private causes of action. One can only assume that the results of these lawsuits and investigations will greatly influence Congress with respect to whether to repeal McCarran-Ferguson. Only time will tell if there is a basis for the allegations made by state attorneys general against insurers, reinsurers and brokers and whether Congress will act to reform federal antitrust law as it applies to the business of insurance.
