

STATE OF CONNECTICUT AND GUY CARPENTER SETTLE LANDMARK ANTITRUST CASE FOR \$4.25M: WHAT'S NEXT FOR THE REINSURANCE INDUSTRY?

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On January 31, 2011, one of the world's largest reinsurance brokers, Guy Carpenter & Co. LLC, and its former affiliated reinsurer agreed to pay \$4.25 million to settle a lawsuit brought by the Connecticut attorney general alleging these companies engaged in a series of conspiracies to create closed reinsurance markets and drive-up reinsurance costs. This settlement, which concludes an investigation and landmark litigation that spanned more than three years, is the latest example of increasingly aggressive antitrust enforcement by state attorneys general targeting the insurance and reinsurance industry.

Increased Antitrust Scrutiny on Insurance and Reinsurance Industry

Over the past several years, U.S. insurers and reinsurers have been the target of increased scrutiny by state attorneys general for alleged anticompetitive behavior. A number of these antitrust investigations have resulted in significant settlement payments. In 2004, then New York Attorney General Eliot Spitzer teamed with other investigators in filing lawsuits against insurance brokers, resulting in settlements of \$3 billion in restitution and \$275 million in penalties. In 2007, a multijurisdictional investigation resulted in allegations that several insurance carriers were engaged in unlawful bidding practices by conspiring to provide false quotes to commercial casualty insurance customers in an effort to make those customers believe competitive bidding had resulted in the best prices. This investigation has resulted in several multimillion dollar settlements, including in April 2010 when American International Group Inc. (AIG) paid \$9

million to settle an antitrust suit filed by the Ohio attorney general. More recently, Marsh & McLennan paid \$4.75 million in September 2010 to settle claims in the same Ohio lawsuit. This litigation continues against other insurance carriers.

A number of the behavioral remedies imposed on Guy Carpenter for its activities in the reinsurance industry, which are discussed in more detail below, were modeled after remedies previously imposed on insurers in these prior investigations. In many cases, as a result of these and other investigations, the targeted carriers have reformed the manner in which they compensate their brokers and agents and increased transparency to their customers regarding their business practices.

Alleged Wrongdoing in Guy Carpenter Lawsuit

Insurers often purchase reinsurance to cover exposure to large claims on the policies they write. Because these costs are typically passed on to consumers, any practices by reinsurers deemed anticompetitive by a reviewing court will generally be expected to result in higher insurance prices for individuals and businesses who purchase insurance. Other reinsurance companies seeking to compete for reinsurance business can also be impacted.

The Guy Carpenter lawsuit, filed in Hartford Superior Court in 2007, was noteworthy because it was the first suit brought against a company in the reinsurance industry by any U.S. antitrust enforcement agency – federal or state. In the complaint, the state of Connecticut alleged that for several decades, Guy Carpenter repeatedly placed lucrative business

with a select group of reinsurers – called facilities – in exchange for undisclosed commissions and bonuses. Among the group of facilities was Excess Reinsurance Company, now known as Knightbrook Insurance Co., which was partially owned and managed by Guy Carpenter. In exchange for this business, the complaint alleged that the reinsurers agreed not to compete against prices and terms set by Guy Carpenter. It was further alleged that if the reinsurer was unwilling to participate, that reinsurer was allegedly foreclosed access to future business.

According to the complaint, the facilities primarily served Guy Carpenter's small to mid-size clients, who presumably relied more heavily on the broker's experience and knowledge of the market to obtain the best coverage at the lowest prices. Rather than seek competitive quotes on behalf of these clients, the reinsurance business was reportedly placed with the facilities at rates predetermined by Guy Carpenter, acting as both placement agent for its clients and the underwriter for the reinsurers. The state alleged that Guy Carpenter never disclosed its relationship with the facilities to its clients, or the fact that it was often setting its own price and terms for the reinsurance contracts that covered the clients.

The lawsuit alleged that these ongoing conspiracies principally led by Guy Carpenter illegally fixed prices and inflated insurance costs, created a closed market for certain categories of reinsurance that was insulated from competition or any market forces, and allocated markets among favored reinsurers, all in violation of the Connecticut Antitrust Act (Conn. Gen. Stat. §§ 35-24 et seq.) and the Connecticut Unfair Trade Practices Act (Conn. Gen. Stat. §§ 42-110a et seq.).

Prior to the Guy Carpenter settlement, Hartford Financial Services Group Inc. agreed in October 2009 to pay \$1.3 million to settle claims it had participated in Guy Carpenter's alleged scheme. Guy Carpenter (like Hartford Financial) has maintained that use of the facilities was actually pro-competitive because it allowed the company to offer its clients the best available terms for reinsurance among numerous options. Guy Carpenter's decision to settle this lawsuit forecloses a decision on the merits, and therefore leaves open the question of whether this defense would have been able to withstand judicial scrutiny.

Settlement Terms

In addition to paying the state of Connecticut \$4.25 million to end the litigation, the settlement calls for Guy Carpenter to make fundamental changes to its business nationwide, including the following:

- Provide its clients with enhanced disclosure of any direct or indirect ownership interests in reinsurance companies, if a placement in such reinsurer is proposed.
- Disclose to its clients all commissions, fees, or other remuneration received in connection with placing reinsurance business for the client.
- Provide its clients with detailed descriptions of the structure of the facilities.
- Disclose the factors considered by its brokers when making reinsurance placement recommendations.
- Institute minimum requirements for obtaining competitive bids from reinsurance companies.

Guy Carpenter's obligation to undertake these remedial activities will remain in effect for five years. In announcing the settlement, the Connecticut attorney general stated that these business reforms should make the reinsurance market more transparent and competitive and ultimately may lead to lower insurance prices for consumers and businesses.

Practical Business, Legal, and Legislative Implications Impacting Insurers and Reinsurers

A number of business and legal ramifications could result from the Guy Carpenter settlement for companies in the insurance and reinsurance industry. From a business standpoint, the terms of this settlement could precipitate a change in the way companies do business, particularly with respect to voluntary disclosures made to customers regarding business relationships and bidding practices.

From a legal perspective, these recent investigations highlight the potential antitrust exposure faced by insurers, reinsurers, and brokers. Even though the business of insurance is largely exempt from the federal antitrust laws under the McCarran-Ferguson Act, this settlement highlights the antitrust exposure that exists under various state laws. Following trends from the past few years, the settlement with Guy Carpenter and its formerly affiliated reinsurer could trigger investigations in other jurisdictions or new lawsuits

brought by other state attorneys general alleging violations of state laws. If anticompetitive activities in the reinsurance industry are viewed as increasing consumer prices, private causes of action seeking treble damages for antitrust violations are also possible.

In addition, the recent increase in state antitrust investigations and settlements could ignite the debate concerning federalization of the insurance and reinsurance industry, and potentially influence Congress with respect to ongoing efforts to repeal the federal antitrust insurance exemption in McCarran-Ferguson. Several bills have recently been introduced in Congress, some of which seek to remove the entire industry's federal antitrust immunity (e.g., the Insurance Industry Competition Act), while others are more focused on antitrust immunity relating to the health insurance business (e.g., the Health Insurance Industry Fair Competition Act). Although neither of these bills have been passed by the Senate, the issue of federal antitrust law reform in the insurance industry is ripe for a public debate. The Justice Department has stated that it generally advocates repealing McCarran-Ferguson, claiming the federal antitrust exemption is not essential to maintain state-based regulation of the insurance industry. Only time will tell what impact, if any, the recent state antitrust settlements will have on this debate.

Even if the federal antitrust exemption stays intact, it is important for companies to remember that not all insurance activities are immune from the federal antitrust laws. McCarran-Ferguson narrowly exempts from federal antitrust enforcement "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 a "boycott, coercion, or intimidation." While reinsurance is generally considered to be within the "business of insurance," because it is insurance for insurers, this exemption does not protect companies against bid rigging or other concerted refusals to deal. Companies should therefore assess their potential exposure under both federal and state laws.

Finally, the Guy Carpenter settlement serves as a message to all companies involved in the reinsurance business to pay close attention to developments in antitrust enforcement. To avoid any potential charges of wrongdoing, companies should contact antitrust counsel to ensure that their existing code of conduct and compliance programs minimize federal or state antitrust exposure. If a company is contacted by a state attorney general's office or other enforcement agency, legal counsel should be retained immediately to assist in complying with any investigations.