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ANTITRUST INVESTIGATION REVEALS COLLUSION IN INSURERS' PROPOSITION 103 BOYCOTT

LOS ANGELES -- The November 1988 simultaneous withdrawal of scores of insurance companies from California following the passage of Proposition 103 was the result of collusion among insurance companies, according to a report issued today by Attorney General John Van de Kamp.

The report, the result of a two-year antitrust investigation by the Department of Justice, details written and oral communications among insurance companies for months leading to the passage of the insurance-reform initiative. Subpoenaed records and sworn testimony revealed that companies informed each other of their willingness to pull out of the California property-casualty market and, in some cases, cajoled one another to follow suit.

"This investigation provides further evidence of the culture of collusion that pervades the insurance industry," Van de Kamp said in releasing the report. "Whether a change in the law, like Proposition 103, makes a business unprofitable is a decision independent companies are supposed to reach independently. We found that on the most basic decision -- whether to compete

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at all -- insurance companies were consulting one another, seeking and providing reassurance that they would follow one another in lock-step."

The object of the agreement was to create an atmosphere that would compel the California Supreme Court to grant the companies' request for a stay of the initiative. Within days the Supreme Court granted the stay, and companies returned to the market.

A group boycott is a violation of state and federal antitrust law. The report describes the Attorney General's weighing of the competing reasons for initiating a prosecution -- the severe short-term economic dislocations caused by the companies, the need to prevent future collusion in an industry historically immunized from the antitrust laws, and the continuing vulnerability of California consumers to the exercise of market power by these companies -- against the reasons for declining to prosecute at this time -- the short-lived withdrawal, the difficulty proving damages, the potential chilling effect on First Amendment protected activity, and the competing demands for limited prosecutorial resources. On balance, the Attorney General has decided not to initiate any criminal or civil proceeding at this time.

However, in the report Van de Kamp recommends legislation strengthening the law against collusive boycotts and increasing penalties for the kind of conduct revealed by the investigation.

The summary section of the report is attached. The full report, consisting of 37 pages plus three appendices and 78 exhibits subpoenaed from industry files, is available from the Attorney General's Office in Los Angeles.

NOTE TO LOS ANGELES MEDIA

Attorney General Van de Kamp will be available for interviews on the report in his Los Angeles office today from 1:30 to 2:30.

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STATE OF CALIFORNIA
DEPARTMENT OF JUSTICE

Collusion and Market Power In the Insurance Industry

A Report to the

Governor, Legislature,

and Insurance Commissioner

on

an Investigation into the

Post-Proposition 103 Withdrawals

from the California Insurance Markets

January 2, 1991

John K. Van de Kamp
Attorney General

Collusion and Market Power
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I. SUMMARY

On November 8, 1988, the voters enacted Proposition 103, which contained sweeping changes in the laws regulating the business of insurance, including the establishment of a strict system of prior-approval ratemaking, repeal of insurers' exemption from the antitrust and unfair competition laws, and a rollback of all property-casualty insurance rates to 20% below their November 1987 levels. The next day, November 9, 1988, numerous insurers and their trade associations filed an action in the California Supreme Court, seeking an immediate stay of all provisions of Proposition 103 and a declaration that it was unconstitutional. That same morning, numerous insurers suspended sales, and by the following day at least ninety firms, representing over seventy-five percent of personal-lines insurance in California, announced their withdrawal from, or suspension of sales in, California. The Supreme Court quickly issued an order staying all provisions of Proposition 103, and starting immediately thereafter nearly all of the insurers that had suspended sales began to reenter the California market.

This simultaneous action by numerous putative competitors raised the suspicion that the action may have been the result of unlawful collusive activity. To determine whether that was, in fact, the case, the Attorney General directed that an investigation be conducted into the circumstances surrounding these developments. Subpoenas were served on twenty-nine companies and other organizations, sixty-eight witnesses were examined under oath, and over twenty thousand pages of evidence produced from the companies' and associations' files were analyzed. This report describes the findings of that investigation.

The evidence revealed that:

(1) – Members of the industry were genuinely concerned about the effect of Proposition 103 on their operations. These concerns ranged from the relatively narrow question of the financial effects of the rate rollbacks on each company to

more general concerns that the passage and successful implementation of Proposition 103 would lead to the spread of similar measures across the country.

(2) By August 1987, the industry had begun to take steps to respond to possible passage of what became Proposition 103 -- and the possibility of passage of another insurance-reform initiative, Proposition 100. The measures included formation of an unprecedented coalition of companies and trade associations into an integrated Insurance Industry Initiative Campaign Committee (IIICC), bringing together virtually every property-casualty insurer and every related trade association. The IIICC conducted a vigorous public campaign against the initiatives and on behalf of the industry's own initiative, Proposition 104, involving traditional political activities, common to such campaigns and permitted under the law.

(3) However, during the course of the campaign, meetings and communications ostensibly directed to the campaign were used by numerous insurers to exchange their individual firms' post-election business plans in the event that the IIICC's efforts were unsuccessful. These exchanges sometimes occurred despite the advice of industry lawyers that they raised serious concerns under the antitrust laws.

(4) The investigation revealed that by election day, numerous detailed communications among the insurers had given the companies a clear understanding that many insurers were prepared to participate in what would amount to a mass withdrawal from California if the initiative passed.

(5) The companies further understood that a coordinated judicial attack on the initiative would be launched the day after its passage and that the success of their lawsuit would be aided by a mass withdrawal, creating a crisis in which insurance would become unavailable. That crisis could, in turn, be cited to the Supreme Court as evidence of the need for an immediate stay of Proposition 103 -- a crisis based in large part on the agreed-upon predictions of the companies about their putatively independent market conduct.

An agreement among competitors to withdraw from a market constitutes a group boycott in violation of both federal and state antitrust laws. The communications among insurance companies uncovered by this investigation, signaling to one another their willingness to participate in a simultaneous withdrawal from the market, suggest an unlawful group boycott had been agreed upon.

However, these communications took place during a political campaign and subsequent legal proceedings, presenting special considerations for the exercise of prosecutorial discretion. Bona fide campaign activities are protected from antitrust

liability by the First Amendment and decisional law. But the U.S. Supreme Court has made it clear that agreements to withhold products and services from consumers, even if for the purpose of advancing political objectives, are unlawful and are not protected.

The Attorney General has weighed the competing reasons for initiating a prosecution -- the severe short-term economic dislocations caused by the companies, the need to prevent future collusion in an industry historically immunized from the antitrust laws, and the continuing vulnerability of California consumers to the exercise of market power by these companies -- against the reasons for declining to prosecute at this time -- the short-lived withdrawal, the difficulty proving damages, the potential chilling effect on First Amendment protected activity, and the competing demands for limited prosecutorial resources. On balance, the Attorney General has decided not to initiate any criminal or civil proceeding at this time.

However, this investigation has revealed the need for greater protection of consumers against collusive manipulation of markets, particularly in the insurance industry. Accordingly, the Attorney General recommends specific legislation increasing the penalties for such conduct.