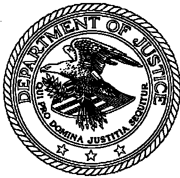

DEPARTMENT OF JUSTICE
Antitrust Division

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November 24, 2008

James M. Burns, Esq.
Williams Mullen
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Washington, D.C. 20006

Dear Mr. Burns:

This letter responds to your request on behalf of your client Ivy Capital Group, LLC ("Ivy") for the issuance of a business review letter pursuant to the Department of Justice's Business Review Procedure, 28 C.F.R. § 50.6.[1] Ivy proposes to form Concepta Services, LLC ("Concepta"), which will offer fire and allied line insurance ("commercial insurance") policies equal to or in excess of $250 million ("large commercial insurance policies") by consolidating the capacity of individual fire and allied line insurers ("commercial insurers"). You refer to the commercial insurers whose capacity Concepta will consolidate as "participants" in Concepta.[2] You have requested a statement of the Antitrust Division's current enforcement intention with respect to the formation and operation of Concepta.

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[1] Your letter asks for the Antitrust Division to express its views as to whether the McCarran-Ferguson Act, 15 U.S.C. § 1011 *et seq.*, applies to the formation and operation of Concepta. Letter from James M. Burns to Office of Assistant Attorney General (June 15, 2007) ("June 15, 2007 Letter"). The McCarran-Ferguson antitrust exemption applies when a challenged practice (1) is part of the "business of insurance," (2) is regulated by state law, and (3) does not constitute an "agreement to boycott, coerce or intimidate or an act of boycott, coercion or intimidation." 15 U.S.C §§ 1012, 1013. Thus, the formation and operation of Concepta are not subject to the antitrust laws if they are covered by the McCarran-Ferguson Act. Because we conclude, based on your representations and the additional assumptions described below, that the formation and operation of Concepta would be unlikely to violate the antitrust laws if they were to apply, we do not address the application of the McCarran-Ferguson Act.

[2] June 15, 2007 Letter at 4.

Factual Background

You represent that Ivy is a privately owned, Delaware limited liability company whose investors are principals in an independent firm that provides management and financial consulting services to Fortune 500 companies.[3] Concepta will be a limited liability company that will be owned by Ivy, Concepta's management, and other entities that are not affiliated with Concepta's participants.[4] Concepta's insurer participants will not have an ownership interest in Concepta.[5]

You represent that the purpose of Concepta is to increase the competitive options available to insureds seeking coverage for large, commercial property insurance risks. You represent that there are a large number of insurers that have sufficient "capacity" to submit bids for commercial insurance policies where the coverage limits are "not particularly large," but that the number of insurers with sufficient capacity declines as the amount of coverage required increases and that "[w]hen the amount of property insurance coverage required approaches and exceeds $250 million, the number of insurers that can respond to such proposals with a quote offering to provide the full capacity becomes extremely limited."[6]

You also represent that Ivy is not aware of any data set that concisely provides the dollar volume of sales of large commercial insurance policies sold in the United States. However, you represent that Ivy has made a good faith estimate that sales of large commercial insurance policies generate approximately $19.8 billion in premiums annually. You further represent that Concepta's most likely members currently generate collectively no more than $900 million dollars in annual premiums from the sale of large commercial insurance policies, approximately 5% of all such premiums.[7] In addition, you maintain that Ivy intends to "seek out members with complementary underwriting expertise and a focus on different niche submarkets, thus broadening the potential number of opportunities on which Concepta can serve as a meaningful competitive option and eliminating any risk that Concepta's members could even potentially have a significant market share in any potential submarket or market segment."[8]

Because of capacity constraints, you maintain that the likely participants in Concepta "*cannot currently* satisfy an insured's insurance coverage unless they either (1) obtain facultative reinsurance for the portion of the coverage sought by the insured that the insurer does not offer to provide on its own; or (2) persuade the insured to restructure its insurance program and accept

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[3] *Id.* at 4 n.5.

[4] *Id.* at 4.

[5] *Id.* at 7.

[6] *Id.* at 2.

[7] Letter from James Burns to Joshua H. Soven at 2-3 (September 11, 2008) ("September 11, 2008 Letter").

[8] *Id.* at 3.

a 'layered' coverage program where multiple insurers provide portions of the coverage required by the insured."[9] You represent that the purchase of facultative reinsurance "is an undesirable option because the insurer incurs significant additional costs that impede its ability to offer the insured coverage on competitive terms."[10] Specifically, you represent that, "[w]hen an insurer purchases reinsurance, it must pay a premium to the reinsurers to whom a portion of the risk has been transferred. Because this expense is not incurred by those insurers that do not need reinsurance, insurers that must purchase reinsurance are competitively disadvantaged in the prices they can offer to the insured. In addition, the insurer typically also must pay a commission to the reinsurance broker that has arranged the placement for the reinsurance agreement. This adds an additional expense for the insurer that an insurer not requiring reinsurance does not incur, and frequently can be 5-15% or higher of the reinsurance premium . . . ."[11]

You represent that in a layered transaction, the insurer will offer to provide a certain dollar amount of coverage in excess of a fixed threshold. For example, the insurer might offer to provide $25 million of coverage in excess of $100 million. You represent that layered insurance proposals are "typically not viewed as a desirable alternative by many insureds" because the insured's broker must "seek out separate coverage to fulfill each of the remaining 'layers' required by the insured, rather than enjoying the benefit of 'one stop shopping' provided by an insurer that is prepared to underwrite the entire coverage risk on its own. This makes the broker's job more difficult, and adds additional time (and sometimes expense) to the process. In addition, layered programs introduce a degree of uncertainty for the insured, because it is not always a simple task to find insurers to satisfy each of the required layers of coverage, and thus on occasion the insured will have to consider whether to 'go bare' (*i.e.*, have no insurance coverage) at various layers of the layered program."[12] Moreover, you represent that "even where the broker identifies suitable insurers to cover all of the program layers, the insurers' contracts typically will *not* have identical terms and conditions of coverage."[13] You maintain that, "having different insurers on a program, at different layers, can add greater inefficiency, risk and costs for an insured, particularly where all of the insurers in the program do not have identical terms and conditions."[14]

You represent that Concepta will use the following mechanism to accomplish its objective of increasing the number of commercial insurers that can participate in the issuance of large commercial insurance policies. A Concepta participant independently will submit a

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[9] Letter from James M. Burns to Joshua H. Soven (February 6, 2008) at 1 ("February 6, 2008 Letter") (emphasis added).

[10] *Id.* at 2.

[11] *Id.*

[12] *Id.*

[13] *Id.*

[14] June 15, 2007 Letter at 2-3 n.3.

proposed "lead" bid with an insurance broker. Concepta's role in consolidating coverage capacity will begin after the insurance broker has selected a Concepta participant as the lead insurer.[15] Once the broker has selected the lead, you represent that Concepta will then determine which of its other participants have underwriting guidelines "that are consistent with the rates and terms of coverage that the 'lead' insurer has agreed to provide to the insured . . . [and] will then provide each such potential participant with a summary 'term sheet' of the proposed terms, requesting that each such insurer determine whether it would like to participate [i]n the program as a 'capacity adding' insurer."[16] You represent that each Concepta participant that decides to participate will be allowed then to indicate the amount of coverage that it is willing to provide.[17]

You represent that if Concepta's participants over-subscribe, then each will have its respective offered shares reduced on a pro-rata basis. Conversely, if Concepta's participants under-subscribe to a potential placement, Concepta will apprise the lead that it has not succeeded in completing the placement and the lead or broker will need to seek the remaining capacity through mechanisms other than those provided by Concepta.[18]

You maintain that Concepta is likely to produce the following procompetitive effects: (1) an increase in the number of insurers that can compete effectively for large commercial insurance policies;[19] (2) greater opportunities for Concepta's participants to utilize their capacity in insurance placements;[20] (3) an increase in the ability of smaller or specialized brokers to assist larger clients on a more comprehensive basis;[21] and (4) lower insurance costs as a result of decreasing brokerage cost.[22] You represent that these procompetitive effects will in large measure be attributable to Concepta's structure eliminating the need for its participants to use facultative reinsurance or layering and Concepta's plan to charge the lead and "follow on" insurers fees that are considerably less than the average brokerage commission fee on fire and allied lines policies.[23]

You further represent that Concepta will employ the following rules and procedures (the

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[15] *Id.* at 4 & n.6.

[16] *Id.* at 4.

[17] Letter from James M. Burns to Joshua H. Soven (November 29, 2007) at 1-2 ("November 29, 2007 Letter").

[18] Letter from James M. Burns to Joshua H. Soven (November 12, 2007) at 2.

[19] June 15, 2007 Letter at 5.

[20] *Id.*

[21] *Id.*

[22] *Id.* at 5-6.

[23] *Id.* at 6.

first three of which you term "safeguards") to ensure that its operations do not produce anticompetitive effects.

1. Concepta will not provide the insurer underwriting guidelines that each Concepta participant shares with Concepta to any other Concepta participant.[24]

2. Concepta will bar its participants "from holding any ownership interest in Concepta, and none of the investors in Ivy will be in any way affiliated with any Concepta participant."[25]

3. The decision to participate in an offering "will remain exclusively in the hands of each insurer [participant]."[26]

4. Concepta will provide incentives for all Concepta participants to compete aggressively to achieve the lead position with the broker by charging the lead "less fees than that charged to the 'follow on' capacity adding participants . . . ."[27]

5. Concepta will not restrict its participants from submitting competing proposals to the broker for any customer.[28]

Further, the only exclusivity requirement that Concepta will impose on its participants is a two-year restriction on participation in a "discretionary capacity aggregation initiative similar in character to Concepta's model."[29] You represent that this restriction "will enhance the likelihood that Concepta's efforts at capacity aggregation will be successful" and "also provides a limited degree of protection to Ivy's proprietary interest in the Concepta model, so that it can attempt to recoup the significant capital expenditures that Ivy has incurred in creating Concepta. While Ivy intends to seek renewal agreements with Concepta [participants] . . . it does *not* intend to restrict Concepta [participants] from participating in competing programs as a condition of its renewal agreements."[30]

In addition, you represent that Concepta will offer a volume discount feature under which the commissions paid by Concepta's participants will decrease as their volume of business with

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[24] *Id.*

[25] *Id.* at 7.

[26] *Id.* at 5.

[27] *Id.* at 7.

[28] November 29, 2007 Letter at 1.

[29] June 15, 2007 Letter, attachment entitled "Sample Terms for Contract between Concepta and Underwriters" at 1.

[30] February 6, 2008 Letter at 4 (emphasis in original).

Concepta increases.[31] You maintain that this volume discount feature "should . . . not have any potential anticompetitive effects since, despite this incentive, Concepta's participants will still have a greater incentive not to use Concepta's services when they can meet an insured's coverage requirements on their own."[32]

Legal Analysis

In the *Antitrust Guidelines for Collaborations Among Competitors*, the U.S. Department of Justice sets forth its antitrust enforcement policy with respect to collaborations among actual and potential competitors.[33] In those Guidelines, the Department explains that it evaluates competitor agreements (other than those of the sort that always or almost always tend to raise price or reduce output and thus are per se illegal) under the rule of reason. The rule-of-reason analysis focuses on the state of competition with, as compared to without, the relevant agreement. The central question is whether the relevant agreement is likely to harm competition by increasing the ability or incentive profitably to raise price above or reduce output, quality, service, or innovation below what likely would prevail in the absence of the relevant agreement.[34]

The Division concludes that the formation and operation of Concepta could offer a new competitive option for insureds to purchase large commercial insurance policies and that Concepta is not likely to harm competition respecting the provision of large commercial insurance policies by increasing the ability or incentive profitably to raise price above or reduce output, quality, service, or innovation below what likely would prevail in Concepta's absence. In particular, because Concepta's prospective participants currently have minimal involvement in the sale of large commercial insurance policies, its formation and operation fall well within the "safety zone" set forth in the Competitor Collaboration Guidelines concerning "competitor collaboration when the market shares of the collaboration and its participants collectively account of no more than twenty percent of each relevant market in which competition may be affected."[35]

Our analysis is expressly based on your representations that (1) Concepta's likely participants currently generate no more than approximately 5% of the total premiums of large commercial insurance policies sold in the United States, and (2) Ivy intends to "seek out members with complementary underwriting experience and a focus on different niche submarkets, thus . . . eliminating any risk that Concepta's members could even potentially have a

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[31] June 15, 2007 Letter at 6.

[32] *Id.* at 7.

[33] U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, ANTITRUST GUIDELINES FOR COLLABORATIONS AMONG COMPETITORS § 1.1, at 2 (2000), *available at* http://www.usdoj.gov/atr/public/guidelines/guidelin.htm.

[34] *Id.* § 3.3, at 10.

[35] *Id.* § 4.2, at 26.

significant market share in any potential submarket or market segment."[36] If, contrary to your representations, Concepta's participants in fact sell large commercial insurance policies that account for a competitively significant percentage of the total premiums of all those policies sold in the United States, or of the premiums generated from the sale of those policies to any competitively significant market segment or niche, then the operation of Concepta may violate the antitrust laws.

Moreover, the Division's conclusion does not rely on your representations about the alleged relative competitive disadvantages of the use of facultative reinsurance or layering to provide large commercial insurance policies. We do not have sufficient information about Concepta's likely participants to determine whether these represented disadvantages preclude them from competing effectively in the provision of large commercial insurance policies. Similarly, the Division has not relied on your representations that Concepta will use certain "safeguards," have only limited exclusivity requirements, and employ a tiered fee structure, to ensure that Concepta does not produce anticompetitive effects. The Division lacks sufficient information to evaluate those provisions. However, as stated above, resolving these issues is not necessary because you have represented that Concepta's likely participants currently account for only a small percentage of the large commercial insurance policies sold in the United States.

In addition, our analysis is limited to whether the formation and operation of Concepta is likely to reduce competition substantially in the provision of large commercial insurance policies. You have represented that Concepta's likely participants also write commercial insurance policies that provide less than $250 million in coverage ("smaller commercial insurance policies"). We lack sufficient information to evaluate whether the formation and operation of Concepta will allow competitors in the provision of smaller commercial insurance policies to reduce competition. The effectiveness of the safeguards may be relevant to preventing a loss of competition respecting those policies and, as stated, we lack sufficient information to evaluate the safeguards. Thus, if the formation or operation of Concepta reduces competition in the provision of smaller commercial insurance policies, Concepta may violate the antitrust laws.

Accordingly, based on the information and assurances that you have provided to us, and the additional qualifications set forth above, the Department of Justice, Antitrust Division, has no present intention to challenge the formation or activities of Concepta. This letter expresses the Division's current enforcement intention and is predicated on the accuracy of the information and assertions that you have presented to us, as well as the additional qualifications set forth in this letter. In accordance with its normal practice, the Division reserves the right to bring an enforcement action in the future if the actual activities of Concepta or its participants prove to be anticompetitive in purpose or effect in any market.

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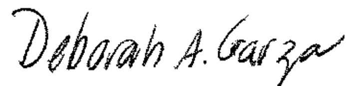
[36] September 11, 2008 Letter at 3.

This statement is made in accordance with the Department's Business Review Procedure, 28 C.F.R. § 50.6. Pursuant to its terms, your business review request and this letter will be made publicly available immediately, and any supporting data will be made publicly available within thirty (30) days of the date of this letter, unless you request that any part of the material be withheld in accordance with Paragraph 10(c) of the Business Review Procedure.

Sincerely,



Deborah A. Garza