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UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW JERSEY

IN RE: INSURANCE BROKERAGE ANTITRUST LITIGATION	Hon. Garrett E. Brown, Jr.
	MDL No. 1663 Civ. Action No. 04-5184
	Electronically Filed
APPLIES TO ALL COMMERCIAL INSURANCE BROKERAGE ACTIONS	Return Date: August 20, 2007 **ORAL ARGUMENT REQUESTED**

COMMERCIAL DEFENDANTS' OMNIBUS MEMORANDUM IN SUPPORT OF MOTION TO DISMISS THE ANTITRUST CLAIMS IN THE SECOND CONSOLIDATED AMENDED COMPLAINT

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PRELIMINARY STATEMENT

For three years now, plaintiffs have attempted to allege a series of sweeping nationwide market-allocation conspiracies among virtually all major insurers and brokers, involving dozens of lines of commercial insurance. Throughout, the basis of their purported antitrust claim has remained the same: that the entire commercial insurance industry has committed a *per se* violation of the antitrust laws because insurers have paid brokers contingent commissions for business generation, and because brokers have formed strategic partnership relationships with insurers in order to consolidate the bulk of their business with a smaller, more manageable number of insurers.

This Court has now twice ruled that plaintiffs' allegations do not state a claim. As Judge Hochberg stated in ruling on defendants' first motions to dismiss: "The existence of contingent commission agreements between the Broker Defendants and other insurers shows that the parties engaged in a business relationship; but is not, without more, an allegation that the Defendants conspired among each other in violation of the Sherman Act." (Oct. 3 Op. 29.) On defendants' second motion to dismiss, after plaintiffs proffered several hundred pages of particularized statements detailing the purported factual basis for their allegations, this Court dismissed the complaint, similarly ruling that it was "not satisfied that Plaintiffs have set forth sufficient allegations that the conduct alleged, i.e., the consolidation of the insurance markets and the steering of certain customers based on contingent commission payments, constitutes a *per se* illegal horizontal customer or market allocation scheme." (Apr. 5 Op. 34.)

Plaintiffs' third attempt to state a claim fares no better. In their Second Amended Complaint ("SAC"), plaintiffs once again focus on the brokers' "strategic partnerships" with different subsets of insurers who paid them contingent commissions in the hope of generating additional business opportunities, coupled with an utterly speculative assertion that all of the brokers formed a "global conspiracy" not to disclose to customers information about one another's respective competitors' contingent commissions. Despite having the benefit of nearly two years of wide-ranging discovery, plaintiffs still have not pleaded any facts that would show a *per se* unlawful horizontal agreement to allocate customers. As before, plaintiffs' new complaint alleges nothing more than commonplace business practices involving vertical agreements between brokers and insurers that can have manifestly pro-competitive effects, and then tacks on the unsupported assertion that these practices were also the subject of agreements among varying groups of insurers.

That is still not enough to state a claim. The Second Amended Complaint should be dismissed for at least three independent reasons:

First, as the Supreme Court recently declared in *Bell Atlantic Corp. v. Twombly*, 127 S. Ct. 1955 (2007), an antitrust complaint must do more to survive a motion to dismiss than "open the possibility that a plaintiff might later establish some 'set of [undisclosed] facts' to support recovery," *id*. at 1968; it must, rather, allege facts that provide "plausible grounds to infer an agreement" that would be unlawful under the antitrust laws, and "not merely parallel conduct that could just as well be independent action." *Id*. at 1966. The Second Amended Complaint, like its predecessors, fails this test. Shorn of conclusory assertions of "conspiracy," the complaint alleges, at most, parallel conduct from which no inference of horizontal conspiracy can be drawn. *Twombly* makes clear that these allegations are not sufficient to state a claim under section 1 of the Sherman Act. (*See infra* pp. 7-14.)

Second, beyond this threshold failing, plaintiffs still do not allege a *per se* unlawful market allocation scheme. Instead, relying mostly on the same facts alleged in the earlier particularized statement, plaintiffs continue to complain principally about the efforts by each defendant broker to consolidate its business with fewer insurers and to steer business to those insurers. The Court has already ruled that these facts do not "adequately allege conduct which constitutes market or customer allocation," as opposed to "just the steering of business to preferred partners." (Apr. 5 Op. 34.) Such preferred provider arrangements are not only commonplace, but have consistently been found not to be *per se* unlawful because of their potential procompetitive benefits, which are amply illustrated in both the Second Amended Complaint and the Supplemental Statement. (*See infra* pp. 16-19.) Nor do "first looks," "last looks" or other purported "incumbent protection" practices alleged in the Second Amended Complaint establish a *per se* unlawful market allocation conspiracy. To the contrary, these practices may serve to enhance, not stifle, competition.

Third, the amended pleadings make it clear that the alleged conduct at issue constitutes the business of insurance, and that plaintiffs' antitrust claims are therefore barred by the McCarran-Ferguson Act. That act embodies Congress's determination to free the states to regulate insurance without interference from private lawsuits brought under federal antitrust law. As the Supreme Court has explained, "a basic motivating policy behind the legislative movement that culminated in the enactment of the McCarran-Ferguson Act . . . was that the States were in close proximity to the people affected by the insurance business and, therefore, were in a better position to regulate that business than the Federal Government." *FTC v. Travelers Health Ass'n*, 362 U.S. 293, 301-02 (1960). Today, all 50 states and the District of Columbia comprehensively regulate the insurance business, establishing rules related to premiums, commissions, and the relationships among insurers, brokers, and insureds. The Second Amended Complaint makes it clear that the alleged conduct at issue — which is expressly addressed to the allocation of risk —

is fundamental to the business of insurance and is actively regulated by the states. It is, therefore, exempt from further regulation under the antitrust laws. (*See infra* pp. 27-34.)

For each of these reasons, the Second Amended Complaint should be dismissed with prejudice.

STATEMENT OF THE CASE

This lawsuit grew out of an investigation by then-New York Attorney General Eliot Spitzer and the New York Insurance Department into the practice of insurers paying contingent commissions to brokers and the adequacy of the brokers' disclosure of those commissions to their clients, which spawned similar investigations by state insurance commissioners in a number of other states. As the Second Amended Complaint reflects, these investigations produced a number of state enforcement actions, including, among others, actions brought by the New York Attorney General, many of which have been resolved through settlements that further regulate the use and disclosure of contingent commissions — but do not prohibit them. These investigations also uncovered episodic instances of alleged bid rigging, involving one office of one broker with respect to the excess casualty line of insurance.

Seeking to exploit these state insurance enforcement actions, plaintiffs filed their First Consolidated Amended Commercial Class Action Complaint ("FAC") alleging a massive industry-wide conspiracy among more than two dozen brokers and insurers in every line of commercial insurance, to pay contingent commissions (which were and are perfectly lawful) and to limit competition in all these lines of insurance. Plaintiffs alleged several "alternate" conspiracies: a single "global conspiracy," as well as multiple "broker-centered conspiracies." (*See* FAC ¶¶ 403-34, Docket No. 183 (Aug. 15, 2005).)

While discovery proceeded on this sprawling theory, defendants moved to dismiss on November 29, 2005, and on October 3, 2006, Judge Hochberg issued an opinion ruling that the

First Amended Complaint failed to state an antitrust claim. The Court concluded, with respect to the alleged "global conspiracy," that Plaintiffs had not "explain[ed] how such a large and diverse group of Defendants acted, combined or conspired as part of a single conspiracy." (Oct. 3 Op. 26.) The Court elaborated: "Plaintiffs' broad allegations sweep together more than a hundred defendants, other unnamed brokers and insurers as well as 'other entities' without alleging any facts to show that an implied or express agreement existed between the alleged conspirators." (Oct. 3 Op. 26.)

Judge Hochberg also concluded that plaintiffs' allegations of "broker-centered" conspiracies, premised on "[t]he existence of contingent commission agreements between the Broker Defendants and other insurers," merely "show[ed] that the parties engaged in a business relationship; . . . it is not, without more, an allegation that the Defendants conspired among each other in violation of the Sherman Act." (Oct. 3 Op. 29.) The Court nonetheless gave plaintiffs another chance to plead their claims by filing "Supplemental Statements of Particularity." Plaintiffs did so on October 25, 2006.

In these particularized statements, plaintiffs repackaged their earlier allegations about contingent commissions, which they now characterized as part of "strategic partnership" relationships that brokers entered into with certain insurers. Plaintiffs alleged, as before, that brokers endeavored to send business to these insurers, and they labeled that practice "market or customer allocation." Defendants moved to dismiss again, and this Court granted the motion on April 5, 2007. The Court ruled that plaintiffs had failed to state a claim for a *per se* violation of the Sherman Act, noting that the alleged strategic partnerships merely amount to "steering of business to preferred partners," rather than a conspiracy to allocate customers or markets. (Apr. 5 Op. 34.) The Court noted that the plaintiffs had alleged "some instances of bid rigging," but found that this did not support the alleged broad conspiracies based on contingent commissions and preferred provider arrangements. (Apr. 5 Op. 30.) The Court nonetheless afforded plaintiffs one last chance to replead.

Plaintiffs filed their Second Amended Complaint on May 22, 2007. That pleading, and the accompanying Revised Particularized Statement ("RPS"), allege six "broker-centered" conspiracies based on each broker's so-called strategic partnerships with varying subsets of insurer defendants. (SAC ¶¶ 85-86.) As to each such broker-centered conspiracy, the complaint alleges a "twofold" theory of purported "market allocation." First, it alleges that the participants in each conspiracy agreed that the broker would "allocate the bulk of its business" to the "conspiring insurers" in exchange for contingent commissions. (*See* SAC ¶¶ 83-86.) Second, it alleges that the insurer defendants within each broker-centered conspiracy "agreed horizontally with each other not to compete for each other's existing customers and the Broker Defendants facilitated that agreement through methods such as bid-rigging, 'last looks' and other incumbent protection devices." (SAC ¶ 67.) Finally, the Second Amended Complaint attempts to connect these broker-centered conspiracies together by alleging a "global" conspiracy. It alleges — without any hint of a factual basis — that there was also an agreement among the broker defendants, in which the insurer defendants were "complicit," to avoid competition by refraining from disclosing each other's contingent commission arrangements. (*See* SAC ¶¶ 92-93, 353-54.)

ARGUMENT

The antitrust claims in the Second Amended Complaint, as in its predecessors, sound in fraud. They are therefore subject to the heightened pleading requirements of Fed. R. Civ. P. 9(b), which requires that the conspiracy claims be pleaded with particularity. (*See* Apr. 5 Op. 15-16) ("Plaintiffs' conspiracy claims are predicated on fraud, as previously determined by the Court, and thus are subject to Fed. R. Civ. P. 9(b)."). *See also Lum v. Bank of Am.*, 361 F.3d

217, 228 (3d Cir. 2004) (emphasizing that under Rule 9(b), "*all* averments of fraud . . . shall be stated with particularity") (emphasis in original).

Plaintiffs' new pleadings do not meet that stringent standard. To the contrary, as detailed below, the Second Amended Complaint does not state an antitrust claim even under the more liberal standards of Fed. R. Civ. P. 8(a).

I. The Second Amended Complaint Does Not Allege Facts Sufficient To Support Its Conclusory Allegations Of Multiple Horizontal Conspiracies.

As the Court held in dismissing the First Amended Complaint, in order to allege a *per se* unlawful naked restraint of trade, plaintiffs must first allege a horizontal conspiracy among competitors. (*See* Apr. 5 Op. 28.) While the Court found, applying *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957), that the plaintiffs had pleaded facts that might show "the possible existence of a horizontal relationship among the defendant insurers," it dismissed the antitrust claims in plaintiffs' First Amended Complaint because plaintiffs had "not shown that the insurers colluded to allocate business." (Apr. 5 Op. 31.) The Second Amended Complaint suffers from this same fatal flaw.

Any uncertainty as to what plaintiffs must plead to allege an unlawful horizontal conspiracy was eliminated by the Supreme Court's recent decision in *Bell Atlantic Corp. v. Twombly*, 127 S. Ct. 1955 (2007). In that decision, the Supreme Court held that the pleading standard articulated in *Conley v. Gibson* — that "a complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief" — has "earned its retirement." *Twombly,* 127 S. Ct. at 1969. Given the high cost and heavy burden of discovery in antitrust cases — well illustrated by this proceeding — the Court held that an antitrust complaint, in order to survive a motion to dismiss, must allege "enough facts to raise a reasonable expectation that discovery will reveal evidence of *illegal* agreement." *Id.* at 1965 (emphasis added).

The complaint in *Twombly*, like the Second Amended Complaint here, alleged a horizontal conspiracy to allocate markets, based on parallel conduct over a period of several years. In *Twombly*, the plaintiffs alleged that the four major incumbent local exchange telecommunications carriers ("ILECs") had acted in parallel both in not entering each other's regions and in preventing entry by new competitors. The Court found these allegations insufficient to state a claim under section 1 of the Sherman Act. *Id.* at 1962-63. Acknowledging the liberal pleading standards of Fed. R. Civ. P. 8(a), the Court noted that even under those standards, "a plaintiff's obligation to provide the 'grounds' of his 'entitle[ment] to relief' requires more than labels and conclusions." *Id*. at 1964-65. "[A]n allegation of parallel conduct and a bare assertion of conspiracy will not suffice." *Id.* at 1966. To cross "the line between possibility and plausibility of 'entitle[ment] to relief,'" a complaint seeking to infer agreement from parallel conduct must allege facts to show some "further circumstance pointing to a meeting of the minds," not "merely parallel conduct that could just as well be independent action." *Id*. at 1965-66.

This standard was not met in *Twombly* because "nothing contained in the complaint invest[ed] either the action or inaction alleged with a plausible suggestion of conspiracy." *Id*. at 1971. As to the supposed agreement to thwart new entrants, the Court found that nothing in the complaint "intimate[d] that the resistance to the upstarts was anything more than the natural, unilateral reaction of each ILEC intent on keeping its regional dominance." *Id*. As to the supposed agreement not to invade each other's regions, the Court held that "a natural explanation for the noncompetition alleged is that the former Government-sanctioned monopolists" — who "doubtless liked the world the way it was, and surely knew the adage about him who lived by the sword" — "were sitting tight, expecting their neighbors to do the same thing." *Id.* at 1972. The Court held, therefore, that the plaintiffs' claims could not survive a motion to dismiss because they failed to allege any "plausible grounds to infer an agreement," *id.* at 1965, as opposed to simply parallel conduct that may be the result of "rational and competitive business strategy unilaterally prompted by common perceptions of the market." *Id.* at 1964.

Despite the benefit of the massive amount of discovery that plaintiffs have had to date, plaintiffs' alleged broker-centered conspiracies and their global conspiracy all fail this test. Under the standard articulated in *Twombly*, facts that show the mere "possibility" of agreement — parallel changes in business models, broker communications of this strategy to insurers, insurers' knowledge of the brokers' other partners and the terms of their agreements, one-off instances of big rigging, first or last looks for incumbent insurers, and conclusory allegations of actions against interest and motive to conspire (Apr. 5 Op. 29-30) — are not sufficient.

A. The Broker Centered Hub-and-Spoke Conspiracies Lack the Necessary Horizontal Agreement Among the Defendant Insurers Along the Rim of the Alleged Conspiracy.

To state a *per se* claim, plaintiffs must plead that the insurers involved in each alleged "hub-and-spoke" broker-centered conspiracy agreed among themselves to allocate customers. *See, e.g.*, *ABA Section of Antitrust Law, Antitrust Law Developments* 25 (6th ed. 2007) ("What makes the series of agreements an actionable conspiracy, however, is some set of facts that shows a connecting agreement among the horizontal competitors that form the spokes; this is the 'rim' of the wheel."); citing *Dickson v. Microsoft Corp.*, 309 F.3d 193, 203-04 (4th Cir. 2002) ("A rimless wheel conspiracy is one in which various defendants enter into separate agreements with a common defendant, but where the defendants have no connection with one another, other than the common defendant's involvement in each transaction . . . [however,] a wheel without a rim is not a single conspiracy."); *Spectators' Commc'n Network, Inc. v. Colonial Country Club*, 253 F.3d 215, 224 (5th Cir. 2001) (finding that plaintiffs failed to establish a hub-and-spoke conspiracy as "there must be an agreement between more than one competitor at the same level to make a horizontal restraint"). Despite nearly two years of discovery, plaintiffs still have not identified any communications reflecting any such agreement among the insurers in any of the alleged broker-centered conspiracies, nor any plausible basis to infer such an agreement under the standards the Supreme Court enunciated in *Twombly*. On the contrary, as in *Twombly*, each of the two distinct types of parallel conduct on which plaintiffs rely can be explained as a "rational and competitive business strategy unilaterally prompted by common perceptions of the market." *Twombly*, 127 S. Ct. at 1964.

Carrier consolidation. Plaintiffs' first theory of market allocation posits a horizontal agreement among the insurer defendants pursuant to which they agreed to pay contingent commissions to the brokers in exchange for the brokers consolidating the bulk of their business with those carriers. But the Second Amended Complaint alleges no facts to suggest any such agreement.

As the Second Amended Complaint concedes, it was the brokers who took the initiative in consolidating their business with this smaller number of carriers. (*See, e.g.*, SAC ¶ 203.) Once a broker decided to consolidate, it was manifestly in the independent business interest of each insurer to compete, through better service and better prices, as well as payment of contingent commissions, to be one of those select insurers. As the Second Amended Complaint acknowledges, Zurich, through its strategic partnership with Willis, "experienced a 50-60% growth rate" in a single year (SAC ¶ 276), and CNA and ACE achieved similar rates of growth. (*See* SAC ¶¶ 323-24.) As in *Twombly*, "there is no reason to infer that the [insurers] had agreed among themselves to do what was only natural," 127 S. Ct. at 1971, in seeking to grow their business by paying contingent commissions.[1]

Incumbent Protection. Plaintiffs also claim that the insurer defendants selected by each broker as its "strategic partners" agreed horizontally not to compete for each other's existing customers, and that the brokers "facilitated that agreement through methods such as bid-rigging, 'last looks' and other incumbent protection devices." (SAC ¶ 67.) However, with the sole exception of a few placement-specific instances of purported bidding misconduct, all of the conduct plaintiffs allege regarding "incumbent protection" is explained by the obvious independent economic self-interest of each individual insurer.[2] An insurer, like any other business, would rather retain existing customers than lose them. Moreover, an incumbent insurer is already familiar with the risks posed by an existing customer, which enables it to expend less money and resources to underwrite the risk. It is thus natural (and sensible) for an insurer to pay contingent commissions that reward renewal of existing accounts. *See, e.g*., 1 Bernard L. Webb et al., *Insurance Company Operations* 107-08 (3d ed. 1984) (reporting that some insurers are increasing commissions paid for renewals because switching by policyholders "increases company expenses"). Again, as in *Twombly*, "there is no reason to infer that the [insurers or brokers] had agreed among themselves to do what was only natural anyway." 127 S. Ct. at 1971.

[1] It adds nothing for plaintiffs to allege that the Defendant Brokers, in trying to negotiate higher commissions, sometimes told insurers who these brokers' other preferred providers were or what commissions they were paying. (*See, e*.g., SAC ¶ 141.) This conduct is exactly what one would expect of a distributor bargaining with a supplier for larger commissions for its services — conduct the antitrust laws protect, not prohibit. *See, e.g.*, *Hall v. United Airlines, Inc.*, 296 F. Supp. 2d 652, 665 (E.D.N.C. 2003), *aff'd*, 118 Fed. Appx. 680 (4th Cir. 2004).

[2] While the Second Amended Complaint does allege episodic instances of bid rigging, plaintiffs do not — and could not — assert a bid-rigging claim, as explained at pp. 25-27 *infra*. Nor do these allegations support plaintiffs' market allocation conspiracy claims, which are based on wide-ranging strategic provider relationships and payment of contingent commissions. (*See infra* pp. 16-19).

B. The Alleged Global Conspiracy Among the Broker Defendants Is Based On Sheer Speculation with No Factual Allegations to Support That Speculation.

The Second Amended Complaint is even more bereft of facts and logic to support its speculative allegations of a "global conspiracy" among the broker defendants to avoid competition by refraining from disclosing one another's contingent commission arrangements. *See Twombly*, 127 S. Ct. at 1965 ("Factual allegations must be enough to raise a right to relief above the speculative level.").

First, plaintiffs' new pleadings offer no specifics as to when, where, how, and by whom the alleged global conspiracy was formed. *See Twombly*, 127 S. Ct. at 1971 n.10 (stating that because "the pleadings mentioned no specific time, place or person involved in the alleged conspiracies," they would not satisfy the notice pleading requirements of Rule 8(a) since "a defendant seeking to respond to plaintiffs' conclusory allegations in the §1 context would have little idea where to begin"). This is an especially egregious omission where, as here, the defining feature of the conspiracy is an alleged agreement to refrain from disclosing information about contingent commissions to customers — conduct that sounds *wholly* in fraud. (*See supra* pp. 6-7.)

Second, to the extent the Second Amended Complaint and Revised Statement do supply details as to when each Broker Defendant moved to consolidate its markets, those details — which show that the brokers did so over a period of several years — undercut, rather than support, any inference of global conspiracy from parallel conduct. They show that Marsh began to consolidate its markets in the "early to mid 1990s," (*see* RPS ¶ 3), whereas Wells Fargo/Acordia did not begin doing so until 1997 (*see* RPS ¶ 179), and that other brokers began consolidating their markets at varying times in between. (*See* RPS ¶¶ 111, 276, 332.) This history is more indicative of interdependent conduct by firms in a concentrated industry — which is not actionable under the antitrust laws — than it is of any conspiracy. *See In re Baby Food Antitrust Litig.*, 166 F.3d 112, 131-32 (3d Cir. 1999) (time lags of 3-6 months between defendants' pricing moves, *inter alia,* "refute rather than support" allegation of conspiracy).

Third, the purported global conspiracy is inherently implausible given plaintiffs' admission in the RICO Case Statement that brokers disclosed *their own* contingent commission income to customers. (*See, e.g.*, Third RICO Statement 21-22.) It would be irrational for brokers — having disclosed their own contingent commissions — to conspire *not* to reveal that *other brokers* were receiving similar compensation. The whole premise of plaintiffs' claim is that customers would not deal with brokers who receive contingent commissions and would move all their business to brokers who do not.

Fourth, even if the brokers deliberately withheld information about their own and one another's contingent commissions, that would not be in the least suggestive of a conspiracy. Plaintiffs themselves allege that the broker defendants "knew that exposing another broker's contingent commission arrangements to the other brokers' customers would lead to retaliation." (SAC ¶ 355.) As in *Twombly*, each broker "surely knew the adage about him who lives by the sword," 127 S. Ct. at 1972, and thus recognized that it was in its own unilateral economic self-interest not to disclose other brokers' contingent commissions.[3]

[3] Indeed, according to plaintiffs, the first brokers who "consolidated their markets" were able thereby to increase their revenues and profits. If the brokerage business is concentrated as plaintiffs allege (*see* SAC ¶¶ 74-75), it would be natural for other brokers to copy this practice. *See Twombly*, 127 S. Ct. at 1964 ("[A] common reaction of 'firms in a concentrated market [that] recognize[e] their shared economic interests and their interdependence with respect to price and output decisions' is 'not in itself unlawful'") (quoting *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 227 (1993) (alterations in original)).

Finally, it adds nothing to allege, as the First Amended Complaint did and as the Second Amended Complaint does again, that defendants' "membership in the CIAB afforded them many opportunities to exchange information and . . . adopt collective policies towards nondisclosure of rival brokers' contingent commissions." (SAC ¶ 364.) As Judge Hochberg ruled, "Plaintiffs' general assertions that the Defendants have communicated and shared information through various trade groups and conferences" are insufficient to support any inference of "actual concert of action." (Oct. 3 Op. 26-27.)[4]

In summary, accepting as true plaintiffs' allegations that brokers each steered insurance business to selected carriers in return for payments of contingent commissions, those allegations amount — as before — to nothing more than parallel conduct that may be, at best, "consistent with conspiracy, but just as much in line with a wide swath of rational and competitive strategy unilaterally prompted by common perceptions of the market." *Twombly*, 127 S. Ct. at 1964. After reviewing millions of pages of defendants' documents and taking hundreds of depositions, plaintiffs are no closer to "nudg[ing] their claims [of conspiracy] across the line from the conceivable to the plausible." *Id*. at 1974. The Second Amended Complaint should, therefore, be dismissed.

II. Plaintiffs Have Not Alleged Naked Restraints That Support a *Per Se* Claim.

As before, plaintiffs continue to pursue only a *per se* theory of liability, as evidenced by their repeated incantation of the phrase "naked restraint" and their failure to plead the elements

[4] *See also Twombly*, 127 S. Ct. at 1971 n.12 (noting that Adam Smith would likely be "surprised to learn" that belonging to the same trade guild could "force his famous pinmaker . . . to hire lawyers, prepare for depositions, and otherwise fend off allegations of conspiracy" if he charged the same prices as his fellow guild members).

of a rule of reason claim.[5] But the Second Amended Complaint — even if it adequately alleged a horizontal agreement, which it does not — fails to allege an agreement amounting to a naked restraint of the type necessary to sustain a *per se* claim. (*See, e.g.*, SAC ¶¶ 64, 69, 93.)

Naked restraints are those with "no purpose except stifling of competition." *Palmer v. BRG of Ga., Inc.*, 498 U.S. 46, 49 (1990); *White Motor Co. v. United States*, 372 U.S. 253, 263 (1963). Professors Areeda and Hovenkamp "define a particular horizontal agreement as 'naked' if it is formed with the objectively intended purpose or likely effect of increasing price or decreasing marketwide output in the short run . . . ." 11 Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* 1906a (2006). The courts have emphasized, therefore, that, "as a general matter, the per se rule should be invoked only on the strength of unambiguous judicial experience demonstrating that particular conduct is a naked restraint of trade with no purpose except stifling of competition." *ABA Section of Antitrust Law, Antitrust Law Developments* 51 (6th ed. 2007) (internal quotation marks and citation omitted); *see also Evans v. S. S. Kresge Co.*, 544 F.2d 1184, 1191 (3d Cir. 1976) (same).

The conduct alleged in the Second Amended Complaint does not come close to this definition. While plaintiffs *assert* that the alleged conspiracies constituted "market allocation" schemes, the *facts* alleged do not establish a plausible "plan or scheme to divide the market among the alleged conspirators in some unlawful manner." (April 5 Op. 31.) Nor do those facts establish any form of naked restraint. Instead, the actual conduct plaintiffs allege consists of a variety of practices — such as the development of strategic partnerships with insurers and the

[5] To state a rule of reason claim, plaintiffs would, at a minimum, need to define a relevant product and geographic market in which the alleged restraint allegedly injured competition. *See Queen City Pizza, Inc. v. Domino's Pizza, Inc.*, 124 F.3d 430, 436-41 (3d Cir. 1997) (dismissing rule of reason claim for failure to allege relevant market). In their Second Amended Complaint, plaintiffs make no effort to do so.

use of "last looks" and other bidding-related practices that allegedly favor incumbents — that are, on their face, potentially procompetitive. *See Broadcast Music, Inc. v. CBS*, 441 U.S. 1, 19-20 (1979) (to be *per se* illegal a practice must "facially appear[] to be one that would always or almost always tend to restrict competition," rather than "one designed to increase economic efficiency and render markets more, rather than less, competitive") (internal quotation marks and citation omitted). While the Second Amended Complaint contains allegations about episodic instances of bid-rigging, plaintiffs have repeatedly renounced any bid-rigging claim, and their allegations do not state such a claim in any case.

A. Plaintiffs Have Not Alleged A Plausible Market Allocation Method.

As the Court explained in its April 5 decision dismissing the First Amended Complaint, "the essence of a market allocation violation . . . is that competitors apportion the market among themselves and cease competing in another's territory or for another's customers." (Apr. 5 Op. 19 (quoting *Mid-West Underground Storage, Inc. v. Porter*, 717 F.2d 493, 497 (10th Cir. 1983).) In their Second Amended Complaint, plaintiffs seek to meet this requirement by asserting that five of the six purported broker-centered allocation conspiracies operated as "incumbent protection" schemes,[6] in which the insurer defendants supposedly "agreed horizontally with each other not to compete for each other's existing customers and the Broker Defendants facilitated that agreement through methods such as bid-rigging, 'last looks' and other incumbent protection devices." (SAC ¶ 67.) But the facts they allege do not establish a plausible method of customer or market allocation and, indeed, refute any contention that insurers ceased competing for one another's customers.

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[6] *See* SAC ¶¶ 114, 158, 217, 265, 335. No such allegations are made as to HRH.

First, plaintiffs allege generally that "[t]he method by which premium was allocated among the participants in each Broker-Centered Conspiracy was *loosely determined by the structure and content of the contingent commission agreements* executed by the parties," (SAC ¶ 87 (emphasis added)), and their factual allegations demonstrate crucial variations among contingent commission agreements refute any claim of an incumbent protection conspiracy — and in fact make it implausible they could have been used by insurers to allocate business among themselves on any basis.[7] As the Second Amended Complaint shows, some contingent commission agreements were based on renewal business, while others were based on total volume or on growth, with different agreements having different payment thresholds and commission rates, all of which changed over time. (*See, e.g.*, SAC ¶¶ 78-79, 87, 140, 207.)

These variations created multiple, conflicting incentives that naturally caused brokers in some cases to seek to place risks with the incumbent, but in other cases to try to move clients from one strategic partner to another.[8] The Second Amended Complaint alleges, for example, that Marsh "steered business to Chubb" from Zurich (SAC ¶ 132), both of whom allegedly were "participants in the Marsh Broker-Centered Conspiracy." (SAC ¶ 95.) Similarly, plaintiffs allege that Marsh "steered business to Hartford" because Marsh was just below its growth threshold and

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[7] Indeed, plaintiffs' failure to allege any method of allocation further undermines the existence of any plausible horizontal agreement among competitors (*see supra* pp. 16-19). In *Twombly*, the method of allocation — allegedly dividing customers by geographic territories — was at least clear and thus there was some identifiable purpose behind the posited horizontal agreement. Here, given the absence of any method of allocation, there is no identifiable purpose for any alleged agreement among insurers.

[8] For example, a broker may be compensated for placing a policy with an incumbent insurer who pays a contingent commission based on renewal volume at a given rate and above a specified threshold, or a competing insurer who pays a contingent commission based on the volume of new business, at a higher rate but with a lower threshold. (*See, e.g.*, SAC ¶ 131 (quoting Marsh employee stating that "[*s*]*ome PSAs are better than others*"), 194 (Aon explaining "[w]e went to them because our agreement is more favorable.").)

would "get an extra point on all business" above that threshold. (SAC ¶ 132.) Far from establishing an "incumbent protection" conspiracy — or *any* plausible method of market allocation — these allegations show that insurers used contingent commissions to compete with one another for the services of brokers. To the extent that contingent commission agreements may have created incentives for individual brokers to steer business to insurers offering them the most lucrative commissions, this Court has already held that such "steering" allegations do not constitute "a horizontal conspiracy to allocate the market." (Apr. 5 Op. 32.)[9]

Second, plaintiffs' allegations that brokers used "last looks" and various other purported "incumbent protection devices" to shield insurers from competition for their existing accounts are logically inconsistent with there having been an agreement among the insurers not to compete for each other's existing business. If there were such an agreement among insurers, and it were therefore preordained that the incumbent would retain its accounts without facing competition, there would be no need to point to "last looks" or "first looks," the entire purpose of which is to promote competition between an incumbent and other insurers bidding for the business of its existing policyholders. As plaintiffs acknowledge, the practice of giving "last looks" gives an incumbent insurer an opportunity *to submit a quote that offers a lower price or better terms* than quotes submitted by non-incumbent insurers. (*See* SAC ¶ 337 ("insurers were able to review the other bids of other carriers and bid to retain the business . . . .").)

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[9] Nor is there any merit to plaintiffs' conclusory allegations that volume thresholds in contingent commission agreements effectively "guarantee[d] the delivery of a specified minimum amount of premium volume." (SAC ¶ 130; *see also* SAC ¶ 171.) By their very nature, payments made under contingent commission agreements are "contingent" upon the broker meeting specified thresholds. (*See* SAC ¶¶ 77-78.) Plaintiffs' allegation that an insurer may have anticipated that a broker would succeed in meeting the minimum threshold in a contingent commission agreement (*see, e.g.*, SAC ¶ 130) is speculative, does not resolve conflicting incentives, and provides no "method of allocation" among insurers that this Court required to state a market allocation claim.

Finally, plaintiffs' assertion of a market allocation scheme is directly contradicted by multiple factual allegations in the Second Amended Complaint and Revised Particularized Statement that show insurers that were purportedly members of a "strategic partnership" with the same broker vigorously competing with one another for the business of that broker's clients. In one example, plaintiffs quote an Aon document reporting that the competition between two of its insurer "partners" — Chubb and St. Paul — had become so heated that one was "screaming loudly" that it had not been given "an equal opportunity" to compete for a particular placement. (RPS ¶ 141.) Similarly, in another internal memorandum, a Hartford executive is quoted as urging his colleagues to "get there first!" because they would "be competing with Travelers [for Acordia's small business customers]." (RPS ¶ 205.) In yet another document quoted by plaintiffs, a Crum & Forster executive emphasized the importance of a "new business incentive" in "generating opportunities" to win Willis clients away from Zurich, another alleged member of the Willis broker-centered conspiracy. (RPS ¶ 370.)

In the end, plaintiffs still have not identified any mechanism by which a broker supposedly allocated insureds among the many carriers on its preferred list that paid contingent commissions,[10] nor have plaintiffs explained why it would make economic sense for insurers to give brokers the power to decide which risks each carrier must insure. Plaintiffs continue to rely on the same theories of market allocation as before, and the Second Amended Complaint does nothing to correct the insufficiency of their earlier complaints.

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[10] For example, plaintiffs allege that Marsh had 13 carriers on its preferred list paying contingent commissions (SAC ¶ 96), but never explain how Marsh decided which carrier would receive which client. Similarly, plaintiffs allege that HRH allocated only 35% of its clients to three carriers (SAC ¶¶ 237, 253), without explaining how, nor do they explain what happened to the other 65%. Finally, plaintiffs do not explain how Wells Fargo divided clients between the 5 carriers, "among other[s]," on its preferred list. (SAC ¶¶ 207, 224.)

B. The Alleged Conduct Does Not Constitute a Naked Restraint of Trade.

Unable to allege a coherent horizontal market allocation, plaintiffs seek to characterize the brokers' strategic partnership arrangements as *per se* unlawful allocation agreements by declaring those arrangements to be "naked restraints of trade." (*See, e.g.*, SAC ¶ 64.) Like the "allocation" label, however, this label, too, simply does not fit the conduct alleged.

As explained above, "the per se rule should be invoked only on the strength of unambiguous judicial experience demonstrating that particular conduct is a naked restraint of trade with no purpose except stifling of competition." *ABA Section of Antitrust Law, Antitrust Law Developments* 51 (6th ed. 2007); *see also Evans*, 544 F.2d at 1191 (same).

The conduct alleged in the Second Amended Complaint does not come close to this definition. To the contrary, plaintiffs continue to allege a variety of practices that, on their face, are potentially procompetitive. These practices — the development of strategic partnerships with insurers and the use of "last looks" and other bidding-related practices that allegedly favor incumbents — therefore cannot be condemned as naked horizontal restraints.

1. Strategic Partnerships Are Not Naked Restraints.

Despite plaintiffs' repeated assertions to the contrary, "strategic partnerships" between individual brokers and their "preferred" insurance carriers are not naked restraints of trade. According to plaintiffs, these strategic partnerships reflect agreements between the "preferred" insurers that the *broker* would consolidate its business by "directing" some portion of its premium volume to them. (SAC ¶¶ 66, 96, 158, 202, 237, 264, 327.) But, as both the Second Amended Complaint and Supplemental Statement show, there are many legitimate procompetitive business reasons for a broker to seek to consolidate its business with a smaller, more manageable number of insurers.

The Second Amended Complaint alleges, for example, that individual brokers began to form strategic partnerships with certain insurers "[i]nstead of shopping their clients' business to 30 or 40 different insurance companies or more…." (SAC ¶ 83.) On its face, reducing the costs associated with marketing a client's business to as many as 40 insurers could result in significant savings for a broker and its clients. As a 2004 Aon business plan quoted in the complaint explains, "Our strategy in middle market is to create a condensed group of markets that can handle 80-90 percent of our business *obtaining cost efficiencies in dealing in this market segment*." (SAC ¶ 167 (emphasis added).)[11] The possibility of such efficiencies is fatal to a claim of a *per se* violation. *See Nw. Wholesale Stationers v. Pac. Stationary & Printing Co.*, 472 U.S. 284, 294 (1985) (*Per se* illegal restraints are those that cannot be "justified by plausible arguments that they were intended to enhance overall efficiency and make markets more competitive.").

The Second Amended Complaint also alleges that, in forming these strategic partnerships, several brokers created specialized divisions to manage the placement of insurance in a "focused, centralized, and organized manner" (SAC ¶ 98 (discussing Marsh's Global Broking unit)) and to "improve revenue management [and achieve] greater market leverage" (SAC ¶ 162 (discussing Aon's Syndication Group)).[12] Needless to say, improved organizational efficiency and increased leverage in negotiating with insurers are both legitimate business objectives, which contradict plaintiffs' hollow claim that the strategic partnerships were naked

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[11] *See also* SAC ¶ 162 (quoting Aon documents stating that purpose was "to drive further market consolidation to achieve . . . improved revenue management . . . [and] greater market leverage") (ellipses and brackets in original). These goals make perfect sense.

[12] *See also* SAC ¶¶ 206 (Wells Fargo/Acordia implemented a "'Millennium Partnership Program' in order to 'leverage [its] major [insurer] relationships.'") (alteration in original), 269 (Willis document suggesting that "leverage can only be maximized by 'Partnering' with a select number of carriers").

restraints. *Cf. Westchester Radiological Assocs. P.C. v. Empire Blue Cross & Blue Shield, Inc.*, 707 F. Supp. 708, 710-11 (S.D.N.Y. 1989) (alleged restraint "not clearly anticompetitive" and may have been "necessary to achieve a procompetitive result" where Blue Cross "produce[d] lower prices for consumers by using its bargaining power to purchase radiology services as part of a bundle of hospital services").[13]

In their effort to make these routine strategic partnerships appear unlawful, plaintiffs point to instances where brokers engaged in what they call "book-rolls" and "share-shifts" to shift policyholders from one insurer to another. (SAC ¶¶ 218-21, 277-81, 286-87; RPS ¶¶ 202-10, 356-61, 369-71.) But these practices, too, can be beneficial to policyholders, and thus cannot be characterized as *per se* antitrust violations. For example, when an insurer's financial strength becomes an issue, brokers may need to swiftly rewrite the policies of many clients to ensure their claims are paid.[14] The so-called "book rolls" and "share-shifts" described by plaintiffs involving

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[13] Plaintiffs have scrubbed their Second Amended Complaint and Revised Particularized Statement to eliminate many of the factual allegations from prior pleadings that demonstrate the potential procompetitive aspects of, and cost reductions associated with, strategic partnerships. (*See, e.g.*, October 25, 2006 Supplemental Statement of Particularity ¶¶ 11 ("soft market conditions" made it "unprofitable" to deal with a large number of insurers), 12 (alleging that "[t]he time required to competitively bid their clients' insurance needs in a fragmented market with numerous supply outlets . . . was a major component of the brokers' labor overhead"), 122 (Strategic partnership agreements enabled the brokers to reduce these costs by "'focus[ing] large, high quality premium streams at select, financially secure and highly rated carriers.'") (quoting MARSH-MDL 008731736), 547 (Brokers looked to create "additional economic value … through expense reduction created by structural change."), 589 (quoting an HRH document as saying that "[d]oing more business with fewer carriers will . . . add efficiency to our operations").) However, "[w]hen leave to amend is granted, the allegations in the original pleading continue to constitute binding judicial admissions of a party." *Gerlach v. Volvo Cars of N. Am.*, No. 96-CV-1476, 1997 WL 129004, at *4 n.2 (E.D. Pa. March 17, 1997). Plaintiffs' belated attempt to walk away from obviously true statements in documents they themselves cited does not make those statements any less meaningful in determining whether defendants' alleged conduct amounted to naked restraints of trade.

[14] A broker may also move certain accounts to an insurer if that insurer offers an additional benefit or cost-saving efficiency, such as a service center. (*See, e.g.*, RPS ¶ 207.)

the Kemper accounts illustrate this point. (RPS ¶¶ 208-10.) Quickly and efficiently removing policies from a failing insurer to a financially responsible insurer, which accepts the risks — here, the St. Paul Companies — benefits the policyholder. (RPS ¶ 208-09.) Again, therefore, these practices cannot be said to have "no purpose except stifling competition." *Palmer*, 498 U.S. at 49.

In short, the strategic partnerships alleged here are akin to the "preferred provider" arrangements that are common throughout the economy. These arrangements have consistently been held not to be *per se* illegal, but to require evaluation under the rule of reason because of their potential procompetitive effects. *See, e.g.*, *Stop & Shop Supermarket Co. v. Blue Cross & Blue Shield of R.I.*, 373 F.3d 57, 62 (1st Cir. 2004) (affirming district court's determination that health insurer's "closed network" agreement with pharmacy chains for prescription reimbursement was not a *per se* violation of the antitrust laws); *Med. Arts Pharmacy of Stamford, Inc. v. Blue Cross & Blue Shield of Conn., Inc.*, 675 F.2d 502, 505 (2d Cir. 1982) ("Blue Cross pharmacy agreements are novel restraints with potential procompetitive effects, and therefore must be analyzed under the rule of reason."); *Quality Auto Body, Inc. v. Allstate Ins. Co.*, 660 F.2d 1195, 1202-03 (7th Cir. 1981) (holding that *per se* analysis not appropriate for claim challenging insurance companies' "preferred list" of auto repair shops).[15]

[15] The potential procompetitive effects of arrangements like these are well recognized in the economics literature. *See generally* Joshua D. Wright, *Antitrust Law and Competition for Distribution*, 23 Yale J. on Reg. 169, 178-79 (2006) (explaining that payments from manufacturers to distributors inure to the benefit of consumers); Benjamin Klein, *Exclusive Dealing as Competition for Distribution "On the Merits"*, 12 Geo. Mason L. Rev. 119, 120 (2003) ("[C]ompetition for distribution is . . . an important part of the normal competitive process that benefits consumers.").

2. The Alleged Incumbent Protection Practices Are Not Naked Restraints.

Similarly, none of the purported "incumbent protection" practices alleged in the Second Amended complaint, such as "last looks" and "first looks" (*see, e.g.*, SAC ¶¶ 67, 88, 169, 221, 281, 337) qualifies as a naked restraint of trade with no purpose other than to stifle competition. In each case, these practices may serve to enhance, not stifle, competition.

Permitting an insurer a last look — or last opportunity — to retain existing business is not a "restraint" in any meaningful sense, and certainly not one that will necessarily increase prices or decrease output. Although plaintiffs generally assert that last looks enable insurers to submit bids "without having to provide their best, most competitive prices," plaintiffs do not allege a single fact to support that conclusory allegation. (*See* SAC ¶ 337.) Nor could they. The practice of giving incumbents a last look plainly benefits policyholders in several ways. Most important, a last look gives the incumbent insurer an opportunity to match or beat the best competitive price the broker can obtain from other insurers, enabling policyholders to obtain competitive prices and avoid the heavy costs associated with switching from one carrier to another. Staying with one insurer for a longer period can also benefit a policyholder by allowing that insurer to gain greater experience with the risks of the individual insured, thereby enabling the insurer to price the policyholder's risks more accurately and to service its claims more efficiently. In light of these potential benefits to policyholders, agreements between insurers and brokers to adopt such a practice cannot be condemned as a naked restraint.

The practice of giving certain insurers "first looks" at new or renewal business (*see, e.g.*, SAC ¶¶ 88, 171, 337) or of providing information to one insurer about another insurer's bids (*see, e.g.*, SAC ¶¶ 88, 169, 337, 396) can likewise promote competition. For example, providing a first look may give an incumbent insurer an opportunity to provide an initial bid that meets the customer's expectations, thereby saving the insurer, the broker, and the customer the time, expense, and uncertainty associated with soliciting bids from other insurers. Similarly, providing information to one insurer about another insurer's bids has the potential to stimulate competition by giving insurers information they can use to meet or beat their competitors' bids. Because these practices have potential procompetitive effects and are not inherently likely to increase prices or reduce output, they are not naked restraints "with no purpose except stifling of competition." *Palmer*, 498 U.S. at 49.

Courts have consistently held, for these reasons, that giving suppliers a first or last look is neither *per se* illegal nor anticompetitive under the rule of reason. *See, e.g.*, *Sitkin Smelting & Refining Co. v. FMC Corp.*, 575 F.2d 440, 447-48 (3d Cir. 1978) (secret agreement to give one bidder a last opportunity to match the best price is neither *per se* illegal nor anticompetitive under the rule of reason); *accord*, *Allied Erecting & Dismantling, Co. v. USX Corp.*, 249 F.3d 191, 198 (3d Cir. 2001) (Last looks are a "desire to find the market price rather than influence the market price" and do not violate the Sherman Act.) (internal citations omitted); *Satellite Fin. Planning Corp. v. First Nat'l Bank of Wilmington*, 633 F. Supp. 386, 397 (D. Del. 1986) (finding that right to first look at credit applications was not anticompetitive conduct).[16]

Although the Second Amended Complaint, like its predecessors, contains scattered allegations of bid rigging with respect to specific placements, mostly involving one office of one broker (Marsh) and one line of insurance (excess casualty), those allegations do not establish a *per se* illegal market allocation conspiracy. As a threshold matter, plaintiffs are not attempting to

[16] Nor would the alleged practice of certain brokers giving their preferred insurers a "right of first refusal" (*see, e.g.*, SAC ¶ 101) be *per se* illegal. *See Ohio-Sealy Mattress Mfg. Co. v. Sealy, Inc.*, 585 F.2d 821, 829 (7th Cir. 1978) (a right of first refusal is "a contract term inoffensive in itself" under the antitrust laws).

allege a bid-rigging conspiracy, as they have made clear in each of their complaints and in repeated representations to this Court.[17] Nor could they state such a claim if they wished to — either within excess casualty or beyond — because they provide none of the required specifics identifying the alleged bids that were rigged or the victims of any allegedly rigged bids, and none of the plaintiffs has standing to pursue any claim for bid rigging in any case.[18]

Thus, while the Second Amended Complaint includes one count (Count II) that is limited to excess casualty placements by Marsh, that count expressly alleges a market allocation conspiracy and is no more predicated on bid-rigging than plaintiffs' equally implausible broader conspiracies. This count is virtually identical to plaintiffs' flawed market allocation claim involving all lines of commercial insurance — the *only* difference being that it is limited to one broker and excess casualty — and it fails for all the same reasons that the broader claim fails. In fact, there is no allegation that the alleged "excess casualty conspiracy" functioned any differently from the alleged conspiracies involving vertical strategic partnerships in all commercial insurance — indeed, there are no factual allegations about a Marsh excess casualty conspiracy at all, just the conclusory count that is identical in language to the other counts.

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[17] *See, e.g.*, Letter from B. Clobes and E. Kallas to Hon. Faith S. Hochberg (Aug. 24, 2006) (stating that plaintiffs "do not allege that defendants are liable under the antitrust laws because they engaged in 'bid rigging'"); Hr'g Tr. 36, Nov. 6, 2006 (plaintiffs' "theory remains unchanged.") The Second Amended Complaint alleges no class of bid-rigging victims, and the only damages alleged – increases in premiums due to contingent commission payments – are unrelated to bid-rigging. (SAC ¶¶ 369-72, 551). Indeed, even Count II refers to a "Marsh Broker-Centered Conspiracy," which is defined as a conspiracy to allocate markets through contingent commission payments. (SAC ¶¶ 65-68, 98).

[18] Only plaintiffs who allege that they were victims of bid rigging have standing assert a claim on behalf of themselves or a class. *See Lewis v. Casey*, 518 U.S. 343, 357 (1996); *see also Warth v. Seldin*, 422 U.S. 490, 502-05 (1975) (affirming dismissal of complaint for lack of standing because named plaintiffs could not show injury to "themselves personally"). Because plaintiffs do not claim that they themselves participated in a placement that involved an allegedly rigged bid, they lack standing to assert a claim directed at such purported misconduct.

Far from pursuing a bid-rigging claim, plaintiffs cite episodic instances of bid rigging *only* as part of a broader market allocation scheme supposedly tied to contingent commissions and preferred provider arrangements (*see, e.g.*, SAC ¶ 67), an extrapolation that this Court has already rejected. (*See* Apr. 5 Op. 30-31.) But those alleged instances of bid-rigging go no further now than they ever did before to support the broad conspiracy plaintiffs insist on pursuing. Indeed, even under the standard established by *Twombly*, plaintiffs' bid-rigging allegations fail to provide any conceivable, much less "plausible," basis to infer the alleged horizontal contingent-commission-centered market allocation conspiracy plaintiffs allege. *See* 127 S. Ct. at 1965.

III. Plaintiffs' Claims Are Barred By The McCarran-Ferguson Act.

The McCarran-Ferguson Act, enacted in 1945, embodies Congress's determination to free the states to regulate insurance without interference from the federal antitrust laws. As the Supreme Court has explained, "a basic motivating policy behind the legislative movement that culminated in the enactment of the McCarran-Ferguson Act . . . was that the States were in close proximity to the people affected by the insurance business and, therefore, were in a better position to regulate that business than the Federal Government." *FTC v. Travelers Health Ass'n*, 362 U.S. 293, 301-02 (1960). Today, all 50 states and the District of Columbia comprehensively regulate the insurance business, establishing rules related to premiums, commissions, and the relationships among insurers, brokers, and insureds.[19]

[19] *See, e.g.*, ARIZ. REV. STAT. ANN. §§ 20-441 to 20-469 (2007); CAL. INS. CODE §§ 790 to 790.15 (West 2007); CONN. GEN. STAT. ANN. §§ 38a-815 to 38a-819 (2007); DEL. CODE ANN. tit. 18, §§ 2301 to 2318 (2007); FLA. STAT. ANN. §§ 626.951 to 626.99 (West 2007); 215 ILL. COMP. STAT. ANN. §§ 5/421 to 5/434 (West 2007); LA. REV. STAT. ANN. §§ 22:1211 to 22:1220 (2007); MD. CODE ANN., INS. §§ 27-101 to 27-213 (West 2007); MASS. GEN. LAWS ch. 176D, §§ 1 to 14 (West 2007); MICH. COMP. LAWS ANN. §§ 500.2001 to 500.2093 (West 2007); N.J. REV.

The Second Amended Complaint is more clear that plaintiffs' federal antitrust claims are barred by the McCarran-Ferguson Act, which exempts from scrutiny under the federal antitrust laws all conduct that (i) is part of the "business of insurance," (ii) is regulated by state law, and (iii) does not constitute a "boycott, coercion, or intimidation." 15 U.S.C. §§ 1011-15 (West 2007).[20] Courts routinely dismiss under the McCarran-Ferguson Act antitrust claims virtually indistinguishable from those asserted here. As the Third Circuit has observed, "there is nothing more basically 'insurance' than the sale of an insurance contract." *Sabo v. Metro. Life Ins. Co.*, 137 F.3d 185, 191 (3d Cir. 1998) (harassment of insurance agents to effectuate a fraudulent insurance "churning scheme" concerns business of insurance).

In Judge Hochberg's October 3, 2006, Opinion on defendants' motions to dismiss the First Consolidated Amended Commercial Complaint, the Court concluded that the McCarran-Ferguson Act did not apply to the conduct alleged. The Court found that the practices alleged in that complaint did not constitute the "business of insurance" because they were not sufficiently "related to risk-allocation." (Oct. 3 Op. 19.) Since that time, however, plaintiffs have gone

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STAT. ANN. §§ 17:1-1 to 17:1-28 (West 2007); N.Y. INS. LAW §§ 2401 to 2409; 2602 to 2612 (McKinney 2007); and TENN. CODE ANN. §§ 56-8-101 to 56-8-119 (West 2007).

[20] Section 1012(b) of the McCarran-Ferguson Act provides that:

> No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee of tax upon such business, unless such Act specifically relates to the business of insurance; *Provided*, that after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended [15 U.S.C.A. 41 *et seq.*], shall be applicable to the business of insurance to the extent that such business is not regulated by State law.

15 U.S.C. § 1012(b) (emphasis in original). Section 1013(b) provides that: "Nothing contained in the Chapter shall render the said Sherman Act inapplicable to any agreement to boycott, coerce, or intimidate, or act of boycott, coercion, or intimidation." § 1013(b).

through two iterations of the complaint, and their Second Amended Complaint now leaves no doubt that risk-allocation is at the very core of their allegations. As detailed below, the allegations in the Second Amended Complaint more than satisfy the three requirements for application of the McCarran-Ferguson Act.

A. The Alleged Conduct Is the "Business of Insurance."

The Second Amended Complaint dispels any doubt that the challenged conduct involves the business of insurance under the three-part test the Supreme Court adopted in *Union Labor Life Insurance Co. v. Pireno*, 458 U.S. 119, 129 (1982), which asks whether the conduct: (1) has the effect of transferring or spreading a policyholder's risk; (2) is an integral part of the policy relationship between insurer and insured; and (3) is limited to entities within the insurance industry.[21]

First, it is plain from the face of the Second Amended Complaint that the alleged practices "ha[ve] the effect of transferring or spreading a policyholder's risk." As plaintiffs acknowledge, "the fundamental nature of the contract between the insured and the insurer" consists of "the insured pay[ing] a premium to transfer the risk defined in the policy to the insurer." (SAC ¶ 71.) This concession is critical because their entire claim rests on the premise that the conduct they allege constitutes the "method by which premium volume" — and therefore the risk transferred by payment of those premiums — "was allocated among" insurers. (SAC ¶ 87.) This, of course, is the essence of "transferring or spreading a policyholder's risk." *Pireno*, 458 U.S. at 129. Moreover, plaintiffs claim that the alleged conspiracy inflated the premiums they paid for insurance, and "it is axiomatic that the fixing of rates is central to transferring and

[21] None of these criteria is dispositive in itself, nor need all of them be satisfied for conduct to be part of the business of insurance. *Id.*

spreading the insurance risk." *Slagle v. ITT Hartford*, 102 F.3d 494, 498 (11th Cir. 1996) (citing *In re Workers' Comp. Ins. Antitrust Litig.*, 867 F.2d 1552, 1556 (8th Cir. 1989)).[22]

As the Supreme Court has recognized, the difficulty of "underwrit[ing] risk in an informed and responsible way" is at the core of "spreading of risk." *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205, 221 (1979) (recognizing that Congress's "primary concern" in enacting McCarran-Ferguson was insurers' potential inability to "underwrite risks accurately" without cooperation). One function of an insurance broker is to facilitate information exchange between insurers and insureds, thereby improving the accuracy of underwriting and the appropriate matching of risk with risk appetite.[23] As plaintiffs acknowledge, "brokers serve a critical intermediary function in the commercial insurance marketplace, matching their clients — insurance purchasers — with sellers, the insurers," and providing such services as "analyzing the client's risk, assessing the type of insurance needed, comparing and interpreting policies and, importantly, providing unbiased, sound and accurate advice regarding the insurance marketplace and the insurers they recommend." (SAC ¶ 72.) For complex risks especially, broker-provided information can allow insurers to underwrite based on

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[22] *See SEC v. Nat'l Sec., Inc.*, 393 U.S. 453, 460 (1969) ("Certainly the fixing of rates is part of this business [of insurance]."); *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205, 212-13 (1979) (recognizing "the significance of underwriting or spreading of risk as an indispensable characteristic of insurance"); *German Alliance Ins. Co. v. Lewis*, 233 U.S. 389, 412 (1914) ("The effect of insurance — indeed, it has been said to be its fundamental object — is to distribute the loss over as wide an area as possible.").

[23] *See, e.g.*, Lauren Regan & Sharon Tennyson, *Agent Discretion and the Choice of Insurance Marketing System*, 39 J. L. & Econ. 637, 646 (1996) (Contingent commissions "assure[] that the agent's financial reward for each policy sold is directly related to that of the insurer . . . provid[ing] the agent with an incentive to obtain information which yields correct placement of applicants with insurers.").

insured-specific data or observations, rather than relying on historic losses for an industry class.[24] In addition, plaintiffs also allege that "[t]he insurers are . . . largely dependant on the largest brokers to assure access to business." (SAC ¶ 76.)

Controlling access to risk, by controlling access to policy holders, by definition implicates the "transfer of risk characteristic of insurance." *Pireno*, 458 U.S. at 130; *see also id.* at 128 n.7 ("[I]nsurance is an arrangement for transferring and distributing risk.") (internal citations omitted). Plaintiffs' allegations that policyholder-broker-insurer relationships were corrupted through illegal market allocation and steering therefore go to the very core of the business of insurance. *See, e.g.*, *Owens v. Aetna Life & Cas. Co.*, 654 F.2d 218, 225-26 (3d Cir. 1981) (insurance brokering pertains to "risk spreading" and is part of the business of insurance).

If, as plaintiffs allege, brokers' consolidation of their business with a manageable number of insurers was driven by a desire to increase their depth of experience with their partner-carriers (*see, e.g.*, SAC ¶¶ 98, 167), then the focused attention and repetition would give brokers greater understanding of key insurers' claims and service histories and risk appetites, enabling them to service their clients' insurance needs more effectively. As discussed in Part II(B)(2) *supra*, this is potentially procompetitive conduct, the regulation of which Congress, in enacting the McCarran-Ferguson Act, sought to leave to state insurance commissions, rather than the federal

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[24] *See id.* at 639 ("[Agents] frequently play an important role in applicant risk assessment. The agent is the first contact the insurer has with a potential policyholder and may be able to obtain information which would be difficult or costly for the firm to verify . . . The agent's information may be used by the insurer in the decision regarding whether to insure, or under what conditions to insure, an applicant.").

courts. *Royal Drug*, 440 U.S. at 221 ("[I]t is very difficult to underwrite risks in an informed and responsible way without intra-industry cooperation").[25]

Second, because the challenged practices involve the payment of contingent commissions to brokers, the practices are integral to the policy relationship between insurers and insureds. *See J.J. White, Inc. v. William A. Graham Co.*, No. 96-6131, 1997 WL 134896, at *2 (E.D. Pa. Mar. 17, 1997) ("Because the broker serves as an intermediary between the insurer and a policyholder, and because a broker will not serve without pay, compensation for brokering is an integral part of the relationship between the insurer and the policyholder."). Likewise, allegations regarding "sale[s] and marketing" of insurance "strike at the insurance business 'core'…because they directly impact on the sales of insurance policies and ultimately affect the relationship between insurer and insured." *Sabo*, 137 F.3d at 191.[26]

Finally, the alleged conduct is limited to entities within the insurance industry. *Pireno*, 458 U.S. at 129. The alleged victims (policyholders) and the alleged co-conspirators (insurers and brokers) are all participants in that industry.

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[25] The same is true of the so-called "incumbent protection devices" plaintiffs allege, such as "last looks," "first looks," and the like. Again, as discussed at pp. 24-26 *supra*, these practices have the potential to benefit policyholders by enabling brokers to use their bargaining leverage with the insurers with whom they have strategic partnership relationships to get those insurers to match competitive quotes they receive from other carriers, allowing their clients to obtain lower, more competitive rates while not having to switch to another insurer. And, again, whether those potential benefits outweigh any potential anticompetitive effects is something that Congress left to be decided by state insurance regulators, not federal courts.

[26] In *Sabo,* the alleged misconduct involved an alleged fraudulent scheme by an insurer to use brokers to churn policies — that is, to cause policyholders to switch from one insurer to another more frequently than was in the insured's interest. *See Sabo*, 137 F.3d at 187. Here, the plaintiffs seek to recover for an alleged "incumbent protection" scheme, in which the brokers purportedly sought to prevent policyholders from switching insurers. It is hard to see how anyone, even plaintiffs, could argue that this latter alleged scheme does not implicate the business of insurance when the Third Circuit has squarely held that the former does.

B. The Alleged Conduct Is Regulated by State Law.

The Second Amended Complaint — which describes investigations into the alleged conduct by several state insurance departments (*see, e.g.*, SAC ¶¶ 482, 484, 487, 489) — shows that the conduct alleged not only involves the business of insurance, but is actively regulated by the states under their unfair insurance practices laws.[27] As noted above, all 50 states and the District of Columbia regulate the business of insurance and unfair trade practices of insurance companies (*see supra* p. 27), and insurance statutes in a majority of states *expressly* provide that they are intended to regulate insurance as envisioned by the McCarran-Ferguson Act.[28] This is all that is required to bring the alleged conduct within the McCarran-Ferguson exemption. *See Mackey v. Nationwide Ins. Cos.*, 724 F.2d 419, 421 (4th Cir. 1984) ("A body of state law which proscribes unfair insurance practices and provides for administrative supervision and enforcement satisfies the state regulation requirement of the exemption."); *McIlhenny v. Am. Title Ins. Co.*, 418 F. Supp. 364, 369 (E.D. Pa. 1976) ("[T]he term 'regulated by state law' as used in the [McCarran-Ferguson] Act means only that the state have a general regulatory scheme governing the conduct of the insurance business and not that there must be a statute or regulation dealing specifically with the practice in question.").

[27] "State regulation . . . exists when a State statute generally proscribes . . . or permits or authorizes certain conduct on the part of the insurance companies." *Steingart v. Equitable Life Assurance Soc'y of U.S.*, 366 F. Supp. 790, 794 (S.D.N.Y. 1973) (citing *Ohio AFL-CIO v. Ins. Ratings Bd.*, 451 F.2d 1178, 1181 (7th Cir. 1971) (internal quotations omitted)).

[28] DEL. CODE ANN. tit. 18, § 2301 (2007) ("The purpose of this chapter is to regulate trade practices in the business of insurance in accordance with the intent of Congress as expressed in [the McCarran-Ferguson Act]"); N.J. REV. STAT. ANN. § 17:29B-1 (West 2007) (same); OKLA. STAT. ANN. tit. 36, § 1201 (West 2007) (same); *see also J.F. Crawford v. Am. Title Ins. Co.,* 518 F.2d 217, 219 (5th Cir. 1975) ("It must be remembered that the draftsmen of the model Insurance Trade Practices Act, upon which the Alabama Act is patterned, specifically intended to respond to the invitation of the McCarran Act to withdraw from federal control . . . the very kind of conduct which is charged here.").

C. The Complaint Does Not Allege a Boycott.

The alleged conduct at issue is not a boycott within the meaning of the Act, and the Second Amended Complaint no longer makes any pretense of characterizing it as such. Conduct constitutes a boycott only where parties refuse to deal in a collateral transaction as a means to coerce terms respecting a primary transaction. *Hartford Fire Ins. Co. v. California*, 509 U.S. 764, 802-03 (1993); *Gilchrist v. State Farm Mut. Auto. Ins. Co.*, 390 F.3d 1327, 1335 (11th Cir. 2004). "It is th[e] expansion of the refusal to deal beyond the targeted transaction that gives the great coercive force to a commercial boycott: unrelated transactions are used as leverage to achieve the terms desired." *Hartford Fire*, 509 U.S. at 802-03. For example, in *Hartford Fire*, the alleged boycott consisted of an attempt by reinsurers to prevent primary insurers from issuing a particular type of insurance policy: the reinsurers threatened to withdraw *entirely* from the business of reinsuring those primary insurers that continued to issue the objectionable policy. 509 U.S. at 810.

The Second Amended Complaint is devoid of any allegations that would support application of the boycott exception to their claims. It does not allege that defendants somehow refused to deal with plaintiffs on collateral transactions as a means of forcing plaintiffs into paying higher prices. *Cf. Hartford Fire*, 509 U.S. at 801-03. It therefore does not allege a boycott.

CONCLUSION

Plaintiffs have now had three chances to state a claim and have failed. After two years of expansive discovery, plaintiffs still have not pleaded a plausible illegal conspiracy among the insurers to allocate customers. Rather, the practices they allege all involve vertical agreements between individual brokers and individual insurers that plaintiffs' own allegations show had procompetitive purposes — such as reducing the brokers' costs and increasing their bargaining leverage — that could benefit policyholders. The Second Amended Complaint shows, moreover, that this alleged conduct — which involved the sale of insurance contracts and the allocation of risks among particular insurers — falls at the very core of the business of insurance and is actively regulated by the states. Its legality, therefore, is something that Congress, under the McCarran-Ferguson Act, has left to the state insurance regulators, not the federal antitrust laws, to determine.[29]

It is time to stop the expense and disruption imposed on the insurance markets from the pendency of this action. The plaintiffs' antitrust claims should be dismissed, once and for all, with prejudice.

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[29] *Cf. Credit Suisse Sec. (USA) LLC v. Billing*, __ S. Ct. __, No. 05-1157, 2007 WL 1730141, at *12-13 (June 18, 2007) (holding that securities laws preclude application of antitrust laws to conduct where (i) "separating the permissible from the impermissible" requires "securities-related expertise," (ii) "threat of antitrust lawsuits, through error and disincentive, . . . would threaten serious harm to the efficient functioning of the securities markets," and (iii) "enforcement-related need for an antitrust lawsuit" is small because of active enforcement of regulatory rules). All three factors strongly support applying the statutory McCarran-Ferguson exemption here.

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