

IN THE MATTER OF
AMERICAN GENERAL INSURANCE COMPANY, ET AL.
ORDER, OPINION, ETC., IN REGARD TO ALLEGED VIOLATION OF SEC.
7 OF THE CLAYTON ACT

Docket 8847. Complaint, June 17, 1971 — Final order, June 28, 1977

This order, among other things, requires a Houston, Texas insurance company to divest itself completely of the Fidelity & Deposit Co. of Maryland, subject to F.T.C. approval, and prohibits the firm, for a ten-year period, from acquiring any U.S. company engaged in fidelity or surety underwriting, without prior Commission consent.

Appearances

For the Commission: *Jere W. Glover, Lawrence E. Gray, Karen G. Bokot and Harold E. Kirtz.*

For the respondent: *Leroy Jeffers, John L. Murchison, Jr., David T. Harvin, Vinson, Elkins, Searls, Connally & Smith, Houston, Texas. Michael J. Henke, of counsel, Washington, D.C. and George F. Reed, Houston, Texas.*

For intervenor: *Decatur H. Miller and Richard F. Over, Baltimore, Md., Fidelity & Deposit Co. of Maryland.*

COMPLAINT

The Federal Trade Commission, having reason to believe that American General Insurance Company has violated the provisions of Section 7 of the Clayton Act, as amended, 15 U.S.C. 18, by reason of its merger with Fidelity & Deposit Company of Maryland hereby issues this complaint pursuant to Section 11 of said Act, 15 U.S.C. 21 stating its charges in that respect as follows:

I

DEFINITIONS

PARAGRAPH 1. For the purposes of this complaint, the following definitions shall apply:

a. *Property-liability insurance* consists of a broad range of insurance coverage designed to protect the policyholder ("insured") by indemnification against loss or damage to his property resulting from fire, accident, natural perils and crime, liability to others for bodily injury, illness, death or property damage and loss resulting from the default of others.

b. *Fidelity* is a category of property-liability insurance gener-

ally issued in the form of a bond providing indemnity to the insured against loss caused by default or dishonesty of employees and public officials or others holding a position of trust.

c. *Surety* is a category of property-liability insurance generally issued in the form of a bond whereby the surety company guarantees indemnity for breach of performance of specific acts, principally construction of buildings, bridges, tunnels and similar projects, as well as license bonds and bonds guaranteeing the faithful performance by fiduciaries.

d. *Direct premiums written* represents the aggregate amount of recorded originated premiums, other than reinsurance, issued during the year whether collected or not at the close of the year, after deducting all premium returns.

e. *Net premiums written* represents retained premium income, direct or through reinsurance, less payments made for reinsurance ceded.

f. *Total admitted assets* are those assets of an insurer permitted by state laws or departmental rulings to be taken into account in determining a company's financial condition.

II

RESPONDENT

PAR. 2. Respondent, American General Insurance Company (hereinafter referred to as "American General"), is a corporation organized and existing under the laws of the State of Texas, with its office and principal place of business located at 2727 Allen Parkway, Houston, Texas.

PAR. 3. Originally organized in 1926, American General has developed into a diversified "all-lines" insurance company. The company has become a substantial factor in nearly every insurance market largely as a result of an aggressive acquisition policy. Operating primarily as a holding company, American General owned a controlling interest in nine other property-liability companies, seven life insurance companies and seven financial noninsurance subsidiaries in 1968.

PAR. 4. In 1968, the American General Group, which includes American General and its subsidiaries, was the 21st largest property-liability insurer in the United States based on net property-liability premiums written of \$318.4 million. The company ranked 16th on the basis of \$533.5 million in net premiums written for all categories of insurance. Total combined income and admitted assets of the companies comprising the American General Group amounted to \$527.3 million and \$1.5 billion respectively in 1968.

PAR. 5. In 1964, American General secured a major position in fidelity and surety underwriting with the acquisition of the Maryland Casualty Co., a leading independent property-liability insurer. In 1968, the American General Group ranked as the 12th largest underwriter of fidelity, accounting for over 3 percent of the total U.S. market on direct premiums written of \$4.6 million. For that year it was the 6th largest surety underwriter with \$15.1 million in direct premiums written, accounting for over 4 percent of the total U.S. market.

PAR. 6. At all times relevant herein, American General was engaged in "commerce" within the meaning of the Clayton Act.

III

FIDELITY & DEPOSIT COMPANY OF MARYLAND

PAR. 7. Prior to its merger into American General on July 1, 1969, the Fidelity and Deposit Company of Maryland (hereinafter referred to as "F&D"), was a corporation organized and existing under the laws of the State of Maryland, with its office and principal place of business located at Charles and Lexington Sts., Baltimore, Maryland.

PAR. 8. Originally founded in 1890, F&D had proven itself to be a successful and highly profitable company. A specialist in fidelity and surety underwriting, the company had concentrated over 88 percent of its business in these two markets with the remaining business being in the burglary, liability, homeowners and commercial multiple peril, dwelling fire lines and life insurance. In 1968, F&D had total direct premiums written of approximately \$43 million with total admitted assets in excess of \$158 million.

PAR. 9. In 1968, the year prior to its merger into American General, F&D ranked as the third largest fidelity underwriter with \$10.4 million in direct premiums written. This represented over 7 percent of the national market. An aggressive and highly-service oriented company, F&D was the Nation's leading independent fidelity underwriter and a major independent surety underwriter. In that year F&D was the second largest company in surety premiums written. Its direct premiums written of \$27.6 million accounted for over 8 percent of the total U.S. market.

PAR. 10. At all times relevant herein, F&D was engaged in "commerce" within the meaning of the Clayton Act.

IV

THE MERGER

PAR. 11. On or about July 1, 1969, F&D was effectively merged into

American General by reason of an agreement to affiliate dated February 24, 1969, pursuant to which all capital stock of F&D was converted into two shares of common stock and 0.4 shares of \$1.80 preferred stock of American General. The transaction was valued at approximately \$107.5 million.

v

TRADE AND COMMERCE

PAR. 12. Fidelity and surety bonds are primarily underwritten and sold by the same companies. Nevertheless, the two categories of insurance are clearly distinguishable. Since they are designed for different purposes, are sold to wholly different classes of customers and are dissimilar in underwriting concept, they are readily separable into two distinct markets.

PAR. 13. *Surety* underwriting: In 1968, total direct surety bond premiums written in the U.S. by all companies amounted to approximately \$343 million with national concentration among the four and eight largest producers increasing at a substantial rate. From 1962 through 1968 the top four firms increased their share of the market from about 25 percent to nearly 31 percent. Similarly, by 1968 the eight leading firms showed an increase to nearly 48 percent from their 1962 level of about 43 percent. Combined with F&D, American General became the leader in surety bond underwriting with about 13 percent of direct premiums written, based on 1968 data. In addition, the merger resulted in American General being the largest surety bond underwriter in 16 state markets, among the top four underwriters in 29 state markets and among the top eight underwriters in 41 state markets. On the basis of 1968 data the merger had the effect of increasing concentration among the four top underwriters to approximately 35 percent, a relative increase of over 38 percent since 1962.

PAR. 14. *Fidelity* underwriting: In 1968, total direct fidelity premiums written in the U.S. by all companies amounted to approximately \$140 million, and like the case with surety bond underwriters, concentration among the four and eight largest fidelity underwriters increased substantially between the years 1962 through 1968. During this period the four leading producers increased their market share from about 24 percent to over 31 percent. The eight largest firms grew from approximately 44 percent to nearly 54 percent. As a result of the merger, American General became the largest underwriter of fidelity insurance with approximately 11 percent of the national market based on 1968 data. In addition, American General became the largest underwriter in 12 state markets, was among the leading four underwri-

ters in 36 state markets and among the top eight companies in 41 state markets. On the basis of 1968 data the merger had the effect of increasing concentration among the four top underwriters to about 35 percent and among the top eight underwriters to nearly 57 percent.

PAR. 15. Increasing concentration and a decline in the number of fidelity and surety bond underwriters is directly attributable to a significant merger trend in recent years in the property-liability field. Between the years 1960 and 1968 a total of 580 mergers and acquisitions involving property-liability insurers took place. The value of their admitted assets exceeded \$9.9 billion. Over 60 fidelity and surety bond underwriters have been acquired since 1957 and of these over half have been horizontal in nature. This trend has accelerated sharply in the 1960's with over 20 major horizontal combinations having taken place between 1963 and 1969.

VI

EFFECT OF MERGER

PAR. 16. The effect of the merger of F&D into American General may be substantially to lessen competition or to tend to create a monopoly in the business of underwriting fidelity and surety bonds in the United States and in various state and other geographic markets, in violation of Section 7 of the Clayton Act, as amended, 15 U.S.C. 18, in the following ways, among others:

- a. Substantial, actual and potential competition between American General and F&D has been, or may be, eliminated;
- b. F&D has been eliminated as a substantial independent factor in the business of underwriting fidelity and surety bonds;
- c. Concentration in the business of underwriting fidelity and surety bonds has been increased to the detriment of actual as well as potential competition;
- d. An acceleration of the trend toward mergers and acquisitions has been encouraged and may contribute to further increases in concentration and the decline in the number of underwriters of fidelity and surety bonds.

VI

PAR. 17. The merger of F&D into American General as alleged in Paragraph 11 constitutes a violation of Section 7 of the Clayton Act, as amended, 15 U.S.C. 18.

Chairman Kirkpatrick did not participate in this matter.

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INITIAL DECISION BY MONTGOMERY K. HYUN, ADMINISTRATIVE
LAW JUDGE

AUGUST 8, 1975

PRELIMINARY STATEMENT

[1] On June 17, 1971, the Federal Trade Commission ("Commission") issued the complaint herein, charging American General Insurance Company ("American General") [2] with violation of Section 7 of the Clayton Act, as amended (15 U.S.C. 18), by its July 1969 acquisition of substantially all of the stock of Fidelity & Deposit Company of Maryland ("F&D") for American General stock valued at about \$107.5 million. The complaint alleges that the effect of American General's acquisition of F&D may be to lessen competition substantially or tend to create a monopoly in the business of writing fidelity and surety bonds in the United States by eliminating substantial actual and potential competition between American General and F&D, by eliminating F&D as a substantial independent factor in the fidelity and surety bond industries, by increasing concentration in these industries, and by accelerating the merger trend in these industries.

On August 30, 1971, respondent duly filed its answer admitting certain allegations of the complaint and denying others, and asserted that the Commission was without jurisdiction in this matter by virtue of the provisions of the McCarran-Ferguson Act (15 U.S.C. 1011). On October 5, 1971, the Hearing Examiner granted F&D's September 21, 1971 motion for leave to intervene. On February 11, 1972, the Commission dismissed complaint counsel's appeal from the Hearing Examiner's order authorizing intervention.

After briefs, the Hearing Examiner, on March 7, 1972, issued his Initial Decision and order granting the December 27, 1971 joint motion of respondent and intervenor for summary decision and dismissed the complaint for lack of jurisdiction. Upon complaint counsel's appeal and after briefs and oral argument, the Commission, on December 5, 1972, vacated the initial decision and remanded the case to the Administrative Law Judge for further proceedings. The attempt of respondent and intervenor to have the Commission proceedings judicially enjoined has been unsuccessful. *American General Insurance Co. v. Federal Trade Commission*, 359 F. Supp. 887 (S.D. Tex. 1973), *aff'd*, 496 F.2d 197 (5th Cir. 1974).

A number of prehearing conferences were held by my predecessors and myself in September and December 1971, March, July and August 1973, and in February 1974. Evidentiary hearings on the Section 7 issue began on April 8, 1974 and concluded on December 16, 1974. The record

was closed on January 7, 1975, after submission of stipulations regarding the anticipated testimony of [3] certain uncalled witnesses. Counsel for respondent and intervenor and complaint counsel filed proposed findings of fact and conclusions of law, together with supporting briefs, on March 7, 1975, and reply briefs on April 3, 1975.

This case is before me upon the complaint, answer, testimony and other evidence, proposed findings of fact and conclusions and briefs filed by the parties and the intervenor. These submissions have been given careful consideration and, to the extent not adopted herein in the form proposed or in substance, are rejected as not supported by the record or as immaterial. Any motions not heretofore or herein specifically ruled upon, either directly or by the necessary effect of the conclusions in this decision, are denied.

Having heard and observed the witnesses and after having carefully reviewed the entire record in this proceeding, together with the proposed findings and conclusions submitted by the parties and the intervenor, the Administrative Law Judge makes the findings set forth below.¹ [4]

FINDINGS OF FACT

I. *Identity and Business of Respondent*

1. Respondent American General Insurance Company (hereinafter "American General") is a corporation organized and existing under the laws of the State of Texas, with its office and principal place of business at 2727 Allen Parkway, Houston, Texas (Complaint and Answer, par. 2).

2. American General was organized in 1926 and has since diversified into an all-lines insurance company (Complaint and Answer, par. 3). It operates in all 50 states, in every province of Canada, in western Europe and in other places throughout the world, offering insurance and

¹ References to the record are made in parentheses, and the following abbreviations are used:

F - Findings of this initial decision.

CPF - Proposed findings of fact, conclusions of law and order of complaint counsel, followed by the proposed finding referred to.

CRB - Complaint counsel's reply brief, followed by the page numbers referred to.

RPF - Respondent's proposed findings of fact and conclusions of law, followed by the proposed finding referred to.

RB - Respondent's brief in support of proposed findings, followed by the page number referred to.

RRB - Respondent's reply brief, followed by the page number referred to.

CX - Complaint counsel's exhibits.

RX - Respondent's exhibits.

The transcript of the proceedings is referred to with the last name of the witness and the page number or with the abbreviation Tr. and the page.

Intervenor F&D joined in respondent's various pleadings, including proposed findings of fact and conclusions of law and supporting briefs, or filed separate pleadings noting its support of respondent's positions, throughout the proceedings before the Administrative Law Judge. Therefore, the findings and discussions with respect to all substantive issues of fact and law contained in this Initial Decision apply equally to F&D's submissions.

financial services (CX 87, 88). At all times relevant herein, respondent was engaged in commerce, as "commerce" is defined in the Clayton Act, 15 U.S.C. 12 (Complaint and Answer, par. 6).

3. American General now operates primarily as a holding company. At the time of its July 1969 acquisition of Fidelity & Deposit Co. of Maryland ("F&D"), American [5] General had a controlling interest in nine property and liability insurance companies (including the six-company Maryland Casualty Group and one company which has since been sold), six of which wrote fidelity and surety bonds (RRB, p. 15; CX 3, p. 17; CX 4, p. 12; CX 9; CX 19, pp. 79-80; CX 24C, pp. 26-27; CX 25, 39, 40; CX 78A; CX 85-88).

4. American General also owned six life insurance companies at the time of the acquisition of F&D (CPF 8; CX 19, pp. 80-84), and had interest as well in several noninsurance financial institutions (CX 19, pp. 81-82).

5. American General's 1964 acquisition of Maryland Casualty Company ("Maryland Casualty"), an independent multiple lines company, and its affiliated companies, was a significant acquisition in the fidelity and surety fields (RRB, p. 19; Complaint and Answer, par. II 5; CX 24C, p. 42). In 1963, the year prior to that acquisition, American General had net fidelity and surety premiums of approximately \$775,000, whereas Maryland Casualty's net fidelity and surety premiums totalled \$12,379,000 (CX 24C, p. 12). In 1964, Maryland Casualty ranked 11th nationally in direct surety premiums with \$8.9 million in direct premiums and 3.37 percent of the market, and ranked 13th in direct fidelity premiums with \$3.8 million in direct premiums and 2.88 percent of that market (CX 95C, E).

At the time of its acquisition in 1964 by American General, Maryland Casualty was a substantial and profitable company (CX 24C, p. 21). From 1955 to 1963, inclusive, it ranked consistently among the Nation's top 10 surety writers, and ranked each year among the Nation's top 15 fidelity writers during that same period (CX 95, 96; RX 235, 236, 237).

6. In its prospectus of August 2, 1964, issued prior to acquiring control of Maryland Casualty, respondent asserted its intention to maintain the *status quo* as to Maryland Casualty's operations, saying, "* * *it is contemplated that no change will be made in Maryland's name, identity, or home office location, and that, consistent with the best interests of Maryland and its stockholders, no substantial change will be made in Maryland's customs, methods, home office personnel, field and agency personnel, investment practices, and banking and investment connections. It is the intention of American General that all Maryland [6] personnel will continue to enjoy their job security, consistent with good business practice. This assurance applies particu-

larly to Maryland's president, Mr. H. Ellsworth Miller, who is regarded by American General as competent and well qualified." (CX 24C, p. 3). Respondent was later to use similar language in its proxy statement referring to the acquisition of F&D (CX 19, pp. 6 and 7).

7. However, in its 1964 Annual Report, American General announced its intention of consolidating Maryland Casualty and American General operations (CX 7, p. 14). The American General 1965 Annual Report indicated that this policy of unifying the two companies was becoming a reality, that the two were becoming, in effect, one all-lines insurance group rather than remaining two separate insurance companies (CX 6, p. 16). This is evidenced by the fact that, in its annual reports, American General shows its operating results by line of business rather than by companies or company groups.

8. In 1966, American General changed Maryland's management, including naming a new president to replace H. Ellsworth Miller, and appointing Gus S. Wortham, then chairman and chief executive officer of American General, as chief executive officer of Maryland Casualty (Woodson, Tr. pp. 1039, 1047-1049).

9. Respondent has been a member of the Surety Association of America (the trade association of fidelity and surety underwriters) for some 15 years, and is a member of its Executive Committee (Pearson, Tr. 271; CX 116, p. 6; CX 145A-K).

10. In the period 1958 to 1968, respondent American General's statutory earnings grew from \$2,230,000 to \$30,676,000, capital and surplus increased from \$20,824,000 to \$261,550,000, and premium income went from \$37 million to \$450 million (CX 3, pp. 14-15; CX 8, p. 6). In 1968, American General's combined income and admitted assets were \$527 million and \$1.5 billion, respectively (Complaint and Answer, par. II 4). The company ranked approximately 15th nationwide among United States stock property-liability companies, and ranked about 9th that year by insurance in force among all stock life insurance companies (CX 3, p. 22). [7]

II. *Identity and Business of the Acquired Firm*

11. Fidelity and Deposit Company of Maryland (F&D) was, prior to its acquisition by American General on July 1, 1969, a corporation organized and existing under the laws of the State of Maryland, with its office and principal place of business located at Charles and Lexington Sts., Baltimore, Maryland (Complaint and Answer, par. 7).

12. Originally founded in 1890 as a banking and bonding institution, F&D had proven itself to be a successful and highly profitable company (CX 11, p. 3; CX 12, p. 3; CX 13, p. 3; CX 14, p. 3; CX 15, p. 3; CX 16, p. 3; CX 63A; Shrake, Tr. 1334, 1404; Culbertson, Tr. 1488, 1490, 1528).

13. In 1910, F&D extended the scope of its activities to include the writing of burglary, robbery and theft insurance. In 1942, F&D entered the inland marine insurance field, but has confined its writings therein to the Personal Property Floater policy, which is a comprehensive form of insurance covering personal property, wherever located, against almost any cause or loss or damage. In 1958, F&D further broadened its activities to include fire, extended coverage and homeowners' multiple peril coverages which provide protection to homeowners against loss or damage to their homes caused by fire, windstorm, hail and other losses and liabilities incident to home ownership (CX 17, p. 89). In 1964, F&D created a subsidiary to write life insurance, Maryland Life Insurance Company of Baltimore (CX 15, p. 5).

14. Despite such diversification, F&D remained a specialist in fidelity and surety underwriting. Eighty-eight percent of its business in 1968 was concentrated in these two lines, with the remaining business being in the burglary, liability, homeowners and commercial multiple peril, dwelling fire lines and life insurance (Complaint and Answer, par. 8; CX 11, p. 6; CX 12, p. 6). Surety constitutes the larger part of F&D's bond business and is more than twice as large as its fidelity. In 1968, fidelity accounted for 25.2 percent and surety accounted for 63.4 percent of F&D's premiums (CX 11, p. 6). The bulk of F&D's surety business consists of contract bonds. For example, in 1970, 74 percent of F&D's surety premiums were derived from contract bonds (CX 1, p. 7; CX 11, p. 5; RX 79).

[8] 15. F&D writes business in all 50 states through 51 branch and service offices. Two-thirds of F&D's 1100 employees work in the branch offices (CX 17, pp. 90-91). At all times relevant herein, F&D was engaged in "commerce" within the meaning of the Clayton Act (Complaint and Answer, par. 10).

16. An aggressive and highly service oriented company prior to the acquisition by American General, F&D was the Nation's leading independent fidelity underwriter and a major independent surety underwriter (CX 11, p. 5; CX 15, p. 3; CX 16, p. 3; CX 68A; Culbertson, Tr. 1700-1701). By 1967, F&D had become the leading writer of court and fiduciary bonds, a very profitable surety line (CX 12, p. 6; CX 14, p. 4).

17. In 1968, the year prior to its acquisition by American General, F&D had total direct premiums written of approximately \$43 million, with total admitted assets in excess of \$158 million, and a capital and surplus account in excess of \$89 million (Complaint and Answer, par. 8; CX 17, p. 54).

18. F&D was regarded in the industry as a very conservative company, which carefully controlled its underwriting practices and

accepted only those risks with a very low probability of loss (Krupp, Tr. 991; Spickard, Tr. 1119; McVay, Tr. 1380; Culbertson, Tr. 1486, 1731-1732; CX 12, p. 5; CX 63; CX 68A).

19. F&D has been a member of the Surety Association of America for some 15 years and is represented on its executive committee. Mr. Coe Culbertson, president of F&D and a witness in these proceedings, currently occupies F&D's seat on that committee (Pearson, Tr. 271; Culbertson, Tr. 667, 679A-680A; CX 145A-K).

20. American General acquired ownership of F&D on July 1, 1969, for stock valued at \$107.5 million (Complaint and Answer, par. 11). The acquisition represented American General's second major acquisition in 5 years in the fidelity and surety markets (F. 5, *supra*).

21. American General's reason for acquiring F&D, as set forth in its proxy statements filed with the SEC, was that "American General's fidelity and surety business will be strengthened by the addition of Fidelity's fidelity and surety business." (CX 17, p. 6; CX 18, p. 6; CX 19, p. 6).

[9] 22. F&D made a substantial contribution to American General's financial position. F&D's admitted assets in 1968 were \$158,333,000 and added 10 percent to American General's admitted assets. F&D's capital and surplus for 1968 was \$89,406,000 or 34 percent the size of American General's (CX 17, p. 64). Admitted assets and capital and surplus of F&D (\$247,739,000) were far in excess of the purchase price paid by American General (\$107.5 million) for the acquisition.

23. In its prospectus issued prior to acquiring ownership of F&D, American General declared its intention "that there will be no change in Fidelity's* * *Board of Directors, officers, home office personnel, field and agency personnel, basic pattern of operations, nature of business, investment practices and banking and investment connections." (CX 18, p. 7). However, the current chairman, president and chief executive of American General testified that American General envisions consolidation of F&D's investment operations with those of the American General group (Woodson, Tr. 1023).

24. All the members of the American General group except F&D follow an integrated underwriting procedure (Woodson, Tr. 1040-1041).

25. Since 1970, no F&D earnings were retained to increase F&D's capital and surplus. In addition, in 1973, F&D paid American General a special dividend amounting to \$20 million, which reduced F&D's capital and surplus by that amount. The special dividend equalled more than 20 percent of F&D's capital and surplus at that time (Woodson, Tr. 1034-1036; Culbertson, Tr. 1531-1532).

III. Viability of F&D as a Separate Entity

26. In 1968, the year prior to the acquisition, F&D was number three in the fidelity market and number two in the national surety market. It was considered a healthy and ably managed company, with an exceptionally strong financial position and a record of excellent underwriting achievement (CX 68A, B; CX 72).

27. In absolute terms, F&D's direct premium writings of both fidelity and surety showed a marked increase [10] overall in the period between 1962 and 1973.² Perhaps more significant is the fact that F&D's direct premium writings have grown at the same rate as or slightly higher rate than that of the entire industry. F&D's 1972 fidelity writings, in terms of direct premiums written, were 187 percent of its 1962 writings. The industry growth for the same period was 180 percent. Similarly, F&D's 1972 surety writings were equal to 210 percent of its 1962 writings; the industry-wide growth was 200 percent. Clearly, F&D is at least holding its own, if not doing slightly better than the industry as a whole, in terms of absolute volume of business (CX 92-96, 119-125; RX 74-81, 232-233).

28. F&D has always been considered a highly profitable company (Tr. 1488) and has experienced increased profitability in recent years, as indicated by declining loss ratios in its fidelity and surety business. In both lines, F&D's loss ratio began to fall in 1966; the decline was interrupted by a slight increase in 1969, the year of acquisition, then continued through 1973. For several years, F&D's loss ratio in both lines has been substantially below that of the industry as a whole (CX 92-95; RX 74-81, 232-233).³ These figures indicate that F&D has successfully

² F&D's market share in 1968 was higher in both the fidelity (7.4 percent) and surety (8.0 percent) markets than it was in 1962 when F&D ranked first in both markets.

In fidelity, F&D has not shown an increase in writings each year, but every 3-year cycle (with the one exception 1964/1967) has marked an increase in direct premium volume. Moreover, the statistics for F&D fidelity writings do generally track the industry-wide pattern of advances and declines. See Table A.

F&D's surety writings have increased every year except 1973.

³ See Tables A and B, on pp. 11-12. [11]

TABLE A
F&D's Growth in Direct Premiums Written Compared With Industry
(Countrywide).

	F&D	
	Fidelity Direct Premium	Surety Direct Premium
1962	7,865,179	15,773,348
1963	10,775,643	17,292,171
1964	10,154,169	17,945,914
1965	8,657,585	20,579,584
1966	10,971,384	23,937,751
1967	9,922,132	26,284,943
1968	10,392,000	27,581,851
1969	13,174,964	29,256,066

(Continued)

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competed for the more profitable underwriting business in both fidelity and surety.

[13] 29. At the time of its acquisition by American General, F&D was

1970	11,348,479	31,759,184
1971	13,100,423	32,347,260
1972	14,768,072	33,374,278
1973	12,528,836	33,209,760
Growth, 1962-1972: 187%		Growth, 1962-1972: 210%

	Industry	
	Fidelity Direct Premium	Surety Direct Premium
1962	111,904,039	229,277,298
1963	140,011,023	250,394,904
1964	133,703,198	265,512,304
1965	118,920,180	291,194,049
1966	140,591,153	308,662,286
1967	137,907,918	320,000,629
1968	139,685,512	342,858,200
1969	177,224,453	366,185,880
1970	176,258,431	384,594,021
1971	188,386,624	423,407,997
1972	201,691,180	463,670,429
1973	198,235,701	504,493,587
Growth, 1962-1972: 180%		Growth, 1962-1972: 200%

(CX 119-125, 92-96; RX 74-81, 232-233) [12]

TABLE B
F&D's Loss Ratios Company With Industry

	Fidelity	
	F&D's Loss Ratio	Industry
1962	21.0	33.0
1963	80.0	55.0
1964	35.0	45.0
1965	48.0	46.0
1966	56.0	50.0
1967	56.0	48.0
1968	51.7	54.5
1969	56.9	55.5
1970	56.9	49.5
1971	45.6	52.5
1972	39.3	48.1
1973	31.2	49.7

	Surety	
	F&D's Loss Ratio	Industry
1962	17.0	28.0
1963	17.0	46.0
1964	16.0	32.0
1965	16.0	29.0
1966	21.0	29.0
1967	11.0	24.0
1968	20.3	26.2
1969	22.1	24.2
1970	24.2	30.1
1971	31.9	30.5
1972	20.6	25.8
1973	18.1	32.3

(CX 92-95; RX 74-81, 232-233).

capable of continuing in business as a viable independent entity (Fs. 26-28, *supra*).

IV. *Nature of the Fidelity and Surety Bond Industries*

A. Product Market

30. The relevant product markets in this case are two: fidelity bonds and surety bonds (Fs. 31-57, *infra*).

(1) Surety

31. Commercial or corporate surety possesses certain peculiar characteristics not common to other lines of insurance generally (Fs. 32-39, *infra*).

32. Unlike ordinary insurance policies, which are two-party agreements, surety bonds represent three-party agreements in which the principal agrees to perform a certain obligation for an obligee, and in the same instrument, a surety agrees to guarantee that performance or indemnify the obligee if the principal fails to perform under the terms of the contract (Fait, Tr. 139-140; Moritz, Tr. 174A; Pearson, Tr. 282).

33. There are a number of different types of surety bonds, including contract bonds, license and permit bonds, court and fiduciary bonds, and miscellaneous trade and financial guarantees (Sinclair, Tr. 71; Moritz, Tr. 174A; Ruesch, Tr. 452; CX 17, p. 89). Contract bonds account for about 60 percent of the surety premiums written (Sinclair, Tr. 72; Hepburn, Tr. 409, 1206; Ruesch, Tr. 452; Culbertson, Tr. 1686-1687). The contract bond principally covers the bonding of underlying construction contracts performed by a contractor or contractors, and guarantees the faithful performance of those contracts according to plans and specifications of the underlying contract. It also covers the payment obligations of that particular contract (Sinclair, Tr. 71; Fait, Tr. 139-140; CX 117, pp. 4-11). Such bonds are written on a job-by-job basis and cover the underlying contracts for particular projects (Sinclair, Tr. 74). A fiduciary bond guarantees that the individual charged with husbanding and disposition of the assets in a trust or estate will properly perform his fiduciary duties [14] (Sinclair, Tr. 72; CX 76, pp. 4-9). A judicial bond is required when a verdict has been appealed to guarantee that appellant can pay the amount of the judgment (Sinclair, Tr. 73; CX 76, p. 24). A municipality may require a license bond to insure that a person performs his job in accordance with the terms of his license. If the license is violated and an injury results and the licensee cannot pay the damages, the bonding company steps in and pays the damages (Moritz, Tr. 175).

34. Unlike insurance, a surety bond cannot ordinarily be cancelled (Sinclair, Tr. 73-74, 79; Fait, Tr. 143; Ruesch, Tr. 452-453).

35. The rate charged for a surety bond is not set with regard to actuarial tables of loss experience. It is, rather, essentially a flat rate charged for services performed. The premium then is similar to interest paid a bank for a loss. Surety rates bear no relation to, nor are they affected by, insurance rates (CX 117, p. 4; Sinclair, Tr. 73-74, 81-82; Fait, Tr. 140-141; Moritz, Tr. 176-179; Ruesch, Tr. 453; Shrake, Tr. 1392-1393).

36. Surety provides a form of protection not provided by any type of insurance. Insurance compensates for loss; surety guarantees that a job will be completed (Fait, Tr. 143-144; Wells, Tr. 1600-1602; CX 117, pp. 9-11).

37. Salvage is very important on a surety bond but not on an insurance policy. If a loss occurs on a bond, the bond company begins salvage work. In the case of a construction bond, for example, the underwriting company attempts to determine the best way of completing the project. The company will try to assist the principal in fulfilling his contract. If that is impossible, the surety company and the obligee work out an agreement on how to finish the job. The surety company may succeed in recovering or preventing a large portion of the loss (Fait, Tr. 139, 144; Wells, Tr. 1600-1602; CX 117, pp. 9, 11).

38. Unlike an insurance company, the bonding company has a right of subrogation against the principal. It can recover from him any losses on the bond (Fait, Tr. 139-140; Culbertson, Tr. 836).

39. Special expertise, beyond that of the general experienced insurance underwriter, is needed to underwrite surety bonds (Sinclair, Tr. 107; Fait, Tr. 155-156; Moritz, Tr. 188).

[15] 40. Surety is generally recognized as a separate product line. The Surety Association of America exists as a separate trade association for the fidelity and surety industries (Sinclair, Tr. 94). The American Insurance Association has separate counsel and a separate advisory committee for fidelity and surety (Pearson, Tr. 284). There is a trade association, the National Association of Surety Bond Producers, for agents who specialize in fidelity or surety (Pearson, Tr. 275, 290-291; Halpin, Tr. 901-902; Shrake, Tr. 1406).

41. Personal surety, bank letters of credit, self-insurance, cash and securities deposits, and the like, proffered by respondent as forms of guarantee comparable to the security bond, are not widely enough used to be considered practical substitutes for the corporate surety bond (Fs. 36-39, *infra*).

42. The use of personal surety is dying out. Personal surety is almost never used in substitution for a corporate surety bond on a

construction contract (Wells, Tr. 1609-1613). F&D's president, testifying on respondent's behalf, could not give any specific example of bond business lost to personal surety, though he stated that personal surety was in use (Culbertson, Tr. 836-838, 1695).

43. Vague, general statements regarding cash deposits were made during these hearings, but no concrete instances of the actual use of cash or securities deposits in lieu of surety bonds were cited in the record (see, for example, Culbertson, Tr. 836, 1685-1688; Backman, Tr. 1941). It is especially unlikely that deposits of cash or securities could be a practical substitute for surety bonds on construction projects; the tying up of assets that it would involve would be a great burden to the contractor.

44. The record does not support the assertion that bank letters of credit are in sufficient use to be considered a practical substitute for corporate surety bonds. The president of F&D could name no instances of such substitution and stated that letters of credit were not acceptable on Federal and many other public construction projects (Culbertson, Tr. 1685-1686, 1691-1693). Indeed, there is testimony to the contrary, that such use of bank letters of credit is infrequent. In fact, despite their relatively low rate, its use is on the decline (Wells, Tr. 1611-1613).

[16] 45. Despite general and vague assertions by a witness for respondent that "they" (referring to one or more unnamed title companies) "are practicing surety" (Culbertson, Tr. 1693), there is no specific evidence in the record that title companies' guarantees are replacing corporate surety. A witness for complaint counsel testified he knew of no specific case where a title company actually acted as surety (Wells, Tr. 1613). Witnesses for neither side could point to a specific company by name, though they seemed to have specific instances in mind, where a title company either did write or was forbidden to write insurance that was similar to a surety bond (Wells, Tr. 1613-1614; Culbertson, Tr. 1817). On the basis of this record, it cannot be found that title companies provide a practical substitute for corporate surety.

46. In short, the alleged substitutes for surety are either less convenient, more burdensome, less reliable or less easy to obtain than corporate surety bonds and do not in fact constitute practical substitutes for corporate surety bonds (Fs. 36-39, *supra*).

47. Surety is separate and distinct from insurance and has no close substitutes (Fs. 35-40, *supra*).

(2) Fidelity

48. Fidelity bonds are instruments by which the underwriting company agrees to indemnify an employer for losses arising out of the

dishonest acts of his employees (Sinclair, Tr. 87; Moritz, Tr. 181; Ruesch, Tr. 453; CX 2, p. 89). The purpose of fidelity bonds is to indemnify the employer for loss of money and other property sustained through dishonest acts of his bonded employees. The scope of acts insured against includes larceny, theft, embezzlement, forgery, misappropriation, wrongful abstraction, willful misapplication, or other fraudulent or dishonest acts committed by the employee, whether acting alone or in collusion (CX 77, pp. 5-6).

49. Fidelity is more closely akin to insurance than is surety, but it too is a product line separate from general insurance and surety (Fs. 50-56, *infra*).

[17] 50. The principal customer categories for fidelity bonds are financial institutions and mercantile or commercial enterprises (Sinclair, Tr. 87; CX 135). At Insurance Company of North America (INA), at least two-thirds of total fidelity writings are for financial institutions, while at Continental Insurance Company and F&D, some 60 percent of fidelity writings are for financial institutions (Sinclair, Tr. 88; Ruesch, Tr. 454; Culbertson, Tr. 1696). Financial institution fidelity bonds are identified by descriptions of the institutions that purchase them and include: Insurance Companies Blanket Bonds, Small Loan Companies Blanket Bonds, Bankers Blanket Bonds, Savings and Loan Association Blanket Bonds, Credit Union Blanket Bonds, and Stock Brokers and Investment Bankers Blanket Bonds. Other categories of fidelity bonds include: Public School System Employee Blanket Bonds, Blanket Bonds for Federal Departments, Forgery Bonds, and bonds for club and recreational activities (CX 91, Part II, p. 1; Sinclair, Tr. 87-88; Ruesch, Tr. 453-454).

51. Unlike insurance, fidelity bonds involve an element of suretyship: three parties are involved in that the underwriter vouches for or stands as guarantee for the honesty of an employee/principal, to an employer/insured. Moreover, unlike many forms of insurance, fidelity involves the possibility of salvage or subrogation for the insurer (Wells, Tr. 1600-1602).

52. Special training beyond that required for the general insurance underwriter is required for a fidelity bond writer (Moritz, Tr. 188-189), and most companies have different underwriters for fidelity and insurance (Sinclair, Tr. 90, 93-94; Moritz, Tr. 187-189). To write fidelity bonds successfully requires the knowledge of loss prevention techniques and the ability to advise customers of those methods (Wells, Tr. 1600-1602). Fidelity is a specialty line that involves an effort to closely follow the internal and external control aspects of the firm being bonded (Sinclair, Tr. 90, 93).

53. Fidelity rates are based to some extent on loss experience but

bear no relation to surety or insurance rates (Sinclair, Tr. 91, 93; Fait, Tr. 151; Moritz, Tr. 184; Ruesch, Tr. 457).

54. Fidelity is recognized as a separate line in the industry (see Finding 40, *supra*).

[18] 55. That a fidelity bond is sometimes written with a burglary policy, or combined with burglary insurance in a "crime" package, does not alter the finding that fidelity is a separate line. In cases wherein the two are combined in a package, they are accommodations to those customers who need both types of protection. Neither fidelity bond nor a burglary policy supplies the protection afforded by the other. Fidelity protects against employee dishonesty, burglary against outside crime. Thus, they are not functional substitutes.

56. Fidelity is separate and distinct from insurance and has no practical substitutes (Fs. 50-55, *supra*).

57. Surety is distinct from fidelity. Fidelity is sold primarily to financial institutions (Ruesch, Tr. 454; Culbertson, Tr. 1696). They paid 44.7 percent of the fidelity premiums earned nationwide in 1968 (CX 135). The majority of surety bonds are sold to construction contractors. Contractors paid 66.5 percent of the surety premiums earned nationwide in 1968 (CX 136; Ruesch, Tr. 45; Hepburn, Tr. 1206; Culbertson, Tr. 1686-1687). Contractors do purchase fidelity bonds, but they account for much less fidelity than surety (Sinclair, Tr. 92; CX 135). The two types of bonds serve different purposes: one assures the completion of a particular undertaking, the other protects an employer from loss due to dishonesty on the part of his employees. They are not functionally interchangeable. Rates, profits, earnings and predictable losses in the two lines are unrelated. The industry recognizes them as separate and distinct lines (Sinclair, Tr. 90-93; Fait, Tr. 148-151; Moritz, Tr. 184; Ruesch, Tr. 455-457).

58. Surety and fidelity are distinct submarkets within the general insurance industry, and therefore are separate product markets for purposes of this proceeding (Fs. 31-57, *supra*).

B. Geographic Market

59. The geographic market in which the effects of this acquisition must be assessed is the Nation as a whole (Fs. 60-73, *infra*).

60. Not only are American General and F&D licensed to do business and actually doing business in every state in [19] the country (Fs. 2, 15, *supra*), but the major fidelity and surety underwriters operate generally on a nationwide basis (Culbertson, Tr. 806).

The leading fidelity and surety writers are licensed to operate in all or nearly all of the states (Sinclair, Tr. 95-96; Moritz, Tr. 198-199; Culbertson, Tr. 806; Ruesch, Tr. 458-460; Wells, Tr. 1561-1562; Thorne,

Tr. 1648-1649). As set forth below, all of the leading fidelity and surety writers nationally in 1968, the year preceding the acquisition, were also among the top 15 writers in a significant number of states (CX 92):

Surety

<i>Co. and National Rank</i>	<i>Number of States in Which Ranked Among Top 15</i>
1 U.S. Fidelity & Guaranty	50
2 F&D	49
3 Aetna	50
4 Travelers	50
5 Fireman's Fund	44
6 American General	33
7 St. Paul	40
8 Hartford	42
9 Chubb	45
10 Seaboard	30

Fidelity

<i>Co. and National Rank</i>	<i>Number of States in Which Ranked Among Top 15</i>
1 Aetna	47
2 Continental	46
3 F&D	45
4 INA	43
5 Hartford	49
6 Fireman's Fund	44
7 Chubb	29
8 U.S. Fidelity & Guaranty	46
9 Employers of Wausau	49
10 Travelers	36

[20] In 1968, 8 of the top 10 writers in fidelity and 8 of the top 10 in surety were reported by the Surety Association among the top 15 writers in 40 or more states. Three of the nationwide top four surety writers were in the top 15 in every state.

61. Executives of several principal surety and fidelity bond writers testified that they look only or primarily at national market share figures in assessing their company's market position (Sinclair, Tr. 97, 100; Moritz, Tr. 202; Thorne, Tr. 804; Shrake, Tr. 1411; Wells, Tr. 1629, 1658).

62. Ratemaking in the fidelity and surety lines is generally done on a nationwide basis. The rates recommended by the Surety Association of America are generally countrywide in their application. Prior to 1970, those rates were mandatory for Association members (Pearson, Tr. 286-287; Hepburn, Tr. 403-404, 1188). Although Association members are now free to deviate from Association rates, the rates of a

particular company are generally uniform from state to state. Deviations that occur are not generally related to individual states but rather to individual jobs. They are not in response to underwriting experience in a particular state because state statistics simply do not provide sufficient experience, from an actuarial point of view, to devise legitimate rates for a state alone (Moritz, Tr. 201; Hepburn, Tr. 403-404, 1181-1182; Culbertson, Tr. 805-807, 817; Backman, Tr. 1947).

63. The principal bond writers operate throughout the country by means of branch or division offices located throughout the country (Sinclair, Tr. 95-96; Moritz, Tr. 198-199; Ruesch, Tr. 447, 458-468; Culbertson, Tr. 806, 831-832; Wells, Tr. 1561-1562, 1604-1605; Thorne, Tr. 1643-1644, 1644, 1648-1649).

64. Where bonds of significant size are concerned, the home office underwriters generally participate with the branch office in the underwriting (Sinclair, Tr. 76, 91; Moritz, Tr. 199-201; Ruesch, Tr. 460-461; Culbertson, Tr. 806-807).

65. The leading fidelity and surety writers generally, and F&D and American General in particular, have the [21] potential to compete, and in fact do compete, for business on a nationwide basis (Fs. 53-57, *supra*).

66. A local customer generally can purchase through his agent fidelity and surety bonds from bonding companies at any of their offices located anywhere in the country (Fs. 60, 63, *supra*; Culbertson, Tr. 806; Backman, Tr. 1942-1943).

67. A bond customer with operations in more than one state generally can purchase fidelity and surety bonds at one location to cover his entire multi-state operations (Culbertson, Tr. 805, 807, 822-823; Krupp, Tr. 963-965; Backman, Tr. 1952).

68. Accordingly, a customer in need of a fidelity or surety bond can turn to any one of the underwriters licensed to operate in his state. No matter how little an underwriter may have written in that state in the past, it represents an alternative source of supply to the customer. Thus, for the average bond customer, his alternative sources of supply are not limited to those firms which maintain branches or write a large volume of bonds in his state at any given time but extend throughout the entire country as a practical matter.

69. The Nation as a whole is therefore the appropriate geographic market in which to assess the effects of this acquisition (Fs. 60-68, *supra*). The parties are in agreement that the national market is an appropriate geographic market in these proceedings (CPF 78; RPF III-117).

70. Complaint counsel further contend that each state or, in the alternative, each of seven designated states,⁴ also constitutes a relevant geographic market (CPF 163; CRB, p. 41). They have submitted state market share statistics which they argue indicate that the nationwide statistics drastically understate the degree of concentration in the fidelity and surety industries in some states (CPF 34, 41, 104, 107, 132, 135, 164).

[22] 71. A state may, in some circumstances, constitute an appropriate geographic market. However, the record in this proceeding does not support a finding that each state or any state is an appropriate market in which to assess the effects of this acquisition (Fs. 72-73, *infra*).

72. Complaint counsel's state market data in evidence in this proceeding are limited to a single year (1968) (see CPF 99).

The state market shares of underwriting companies can fluctuate widely from year to year. The loss or gain by a company of even one large contract, for example, particularly where allocated to a low-volume state, can make an enormous difference in that company's market share for that state (CPF 169; RPF III-122; RRB, p. 54; Culbertson, Tr. 817-820). Valid conclusions regarding concentration trends in state markets, changes in market shares and ranking, ease of entry or the state of competition cannot be drawn from one year's statistics alone. Therefore, no reasoned assessment of the effects of this acquisition on competition in any "state market" can be made on the basis of the evidence in the record.

73. The state figures in the record may be misleading in another respect. Because of allocation inconsistencies in many types of fidelity and surety bonds, the 1968 figures (CX 92) do not always accurately reflect where the bonds were written, and hence where the competition for any piece of underwriting business took place (RPF III-132-133; RPF III-137; see Fs. 129-136, *infra*). Even the figures for premiums generated by contract surety bonds, which are uniformly allocated to the state in which the work is performed (RPF III-136), do not indicate the place of actual competition, except in cases where the state of performance is also the state where the bond was written (RPF III-139-141).

V. Nature of Competition

74. Fidelity and surety bonds are sold both directly to customers and through agents and brokers. Most are written through agents and brokers (Sinclair, Tr. 75-76; Fait, Tr. 157; Moritz, Tr. 204; Culbertson,

⁴ California, Florida, Illinois, Maryland, New York, Pennsylvania, and Texas.

Tr. 781-782, 788), but both American General and F&D also sold bonds directly (Robbins, Tr. 2523).

[23] 75. An agent is technically a representative of the company that appointed him (Culbertson, Tr. 785; Halpin, Tr. 908; McVay, Tr. 1350). Thus, when a policy is cancelled and a return premium is required, an agent must come up with his share of the return premium (Culbertson, Tr. 786). However, practically speaking, the agent represents the consumer (Culbertson, Tr. 783; Halpin, Tr. 907-908).

76. Most agents are not exclusive agents, but represent several bond companies. An agent can and does choose from among those he represents the one best suited for the particular needs of each of his clients (Culbertson, Tr. 785-786).

77. A broker is licensed to represent the consumer. When a policy is cancelled and a return premium required, the broker owes the underwriting company nothing. Like the agent, a single broker can choose from among many companies in selecting the one to serve his clients' particular needs (Culbertson, Tr. 786-787; Halpin, Tr. 907-908; McVay, Tr. 1350).

78. In general, it is the agent or broker, not the customer, who designates the company with which a customer's bond is to be placed. Most agents and brokers have a "stable" of three to six companies with which they place most of their business. For these reasons, bond companies compete for inclusion in agents' "stables," as well as at the direct customer level (Culbertson, Tr. 181, 781, 783, 788; Moritz, Tr. 201-202; Halpin, Tr. 965-966; Shrake, Tr. 1317-1318, 1322-1324, 1386-1387, 1364).

79. Except in the case of a very small bond, which an agent might be permitted to execute, agents do not make the decision to issue a bond (Sinclair, Tr. 75; Moritz, Tr. 179; CX 12, p. 5). Ultimately, it is the surety or fidelity underwriter in a company's branch or home office who makes the final underwriting decision. He must analyze the risk and determine whether the piece of business is one that would interest his company, and attempt to use his knowledge and experience to improve the quality of a risk he finds marginal (Sinclair, Tr. 77). When a surety underwriter is approached by a contractor with whom he has not dealt previously, he follows certain procedures tailored to the writing of surety bonds. The underwriter must obtain certain financial information. [24] He requests financial statements for the previous years. Most underwriters demand a certified audit. The underwriter may secure a contractor's questionnaire giving his history, length of time in the business, size of jobs he has performed, names of his sureties, description of his lines of credit and names of his suppliers. Then the underwriter checks this information with banks, creditors, sureties and

suppliers of the contractor, and may also order a Dun and Bradstreet credit report on the contractor (Sinclair, Tr. 77-79; Fait, Tr. 141-142).

80. Rates for fidelity and surety bonds were formerly established by the Surety Association of America for its members. Nonmembers were free to file and charge their own rates. Even member companies could vary their fidelity rates through the use of tables of judgment (Ruesch, Tr. 464-465; Culbertson, Tr. 794, 1711-1712; Hepburn, Tr. 1188; Backman, Tr. 2216-2217). At the present, Surety Association rates are advisory only, even for members (Pearson, Tr. 286-287; Hepburn, Tr. 1188).

81. Rates for surety bonds are not set on the basis of loss experience (F. 35, *supra*).

82. Surety and fidelity are profitable lines for insurance companies (Fait, Tr. 138; CX 9, p. 6; CX 10, p. 6; CX 11, p. 5; CX 14, p. 4; CX 63).

83. Fidelity and surety companies compete in terms of service, availability, and price (Moritz, Tr. 202-204; Krupp, Tr. 989; McVay, Tr. 1378-1380; Wells, Tr. 1601).

84. Service encompasses the advice and guidance given by bond companies to agents and consumers on the type and amount of bond needed as well as in the areas of loss prevention and salvage (Moritz, Tr. 203-204; Wells, Tr. 1599-1604; Culbertson, Tr. 1700-1701).

85. Services offered by bond companies to their agents and customers are based on their expertise in the industries in which their customers are involved (McVay, Tr. 1376; Wells, Tr. 1599-1600; CX 164, p. 8). The bond company advises the agent on the type and amount of bond his client needs (Wells, Tr. 1599-1600). If a risk is marginal, the underwriter will attempt to improve the quality of the risk (Sinclair, Tr. 77; Shrake, Tr. 1412). This might involve establishment of a loss prevention system by the client on the advice of the underwriter [25] (McVay, Tr. 1376-1377; Wells, Tr. 1600; Culbertson, Tr. 1701) or the institution of safety programs or elimination of hazardous conditions (Shrake, Tr. 1412-1413).

86. Other services provided by the bond companies could include guidance on the types of work and geographic areas the client should avoid (Wells, Tr. 1603; Culbertson, Tr. 1701). The underwriter might also check on the reliability of potential subcontractors. The bond company may help the client form a joint venture for a large job, or provide information about federal and state regulations covering construction work (Wells, Tr. 1603-1604). After the bond is written, the underwriter makes periodic status inquiries to check the progress of the construction, watch for problems, and assess the activities of the contractor (Sinclair, Tr. 79-80).

87. Salvage is another important service provided by bond compa-

nies. If a loss occurs on a bond, the bond company begins salvage work. On a fidelity bond, salvage could involve recovery of money or property taken from an employer. The bond company pursues the employee who took the money or property and attempts to recoup as much of the loss as possible. In the case of a construction bond on which the principal cannot complete the job, the underwriting company attempts to determine the best way of completing the project. The company will try to assist the principal in fulfilling his contract. If that is impossible, the surety and the obligee work out an agreement on how to finish the job. The surety company may succeed in recovering or preventing a large portion of the loss (Fait, Tr. 144; Wells, Tr. 1600-1602).

88. Service can be an important factor in the agent's or customer's choice of bonding company. F&D, for example, considers its service record a selling device; it feels that it offers excellent service that compensates for somewhat higher prices (Culbertson, Tr. 706, 741; CX 49). It attributes its position as a leading writer of court and fiduciary bonds to the expert assistance it provides to the legal profession (CX 12, p. 6). F&D's president testified that F&D competed with American General in furnishing service (Culbertson, Tr. 793).

89. Availability is the ability of an underwriting company to quickly approve and write bonds and can be a crucial factor in choosing a bond company. Agents have [26] discontinued placing bond business with firms that frequently delay in providing bonds (Krupp, Tr. 988-989; McVay, Tr. 1379; Shrake, Tr. 1396-1397).

90. Price competition in fidelity and surety rates has always existed and exists now despite the Surety Association's establishment of rates. Rate competition exists between F&D and American General for certain classes of bonds (F. 80, *supra*; Moritz, Tr. 203; Culbertson, Tr. 794; McVay, Tr. 1379).

91. Bonding companies compete on the terms described above at several levels. They compete at the direct customer level (F. 67, *supra*); at the agent level, to be chosen one of an agent's "regulars" or to draw business away from an agent's regular stable of companies; and they compete within an agent's "stable" with the other companies the agent regularly draws upon (F. 71, *supra*).

92. Reinsurance is the assumption of a portion of a fidelity or surety risk of the direct writing company by another insurance company (Sinclair, Tr. 82-83; Fait, Tr. 154; Moritz, Tr. 189-190). There are reinsurance companies whose entire business is reinsuring the primary writers (Culbertson, Tr. 798; Wells, Tr. 1615). The leading reinsurance companies for fidelity and surety are General Reinsurance Company, Employers Reinsurance Company, American Reinsurance, North American Reinsurance, and Insurance Company of North America (Sin-

clair, Tr. 84; Fait, Tr. 155; Moritz, Tr. 190; Johnston, Tr. 255; Thorne, Tr. 1682A-1682B).

93. Primary insurers sometimes enter into treaties with reinsurance companies which establish automatic writing lines or acceptances under which the reinsurer assumes a percentage of every bond above a given size written by the primary insurer (Sinclair, Tr. 83-84; Moritz, Tr. 190; Culbertson, Tr. 798, 1549).

94. However, all of the reinsurance in the fidelity and surety industries is not handled by the professional reinsurers (Culbertson, Tr. 1549). Many primary bond writers accept reinsurance on a facultative basis (Fait, Tr. 146; Culbertson, Tr. 1556; Wells, Tr. 1616). The facultative reinsurer evaluates each separate risk based on the underwriting information supplied by the company writing the bond and decides how much of each such risk to reinsure (Culbertson, Tr. 1549).

[27] 95. Some insurers who, based on net premiums, appear to be large factors in the industry in fact sell few bonds to purchasers of fidelity and surety coverage and function primarily as reinsurers. Since reinsurance is included in net premiums, such companies therefore have small amounts of direct premiums and relatively large amounts of net premiums.⁵ For example, in 1973, Pacific Indemnity's net fidelity writings were \$2,890,000 and its direct premium writings were \$606,000. The net was almost 4.5 times as large as the direct (Backman, Tr. 2612-2613). Based on net figures, Pacific Indemnity ranked 21st in that year, and yet the direct figures indicate that the company was quite small (Backman, Tr. 2613-2614). Similarly, in 1972, the company's net fidelity premiums of \$2,675,000 were more than 4.5 times as large as its direct premiums of \$533,000 (Backman, Tr. 2614).

96. Allstate is another company that was more active in reinsurance than in direct writing. In 1973, the company wrote only \$609,000 in direct fidelity premiums, but wrote \$1,038,000 in net premiums. Its 1973 surety business presents a similar picture with direct writings of \$343,000 and net of \$2,053,000 (Backman, Tr. 2817-2819).

97. Pacific Insurance Company had net fidelity premiums of \$3,040,000 but direct of only \$1,705,000 in 1973. Its surety figures for that year are \$1,456,000 in net and \$422,000 in direct premiums written (Backman, Tr. 2777-2778).

98. The professional reinsurers and the reinsurance departments of primary underwriters do not market bonds directly to purchasers of fidelity or surety bonds and do not compete with the primary insurers (Sinclair, Tr. 84; Fait, Tr. 155; Moritz, Tr. 190; Johnston, Tr. 256, 263-264; Culbertson, Tr. 1550; Wells, Tr. 1616). They do not have personnel

⁵ See Fs. 129-136, *infra*, on net and direct premiums.

in the field attempting to sell bonds to clients. (Culbertson, Tr. 1550). Reinsurers normally do not call on brokers or agents (Culbertson, Tr. 1550-1551). The originating company, not the reinsurer, handles claims and settlements (Culbertson, Tr. 1552). Reinsurers are not competitors in the markets for fidelity and surety bonds. See F. 135, *infra*.

[28] 99. Beginning in the early 1960's, the concept of combining several insurance coverages in a single policy (as in a "homeowner's" policy) began to be applied to the commercial insurance lines with the introduction of a "package" policy⁶ commonly known as commercial multi-peril or "CMP"⁷ (Culbertson, Tr. 695-697; Wells, Tr. 1636). Such policies usually include fire, contents, general liability, business interruption and crime. The "crime" portion of CMP often includes some fidelity (Sinclair, Tr. 110-111; Johnston, Tr. 259; Hepburn, Tr. 352-354; Ruesch, Tr. 417; Schraeder, Tr. 508; Culbertson, Tr. 695; Krupp, Tr. 967; Wells, Tr. 1569). Surety is not included in CMP-type policies (Sinclair, Tr. 82, 114; Fait, Tr. 143; Moritz, Tr. 180; Hepburn, Tr. 368; Spickard, Tr. 1134-1135; Culbertson, Tr. 1700).

100. The advantage in CMP policies and packages of policies put together by a single company is convenience and a lower price for the insurance customer. For purchasing all his coverage from one company, he receives a discount on the normal price that would be paid for separate policies (Culbertson, Tr. 709; Krupp, Tr. 971; McVay, Tr. 1354-1368; Wells, Tr. 1566A; RX 137, 146J; RX 164C, D; RX 165, 168, 174). Thus, CMP policies and packaging represent a form of price competition.

101. Nearly all the multiple line companies engage in packaging and actively promote their packages (RX 143, 146E).^{7*}

[29] 102. In response to the threat posed by packaging, F&D developed a package policy of its own for financial institutions (Culbertson, Tr. 708-709; RX 96; CX 48, 51). This SMP (special multi-peril policy for financial institutions) combines property coverage on buildings, business and personal property, and liability coverages on premises and operations. Other coverage can be added to the basic SMP policy. The bankers blanket bond is not included in the SMP but may be written with it (CX 48, 51). F&D tries to package as much of its blanket bond business as possible. It is making "good strides" in this regard, but

⁶ This differs from a "package of policies"; the latter is a "package" or group of coverages secured from one or more different insurance companies for various risks, put together, "stapled together," by an agent to fill his client's needs. See RPF III-14. In contrast, a CMP-type "package policy" is a *single* policy issued by one company covering multiple risks (Krupp, Tr. 966; McVay, Tr. 1353; Wells, Tr. 1569-1570, 1636).

⁷ Other designations for the same or similar concept include "SMP" (special multi-peril) and "CBP" (comprehensive business policy), a specialized package used by Continental in addition to its general CMP writings (Ruesch, Tr. 467; Halpin, Tr. 933).

^{7*} A related selling device is account selling, an effort to sell as many lines to a customer as possible. The record shows that account selling is limited to very large accounts (\$100,000 to \$300,000 annual premiums) and plays a minor role in surety, which always stands on its own (Culbertson, Tr. 678, 1745-1746; Wells, Tr. 1564).

