

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. Bokat 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	Surety
	Direct Premium	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).

still writes a substantial portion of its fidelity bonds outside of packages (Culbertson, Tr. 1702-1708). F&D considers itself highly competitive with regard to SMP-type packages for financial institutions (Culbertson, Tr. 1705).

103. A company wishing to enter the fidelity and surety fields faces certain barriers (see Fs. 147-148, *infra*).

104. Underwriters with training and expertise beyond that of the ordinary insurance underwriter are required. To train such underwriters requires several years, usually of on-the-job training. To become an expert takes longer. At Seaboard, for example, every surety bond is approved by a senior underwriter with 20 years' experience (Sinclair, Tr. 93, 105-107; Fait, Tr. 155-156; Moritz, Tr. 188; Scaglione, Tr. 222). To hire already trained underwriters can be difficult because of their scarcity and the high price they command (Halpin, Tr. 921; Thorne, Tr. 1649). The need for specially trained underwriters is even more pressing in contract bonds than in other surety bonds or in fidelity bonds. A contract bond underwriter must be familiar with financial statements, have a grasp of the construction industry, have a sense for the legal language of contracts and bonds and have considerable experience (Fait, Tr. 155-156).

105. Agents and brokers must be convinced to add a new entrant to their "stables" of underwriters with whom they have established relationships. This can be a difficult task (Fait, Tr. 158-159, 162-163, 165; Thorne, Tr. 1672).

106. Expertise and a reputation for it in the field is slowly acquired and is necessary to service customers, [30] reduce risks, conduct salvage and generally convince agents to place business (Fs. 76-77, *supra*; Moritz, Tr. 189, 204-205). Customers establish a relationship with their bonding company over a period of years (Krupp, Tr. 989-990; Shrake, Tr. 1388). The company becomes familiar with the client's performance in an industry, its financial position and integrity. Once familiarity and trust develop, the client is disinclined to switch to a new bonding company (Fait, Tr. 159; Krupp, Tr. 989; Shrake, Tr. 1388; Wells, Tr. 1605-1606). In addition, a long-standing relationship helps a client obtain a bond faster. Clients frequently need a bond on short notice. If they have dealt with a bonding company over a period of time, that company will already have the financial information on the client needed to determine whether it will write the bond. Expedient action on a bond request is regarded as crucial by agents and clients. Agents have discontinued business with underwriters because of delay in obtaining bonds (Krupp, Tr. 985, 988-989; Shrake, Tr. 1396-1398).

107. Since the size of a bond it may write is measured by its capital and surplus (F. 132, *infra*), a company needs large amounts of capital

and surplus to provide the capacity to write the large bonds needed in today's market, and hence to compete successfully for agents and customers in the market (Fait, Tr. 162-164). Bond companies can expand their capacity through reinsurance treaties (Sinclair, Tr. 84-85; Backman, Tr. 2295-2296). However, the number of professional reinsurance companies are limited (Fait, Tr. 158-159). State requirements of capacity and surplus and sometimes of previous profitable writing experience must be met in order to be licensed (Sinclair, Tr. 95; Moritz, Tr. 198; Fait, Tr. 147). The licensing process can be time-consuming (Johnston, Tr. 254).

VI. *Structure of the Fidelity and Surety Markets*

A. Market Structure

108. In 1968, the year preceding its acquisition of F&D, American General ranked 12th nationally in the fidelity market in terms of direct premiums written, with direct premiums of \$4.7 million and 3.3 percent of the market. It was sixth in surety, with direct premiums written of \$15.2 million and 4.4 percent of the national market (Complaint and Answer, par. 5; CX 92, pp. 3-4).

109. The same year, F&D, the acquired company, was the third largest fidelity underwriter in the United States in 1968, with \$10.4 million in direct premiums written, [31] approximately 7.4 percent of the national market. In the same year, F&D was the second largest surety writer, with 8 percent of the market and \$27.7 million in direct premiums written (Complaint and Answer, par. 9; CX 92, pp. 3-4).

110. The resulting combination held first place in both the surety and fidelity markets, with approximately 12.4 percent of the surety market and 10.7 percent of the fidelity market, based on 1968 figures (CX 92; CX 176, pp. 286-287).

111. In 1968, the year preceding the acquisition, the top four firms in the fidelity market held 31.3 percent of that market in terms of direct premiums written; the top eight accounted for 53.5 percent. After the acquisition (based on 1968 figures), the top four accounted for 34.6 percent, and the top eight, 56.8 percent of the fidelity market (F. 145, *infra*).

112. In the surety market for 1968, the top four firms accounted for 30.6 percent of the market; the top eight for 49.8 percent. After the acquisition, the four largest surety writers had 35.0 percent of the market and the eight largest had 53.6 percent (F. 145, *infra*).

113. In 1968, the 15 largest fidelity writers alone accounted for 75.5 percent of the direct premiums written in the nationwide market. The top 15 surety writers wrote 69.8 percent of the direct premiums written

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in that market in the same year. These leading firms, their shares and premiums written were as follows:

Fidelity

<i>Company or Group</i>	<i>Direct Premiums Written</i>	<i>% Of Total All Co.'s</i>
Aetna Life & Casualty Gp.	12,485,468	8.9
Continental Insurance Cos.	10,609,993	7.6
Fidelity & Deposit of Maryland	10,392,495	7.4
Insurance Company of North America	10,278,060	7.4
Hartford Insurance Company Gp.	9,377,242	6.7
Fireman's Fund American Ins. Cos.	7,380,037	5.3
Chubb & Son, Inc. Gp.	7,306,680	5.2
U.S. Fidelity & Guaranty Gp.	6,915,648	5.0
[32] Employers Insurance of Wausau Gp.	6,182,958	4.4
Travelers Insurance Gp.	5,686,457	4.1
St. Paul Companies	5,303,744	3.8
Maryland American General Ins. Gp.	4,591,744	3.3
Employers Commercial Union Gp.	3,318,787	2.4
Transamerica Insurance Gp.	2,912,612	2.1
Kemper Insurance Gp.	2,613,269	1.9

Surety

<i>Company or Group</i>	<i>Direct Premiums Written</i>	<i>% Of Total All Co.'s</i>
U.S. Fidelity & Guaranty Gp.	28,074,198	8.2
Fidelity & Deposit of Maryland	27,581,424	8.0
Aetna Life & Casualty Gp.	26,968,529	7.9
Travelers Group	22,187,816	6.5
Fireman's Fund American Ins. Cos.	16,311,269	4.8
Maryland American General Ins. Gp.	15,118,894	4.4
St. Paul Companies	14,338,480	4.2
Hartford Insurance Company Gp.	13,005,337	3.8
Chubb & Son, Inc. Gp.	12,739,169	3.7
Seaboard Surety Company	11,545,397	3.4
SAFECO Insurance Group	11,282,420	3.3
Reliance Insurance Cos.	10,976,203	3.2
Continental Insurance Cos.	9,971,940	2.9

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Insurance Company of North America	9,681,491	2.8
United Pacific Insurance Gp. (CX 92, pp. 3-4)	9,204,699	2.7

114. It is not possible to ascertain with precision from this record the total number of separate companies actively engaged in writing fidelity and surety bonds at the time of the challenged acquisition, nor to compare it with the number of writers for prior or subsequent years.

The Surety Association of America's membership lists for 1968 and prior years do not reflect all companies writing fidelity and surety in those years. At that time (and indeed until 1973 when membership requirements were eased), many companies who wrote considerable amounts of fidelity and surety were not members of the Association, but were merely subscribers or manual purchasers because they did not wish to adhere to then-mandatory Surety Association rates for members (see. F. 80, *supra*; [33] Hepburn, Tr. 1194, 1445-1449). Therefore, one cannot ascertain the change in numbers of *all* companies writing fidelity or surety between 1963 and 1968, for example, by comparing the Surety Association "membership and affiliate" figures for those years (160 and 194, respectively); the figures show change in membership only. The same is true of the 1973 figures, and that year there is an added element of distortion in that the Surety Association relaxed membership requirements by making its rates nonmandatory even for members (RX 226; Hepburn, Tr. 1194, 1445-1449).

The "Treasury List" is a list of surety writers who have been approved to write bonds on federal construction contracts (Culbertson, Tr. 859). Though inclusion on the Treasury List is legally required only for those companies writing bonds running to the Federal Government, the list is used as a guide to acceptable securities by other political bodies and by many private architects and engineers, and inclusion on the list enhances the image of a company (Fait, Tr. 153; Culbertson, Tr. 859-860). Until 1975, a company could appear on the Treasury List although it did not write any surety bonds or did not write a significant amount of surety (RPF, V-108-112; Wells, Tr. 1589; Robbins, Tr. 2573). And at the same time, certain companies write surety bonds but do not appear on the list (Culbertson, Tr. 860). Therefore, the 1968 list may not accurately reflect active writers of both fidelity and surety in that year. The Treasury List suffers from another defect in that it does not purport to show all companies grouped under common management, but rather groups some companies under common management and lists others separately (Wells, Tr. 1590; Backman, Tr. 2245-2247; Robbins, Tr. 2574). Thus, the Treasury List of 223 companies in 1968

(RX 92) does not accurately reflect the number of all independent, competing, active surety and fidelity writers for any given year, and valid conclusions regarding growth of fidelity and surety writers cannot be drawn from it.

Figures derived from Best's Aggregates and Averages and set forth in RX 223-225 are flawed in that companies under common ownership are not grouped (Backman, Tr. 2790-2794).

[34] Best's Executive Data Service, though available for only a limited number of years, does group fidelity and surety writers that are under common management. These figures are set forth in CX 42-45 and RX 43-52 and indicate that in 1968 there were 166 groups writing fidelity and 211 writing surety. This compares with 163 fidelity writing groups and 190 surety writers in 1967; and 167 fidelity writing groups and 246 surety groups in 1972.

B. Data Sources

115. The industry data contained in the record are derived from several sources: the annual statements required to be filed with a state's insurance commissioner by all companies operating in the state; compilation of those data by the various reporting companies; and certain other compilations of statistics produced by the Surety Association of America from its own reporting plan.

116. The annual statement is a detailed report of an insurance company's activities in a state, including a series of financial and statistical reports on the company's operation for the year. Every insurance company files an annual statement with each state in which it does business (Sinclair, Tr. 102; Fait, Tr. 151-152; Johnston, Tr. 255; Hepburn, Tr. 338-339). The statements are submitted under oath and are notarized. The form used was developed by the National Association of Insurance Commissioners, an organization of the insurance commissioners of the 50 states, and is similar for all states and all companies (Fait, Tr. 152; Hepburn, Tr. 338-340; Schraeder, Tr. 485-487).

On page 14 of the annual statement, the company's direct premium writings are broken down by line (including fidelity and surety) and by state (Fait, Tr. 152; Hepburn, Tr. 339-341).

117. The Spectator Company part of the Chilton Company, is a financial publishing company that publishes statistics on the insurance industry (Reddy, Tr. 293; Hepburn, Tr. 340).

118. Beginning with 1962, and until 1967, Spectator published a volume on the insurance industry entitled *Direct Writings*. It was essentially a printout from [35] Spectator's computer of the page 14 annual statement statistics filed by the insurance companies with the states. It contained and broke down data on direct writings by

company, line and state for all companies (Reddy, Tr. 295-302). Steps were taken to verify the accuracy and completeness of its data, and corrections were requested from the submitting companies where necessary. *Direct Writings* was a complete compilation of the page 14 material (Reddy, Tr. 302-306; Hepburn, Tr. 341-343).

119. The Surety Association of America is the trade association for fidelity and surety writers throughout the country. It also serves a rating or rating advisory function for its members, and gathers and disseminates statistics as the members' statistical agent before state insurance departments (Pearson, Tr. 272-273; Hepburn, Tr. 324).

120. The Surety Association produces a publication entitled *Fidelity-Surety Aggregates by State and by Type of Carrier Showing Fifteen Largest Writers*, based on annual statement page 14 data (CX 92-96; RX 74-81, 232-233; Hepburn, Tr. 337-339). From 1962 to 1967, inclusive, the page 14 material was supplied to the Association by Spectator, for virtually all companies doing business in the United States (see F. 118, *supra*). It was cross-checked with the Surety Association's own data and compared favorably with it. The final published results reflected nearly 100 percent of all companies' reported fidelity and surety experience in those years⁸ (Hepburn, Tr. 340-343).

After 1967, Spectator stopped disseminating such data, and the Surety Association obtained the page 14 material directly from its affiliated companies and from state insurance supervisors. A spokesman for the Association testified that the results for 1968 gathered this way reflected approximately 98 or 99 percent of the total direct writings of the Nation's fidelity and surety writers (Hepburn, Tr. 344-346). A comparison of RX 43-52, [36] the direct premium figures for 1968 to 1972 given in Best's Executive Data Service, with RX 74-81, the Surety Association figures for those years shows them nearly identical. Since about 1970, the Surety Association has received the page 14 data through the A.M. Best Co. (Greene, Tr. 54; Culbertson, Tr. 804; see Fs. 124-127, *infra*).

121. The *Fidelity-Surety Aggregates* is made available to all the members of the Association, who use it to evaluate their performance and that of other companies, and to follow trends in competition (Sinclair, Tr. 97, 99-100; Fait, Tr. 149; Hepburn, Tr. 352; Wells, Tr. 1580-1581).

122. The Surety Association's analogous statistics for 1955 to 1961, inclusive, appear at RX 235, 236 and 237. These statistics too were derived from the annual statement page 14 data. For those years, the Association sought and received the statements directly from companies who were either members of, subscribers of, purchasers of the

⁸ Excluding nonreported CMP related fidelity; on which see Fs. 137-143, *infra*.

Surety Association rate manual, or statistical reporters to, the Surety Association. The resulting data were not published annually, but for a 6-year period at a time. The published figures are somewhat less complete than for later years, and include some foreign writing, unlike statistics for later years; they do, however, reflect approximately 95 percent of the direct fidelity and surety writings nationwide for those years. The totals derived from compiling the page 14 data for each company were checked against page 7 of that company's statement (which shows total premiums by line of business for that company) but were not checked against other statistical reporting services. No company ever notified the Surety Association of any error, or correction to be made, in its data (CX 191).

123. The Surety Association has also, since 1965, collected and published certain data under its *Fidelity, Forgery & Security Uniform Statistical Plan of the Surety Association of America* (Hepburn, Tr. 314-315; CX 91). The plan serves as a basis for the uniform collection of fidelity and surety statistical data from the companies engaged in the direct writing of those lines. Over 90 percent of such companies participate in the plan (Hepburn, Tr. 315). The reporting companies are required to attest to the accuracy of their submissions by affidavits of the company official responsible for compilation of statistical [37] data (Tr. 317). Derived from this data are several documents in the record reflective of consolidated fidelity and surety experience (CX 64-65, 84; Tr. 318-322). Such documents are intended to be used primarily in ratemaking for the fidelity and surety lines. They are forwarded to all members and reporting companies, and as a matter of law to the insurance supervisors of each state in discharge of the Surety Association's responsibility as statistical agent of the companies (Tr. 322-324).

124. The A.M. Best Company publishes various compilations of data for the insurance industry, including the fidelity and surety lines (Greene, Tr. 520-522).

125. The Best Executive Data Service was introduced in 1963 to provide information on direct premium writings broken down by line and by state, in response to what Best officials felt was a clear market demand for such a product (Tr. 522-524). The Service is based on the annual statement page 14 data. Best's totals are checked against company totals, with cross-checking and balancing done for all companies. Should a company's annual statement be revised subsequent to its submission to Best, Best makes the necessary alterations in its report the following years. The editor of the Service testified that essentially all of the Nation's fidelity and surety business is thus reported (Tr. 525-529).

126. The Executive Data Service is purchased by state insurance authorities as well as by insurance companies, who use it for comparison purposes (Scaglione, Tr. 225-227; Greene, Tr. 522-528; Spickard, Tr. 1120, 1136-1137; Wells, Tr. 1579-1581).

127. Best's Executive Data Service statistics are in accord with Surety Association statistics for the same years (F. 120, *supra*).

128. It is found that the market data in the record are sufficiently complete and accurate to allow valid conclusions to be drawn regarding the effects of this acquisition. They have a common source — the annual statement page 14, have been checked to make certain they accurately reflect that source, and compare favorably with one another. They are the statistics [38] used by industry members and state insurance departments. Whatever their shortcomings,⁹ they are relied upon by those who have most need of an accurate picture of competition in the fidelity and surety lines, and may logically and reasonably be relied upon here.

C. Use of Direct Premiums as an Appropriate Measure of Market Structure

129. Direct premiums are a more appropriate measure of market shares and the effects of this acquisition on competition in the relevant markets, than are net premiums (Fs. 130-136, *infra*).

130. Total premiums generated by the bonds written by a bond company (the "primary writer") are called "direct premiums" (Hepburn, Tr. 329-330; Culbertson, Tr. 795; Backman, Tr. 1968).

131. The primary writer may "spread the risk" on any given bond by ceding a portion of the bond and a proportional share of the direct premiums to a reinsurance company. Reinsurance is handled in either of two ways. The primary insurer may enter into a treaty with a reinsurance company, which establishes automatic writing lines or acceptances, whereby 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). Or, the reinsurance may be handled on a facultative basis, by reinsurance companies or other primary writers. The facultative reinsurer evaluates each risk separately, based on the underwriting information supplied by the primary writer, to decide how much of each risk it would be willing to reinsure (Fait, Tr. 146; Culbertson, Tr. 1549, 1556; Wells, Tr. 1616; CX 80, pp. 25-26). What remains of the direct premiums thereafter (plus any reinsurance the company has itself assumed from other primary

⁹ See Fs. 73, 137-143 for treatment of nonreported fidelity written as a component of CMP policies, and discrepancies caused by differences in allocation methods.

writers) constitutes the company's "net premiums" (Fait, Tr. 154; Culbertson, Tr. 795; Shrake, Tr. 1403; Backman, Tr. 1968-1969).

[39] 132. A bond writer has some control over its net premium volume from year to year. The amount of any single bond that may be written by a company is limited by law to a fixed percentage of its capital/surplus account (Sinclair, Tr. 85), but within the allowable range, management can decide how much of any risk it is willing to retain. Many factors go into such decisions (loss ratio, expenses, profitability) that pertain primarily to the internal (rather than the competitive) position of the company, and there is no consistency among net retentions by sureties or insurers (Culbertson, Tr. 800; Sohmer, Tr. 1095-1096; Backman, Tr. 2769-2770).

133. Because losses and expenses of a bond underwriter are related to net premiums (though not necessarily indicated by them), net premiums are the measure generally used for management reports on the internal position of a company (Moritz, Tr. 207-208; Culbertson, Tr. 796, 1545-1546; Spickard, Tr. 1132).

134. The parties agree that direct premiums are the best measure of market penetration. That is, direct premiums measure a company's production of bonds (the equivalent of sales in other industry) — its ability to get the business — indicating its initial competitive success in the marketplace (RPF IV-36; CPF 184; Halpin, Tr. 924; Spickard, Tr. 1131; Shrake, Tr. 1402-1403; Wells, Tr. 1588-1589; Culbertson, Tr. 1768-1769, 1795).

135. The use of net rather than direct premiums would have the effect of making it appear that several of the major reinsurance companies which produce little or no direct writing are in fact leading competitors in the fidelity and surety market (Fs. 92-98, *supra*). Such an impression would be misleading. The parties agree that reinsurers do not compete directly with the primary writers (RPF IV-48; CPF 205). That reinsurance companies make it possible for primary writers to underwrite larger bonds than their capital and surplus accounts alone would allow, does not, in my opinion, diminish the competitive strength shown by the primary writer in initially acquiring the underwriting business. The primary writer is successfully competing when it acquires business, regardless of the reinsurance phase which follows. Of course, if such a company were continually losing money in its underwriting business, the situation would be [40] different. The company could not in that case be considered a strong or successful competitor in that market.

Nor does the service provided by the reinsurer make it an indirect competitor of the primary writers. What it reflects is that the primary writer has successfully competed with other primary writers on two

levels: for the bonds it writes, and for the extra capacity provided by the reinsurer.

136. That the findings above are to the effect that direct premiums written provide a more appropriate measure than do net premiums of market shares and competitive strength, does not mean that direct premiums are the only measure. Both parties stress the importance of profitability in any assessment of a bond writing company's competitive strength (CPF 229; RPF IV-41, 42; RRB, p. 78). Profitability of the companies involved in this acquisition, most importantly F&D, has been considered carefully (see Fs. 5, 10, 28, *supra*). It is the Administrative Law Judge's opinion that profitability and direct premium writings together give the most accurate picture of a firm's competitive strength in the relevant markets.

D. The CMP Factor

137. As found above, packaging, in the form of CMP-type policies and otherwise, has become an established method of selling in the commercial insurance lines and such "packages" often include fidelity components (Fs. 99-102, *supra*).

138. The fidelity portion of a CMP policy is functionally interchangeable with a fidelity bond sold separately (Fait, Tr. 209-210; Hepburn, Tr. 352-354; Ruesch, Tr. 466; Culbertson, Tr. 698).

139. Surety is not included in CMP-type policies (Sinclair, Tr. 114; Fait, Tr. 143; Moritz, Tr. 180; Hepburn, Tr. 368; Spickard, Tr. 1134-1135; Thorne, Tr. 1682C; Culbertson, Tr. 1700).

140. Most underwriters do not report separately as fidelity that fidelity coverage written as a component of a package policy. Rather, those fidelity premiums are simply included in the "CMP" or "SMP" total. The fidelity component of CMP is consequently not reflected in the [41] regular industry statistics for fidelity premiums written (Hepburn, Tr. 352; Schraeder, Tr. 508-509; Greene, Tr. 539, 1237; Ruesch, Tr. 466-467; Culbertson, Tr. 700-702, 1742-1743).

141. F&D does report as fidelity the fidelity portions of its CMP policies (Culbertson, Tr. 724-725). Consequently, while industry totals for fidelity premiums written are understated by the amount of unreported fidelity written as part of CMP, F&D's share of the fidelity market may be slightly overstated by the regular industry statistics (F. 6 *supra*; Schraeder, Tr. 509; Greene, Tr. 539). The exact extent to which industry totals for fidelity premiums written are understated is not known (F. 140, *supra*; RRB, p. 106).

142. Counsel for both parties, either by projecting industry totals from the few statistics available from companies that do report CMP-related fidelity separately (RRB, pp. 103-106), or by relying on

estimates made by industry witnesses and industry reporting services (CPF 147-162), have proposed estimates of the volume of fidelity written as part of CMP policies. The president of F&D testified that he prepared in 1968 for management evaluation purposes an estimate of the fidelity portion of the CMP market that he considered sufficiently reasonable. His estimate was 1.6 percent for 1967 (Culbertson, Tr. 1716-1719; CX 31C; CX 165; RX 37). Complaint counsel suggest that the fidelity portion of CMP ranges from 3.3 percent to 10.9 percent of the total fidelity written, and that the average fidelity portion of CMP amounts to about 7 percent of the total industry-wide fidelity premiums as reported by the Surety Association for 1969 (CPF 156-159). Respondent, projecting data from three companies, suggests that CMP-related fidelity would be as high as 13.6 percent of the straight fidelity total for 1969. If the 13.6 percent figure were used *arguendo*, F&D's share of the fidelity market in 1969 would be reduced from 7.6 percent to 6.5 percent (RX 74). Respondent's calculations applied to 1973 Surety Association figures would likewise reduce F&D's share that year from 6.3 percent to approximately 5 percent (RRB, pp. 105-106; RX 232). However, the combined share of F&D/American General would still place it in the first place in fidelity in 1969 (RX 74) and in the fourth place in 1973, the same ranks it held without accounting for CMP-related fidelity (RX 74, 232).

143. For the purposes of this proceeding, it is found that the various estimates given by industry and trade association executives are sufficiently reliable to be used. Based on these estimates, the range from 3.3 percent to [42] 10.9 percent may be derived (CPF 155-159). The fidelity portion of commercial multi-peril policies is small, and the percentage of such fidelity represents only a small portion of the total fidelity market. The low figures that prevailed at the time of the merger will not materially affect the totals, market shares, and conclusions concerning that market.

VII. *Trend Toward Concentration*

144. Between 1959 and 1969, some 40 horizontal acquisitions (mergers) of U.S. companies writing fidelity and surety took place (CX 22, 25).

145. The 15-year period from 1959 to 1973 witnessed a trend toward

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increased concentration in both the fidelity and surety markets, as set forth in the following table:¹⁰

¹⁰ Use of net premium figures also shows increased trend toward concentration:

Net Premium Figures						
Concentration in Fidelity and Surety Industries In Terms of Net Premiums Written						
Fidelity						
	(a)	Top 4 (b)		(a)	Top 8 (b)	(c)
1958	24.1			42.8		
1959	23.8			42.6		
1960	25.0			44.4		
1961	23.4			43.3		
	(RX 212)			(RX 212)		
1962	24.32	23.3		45.30	43.3	
1963	25.64	24.7		46.22	44.6	
1964	25.96	25.8		46.95	46.7	
1965	26.88	26.5		47.71	47.3	
1966	27.15	27.1		48.37	48.0	
1967	29.44	29.3		48.73	48.3	
1968	31.10	30.7		50.98	49.8	
1969	33.47	33.1		56.96	52.9	55.9
1970	35.36	34.9		56.79	52.6	54.9
1971	36.19	36.3		57.61	53.6	55.7
1972	35.19	35.2		58.86	54.5	56.7
	(RX 15-25)			(RX 15-25)		
1973	35.34	35.3		57.34	53.5	55.5
		(RX 212)			(RX 212)	(RX 214)
Surety						
	(a)	Top 4 (b)	(c)	(a)	Top 8 (b)	(c)
1958	23.3			39.02		
1959	22.6			38.3		
1960	22.6			39.0		
1961	22.8			39.8		
	(RX 213)			(RX 213)		
1962	24.72	24.2		43.05	41.1	
1963	25.09	25.0		43.28	41.7	
1964	25.42	25.3		43.57	42.3	
1965	24.42	24.5		43.57	42.9	
1966	25.29	25.3		44.70	43.5	
1967	26.37	26.3		46.11	45.0	
1968	28.45	28.4		47.37	46.9	
1969	31.28	29.1	31.1	50.54	47.2	50.0
1970	31.27	28.9	31.2	49.81	46.8	49.4
1971	31.55	29.3	31.6	49.93	47.6	50.0
1972	29.76	28.1	29.8	48.05	45.6	47.7
	(RX 26-36)			(RX 26-36)		
1973	29.14	27.6	29.1	47.56	44.8	46.9
		(RX 213)	(RX 214)		(RX 213)	(RX 214)

(RX 15-36; RX 197-198; RX 212-213; RX 214 also used Best's Aggregates and Averages as a source)

Under "Top 4", 1959-1961, column (a) and column (b) are from RX 212. RX 15-36 include some reciprocals and Lloyd's writings, and group companies under common ownership. RX 212, 213 and 214 do not, hence the RX 15-36 figures are slightly larger for some years than are the corresponding figures taken from RX 212 and RX 213. For "Top 8" Fidelity and "Top 4" and "Top 8" Surety figures: the 1969-1973 column (b) figures apparently omit the American General statistics. See RX 214. RX 214 adds the American General share to F&D's in its Top 8 statistics—the result for the Top 8 including American General is shown in column (c).

Initial Decision

Year	Fidelity		Surety	
	Top 4	Top 8	Top 4	Top 8
1959)	26.0	[24.6]	47.8	[45.0]
1960) ¹¹	27.5	[26.0]	49.3	[46.3]
1961)	26.2	[24.7]	47.7	[45.2]
1962	24.2		45.1	
1963	26.4		47.6	
1964	27.9		48.7	
1965	26.3		46.5	
1966	28.5		51.2	
1967	30.2		51.4	
1968	31.3		53.5	
1968	*34.6		*56.8	
combined*				
1969 not combined	33.0		57.6	
1969*	*35.9		*60.5	
1970*	*35.7		*59.8	
1971*	*38.5		*60.4	
1972*	*37.9		*62.1	
1973*	*37.3		*61.4	

*F&D and American General shares combined in these figures (RX 74-81, 232-233, 235A, 236A, 237A; CX 119-134).

[43] 146. Not only did concentration increase overall during the period 1959-1973, but a small group of companies consistently held leading positions in the fidelity and [44] surety markets. In surety, the top four writers (F&D, Fidelity & Guaranty, Aetna, Travelers) remained the same from 1959 through 1973. In the fidelity market, F&D [45] (either alone, or, after 1968, combined with American General) was among the top four during each of the relevant 15 years. The Hartford group placed in the top four in all but one of those years, 1968, when it ranked number five. Insurance Company of North America was among the top four in eight years, with another year at the number five position. Aetna ranked in the top four for seven of those years and was number five in another year. U.S. Fidelity and Guaranty ranked in the top four for four years (CX 92, pp. 1-2; CX 93D,

¹¹ Complaint counsel argue (CRB, p. 56) that, since it was stipulated in CX 191 that the pre-1962 market share figures as set forth in RX 235-237 were reflective of only 95 percent of the fidelity and surety markets, adjustments must be made to arrive at accurate shares of the total markets for these years. Their method of adjustment is shown in CPF 96, n. 2, and results in the following shares, shown below, and in the brackets in the chart above:

Year	Fidelity		Surety	
	Top 4	Top 8	Top 4	Top 8
1959	24.6	45.0	23.7	41.0
1960	26.0	46.3	23.8	41.1
1961	24.7	45.2	24.2	42.0

These figures are, of course, somewhat speculative. At any rate, the difference between these "adjusted" shares and those set forth in Finding 83 is in no case large enough to be significant. Use of the "adjusted" figures would have no effect on the 15-year trend toward increased concentration found above.

E; CX 94C, D; CX 95C, D, E, F; CX 96C, D, E, F; RX 74-81; RX 233, 236-237).

147. As set forth in Finding 114, *supra*, this record does not permit an accurate determination of the numbers of companies writing fidelity or surety bonds, or both, over a long range time period. At any rate, the record in this proceeding fails to provide clear-cut examples of any *de novo* entrants into either the fidelity or surety market which have become significant factors in those markets during the last 15 years. All the evidence indicates an absence of any pattern of successful entry and rapid growth by new writers of surety or fidelity, such as would counter the anticompetitive effects of a horizontal merger involving a market leader (Moritz, Tr. 189; Scaglione, Tr. 224-225). The eight leading direct writers of fidelity in 1973, or their predecessors, had all written fidelity since at least 1955. The top eight direct writers of surety in 1973, or their predecessors, were also writing surety as early as 1955 (Backman, Tr. 2811-2812; RX 56, 232-233, 235-236). There were no [46] companies among the 15 largest direct fidelity writers in 1972 who did not write fidelity bonds at least as far back as 1962, nor were there any companies among the 15 largest direct surety writers in 1972 who did not write surety bonds at least as far back as 1962 (Culbertson, Tr. 1751-1752; RX 77, 81, 202-203, 208-209).

148. The companies cited by respondent as examples of recent, significant entry into the fidelity or surety markets prove, on examination, to be either not recent or not significant entrants.

a. Travelers, for example, is not a "recent" entry into the surety market. That company began writing surety in 1940 or 1941 (Shrake, Tr. 1305). In 1956, it was the ninth largest direct surety underwriter, in 1973 the third largest (if F&D's and American General's shares are combined for the latter year) (RX 233, 236A). Traveler's rise in ranking required a great deal of work. There is testimony in the record to the effect that the improvement in rank shown in the second 15 years of Travelers' surety experience required much more effort than for that of the first 15 years (Shrake, Tr. 1399). Travelers' progress, taking place as it did over a 30-year period, can hardly be described as "meteoric."

b. Similarly, Great American has had many years' experience in the underwriting of surety bonds. It was active in the business prior to 1955, "withdrew" between 1955 and 1965, and reactivated its surety operations in 1965 (Scaglione, Tr. 240; Culbertson, Tr. 850). It cannot be considered a "recent" entry. Nor can it properly be considered a significant factor in the industry. Its direct surety writings increased from about \$5 million in 1968 to about \$5.6 million in 1972, the company virtually standing still (RX 48, 52). It has recently suffered very unprofitable underwriting results in surety. William Shrake, an agent

with Collier-Cobb, a major agency for bonds, testified that Great American's service has deteriorated, and that it has recently been so slow to respond to requests that it is no longer an acceptable source of supply to Collier-Cobb. Indeed, that agency recently moved 34 contractor accounts from Great American (Shrake, Tr. 1396-1397).

c. Argonaut, founded in 1948 as a writer of workmen's compensation insurance, has entered the surety market somewhat more recently, first underwriting surety in 1959 (Thorne, Tr. 1641). However, it cannot be called a [47] significant factor in the market in the sense that it is a stable, successful writer of surety bonds, one to be reckoned with. Although it wrote \$9.9 million in direct surety in 1972 and ranked number 15 that year (RX 52, 81), it suffered extremely bad underwriting losses in 1973 and 1974 (Thorne, Tr. 1673-1674). These losses were not solely the result of any general economic downturn but were caused partly by poor underwriting personnel who wrote bad bonds (Thorne, Tr. 1674-1675). The head of the company's bonding department admitted that the company had expanded too quickly (Tr. 1678-1679). As a result, the company has had to retrench drastically. It has fired four of its district managers (Thorne, Tr. 1677-1678) and has revoked the authority of the branches to write any new accounts prior to home office approval (Tr. 1660, 1675). Argonaut is re-underwriting its entire book of bond business in order to eliminate all marginal accounts (Spickard, Tr. 1128; Thorne, Tr. 1675). Volume has declined as a result, and a decrease of \$1 million or 8 percent was projected for 1974 (Thorne, Tr. 1679). Argonaut's ability to service customers quickly has been affected to the extent that Collier-Cobb, a major agency, at present does not consider Argonaut to be a viable source of bonds for its clients (Shrake, Tr. 1398). The other companies cited by respondent present similar pictures. Either they are not truly recent entries¹² or they have not exhibited the rapid and substantial gains in size and strength that would mark a truly significant new entrant.¹³ [48]

VIII. *Anticompetitive Effects of the Acquisition in the Fidelity and Surety Markets*

149. Prior to American General's acquisition of F&D, American

¹² Employers of Wausau: Halpin, Tr. 875; Safeco: RX 203 revised, CRB, p. 30; Kemper: CPF 233, Halpin, Tr. 887, 912, 935, RX 52; Western Surety: RPF V-178(a); Union: RX 202 revised; Allegheny Mutual: CRB, p. 34, RPF V-178(h); Home: RPF V-178(b), CRB, p. 33.

¹³ For example — Employers: Halpin, Tr. 87, CRB, p. 30; Unigard: Tr. 852, 857, RX 144B, RX 241; Allstate: CPF 234, RX 47, 52; Backman, Tr. 2818; Kemper: CPF 233, RX 52J; Commercial Union: Backman, Tr. 2829-2830, RPF V-154; Leatherby: Culbertson, Tr. 1755, CPF 237, RPF V-158, V-161; Northwest National: Tr. 853, RX 47, 52, CX 25, CPF 236; Surety Co. of California: RPF V-169; American Bonding: Tr. 251, 262, RPF V-176; Capitol Indemnity: RX 47, 52, RPF V-177; Crum & Foster: RPF V-178(c), CPF 246; Cumis: CRB, p. 34; New Hampshire: RPF V-178(e); Vigilant: CX 188(b), CPF 239; Personal Service: RX 52, CRB, p. 34; Allegheny Mutual: RPF V-178(h), RX 52, CRB, p. 34; International Fidelity: RX 52, RPF V-178(i); Home: RPF V-478(b), CRB, p. 33.

General and F&D competed for underwriting business in the nationwide fidelity and surety markets (Culbertson, Tr. 793; Robbins, Tr. 1281, 2523; Shrake, Tr. 1394, 1399; Fs. 2, 15, 60, 65, *supra*). This acquisition eliminated substantial actual competition between the two companies.

150. The acquisition of F&D by American General strengthened the market position of American General by increasing its market share considerably (F. 110, *supra*).

151. The acquisition substantially increased concentration in the fidelity and surety markets (Fs. 108-112, *supra*).

IX. Discussion

A. The Relevant Product Markets

A threshold issue in this case is, of course, the determination of the product dimensions of an effective area of competition within which the legality of the challenged acquisition must be tested. *Brown Shoe Co. v. United States*, 370 U.S. 294, 324 (1962). There is, in this case, a dispute regarding the product market issue. Complaint counsel contend that the business of underwriting fidelity bonds and the business of underwriting surety bonds constitute separate product markets for Section 7 purposes, each distinct from the other and both from other lines of insurance business, such as life/health and property/liability. Respondent does not seriously dispute the proposition that fidelity and surety are separate and distinct product "lines" but insist they are properly included in broader insurance markets (RPF III-1). Respondent's arguments focus on the proposition that (1) fidelity and surety are an integral part of the broader property/liability insurance in terms of marketing, and (2) there are substitutes for corporate fidelity and surety bonds. Thus, respondent would lump fidelity bonds together with all forms of "dishonesty insurance," such as burglary insurance. And the surety bond market would include bank letters of credit, personal surety and "self-insurance." [49] Respondent argues that a realistic evaluation of the effect of the merger must take into account these two factors.¹⁴

It is well settled that the outer boundaries of a product market are determined by the product and its close substitutes from the functional and economic standpoints. Within this broad market, however, well-defined submarkets may exist which in themselves constitute product markets for Section 7 purposes. And, if there is a reasonable probability that the acquisition may substantially lessen competition in *any* economically significant *submarket*, the acquisition is proscribed by

¹⁴ This last argument of respondent will be discussed hereinafter, pp. 60-61, *infra*.

Section 7. *Brown Shoe Co. v. United States, supra*, at 325. The guidelines in this regard have been well established by the Supreme Court. In *Brown Shoe Co. v. United States, id.*, the Court laid down the following criteria:

* * * The boundaries of such a submarket may be determined by examining such practical indicia as industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors. * * * [Footnote omitted.]

The Court has also made clear that the presence of *all* of the seven factors enumerated above is not required. *United States v. Aluminum Co. of America*, 377 U.S. 271, 275, 276-277 (1964).¹⁵

The Administrative Law Judge is also reminded that the relevant product market must be determined by the nature of the acquiring and acquired firms and by the nature [50] of competition they face. Submarkets should not be contrived in disregard of a broader product market which has economic significance. Nor should product markets be defined to include all substitutes in disregard of the congressional purpose in adopting the amended Section 7 and to obscure the true effect of a merger between sellers of any one of the substitutable products. *Brown Shoe Co. v. United States, supra*, at 326-327; *United States v. Continental Can Co.*, 378 U.S. 441, 456-457 (1964); *United States v. Phillipsburg National Bank*, 399 U.S. 350, 359-360 (1970).

This case involves a horizontal acquisition — the acquisition by American General, an all-lines insurance company and a writer of fidelity and surety bonds, of F&D, a firm largely specializing in fidelity and surety bonds. It is therefore logical to start the product market analysis with fidelity and surety bonds.

Viewed in the light of controlling guidelines discussed above, the record clearly demonstrates that fidelity and surety constitute separate and distinct markets (or submarkets) for Section 7 purposes. Respondent does not seriously dispute the fact that fidelity and surety are separate "lines." The record shows that, in terms of the *Brown Shoe* indicia, fidelity and surety are distinct from each other and each from the other lines of life/health or property/liability lines of insurance.

Most obvious are peculiar uses, distinct prices, and the absence of price sensitivity. Fidelity bonds and surety bonds have separate uses and cannot be used interchangeably with each other or with any other line of insurance (Fs. 36, 55, 57). Both have distinct prices. There is no

¹⁵ In that case, difference in price and absence of price sensitivity were sufficient for the Court to hold that insulated aluminum conductor constituted a product market distinct and separate from that for copper conductor although they are made by the same manufacturers using identical production facilities and have complete functional interchangeability and common customers.

discernible relationship between the prices of fidelity bonds and surety bonds. Surety production, profits and losses fluctuated independently of those of fidelity, and the experience of each was unrelated to that of other insurance lines (Fs. 35, 53, 57). In addition, the record indicates that the industry and the public recognize the fidelity bond business and the surety bond business as two distinct and significant economic entities, separate from each other and from the property/liability insurance industry (Fs. 40, 54). The four above-named factors are sufficient to support a conclusion that fidelity and surety are valid submarkets for the purposes of this [51] case. However, there is further evidence in the record to indicate that fidelity and surety serve largely separate customer groups (Fs. 50, 57).

B. The Relevant Geographic Markets

The parties agree that the Nation as a whole is an appropriate geographic market in which to test the effect of the challenged acquisition. However, there is a vigorous dispute regarding the validity of state markets. Complaint counsel argue that each of the states in the United States is a separate market for the purposes of this case or, alternatively, that at least each of the seven States of California, Florida, Illinois, Maryland, New York, Pennsylvania, and Texas, constitutes a separate geographic market (CRB, pp. 41-42). Respondent advances two principal arguments in opposition. First, respondent contends that the Commission's December 5, 1972 opinion and order remanding the case to the Administrative Law Judge foreclosed, as a matter of law, the issue of state markets from this case (RB, pp. 32-34).¹⁶ Secondly, respondent argues that the record affirmatively shows that states are not economically significant markets (RB, pp. 34-42).

The guidelines for delineation of geographic markets have been clearly laid down by the Supreme Court. The paramount purpose of defining a geographic market is, of course, to determine the geographic dimensions of an effective area of competition in which the legality of a given acquisition must be tested. *United States v. E. I. du Pont de Nemours & Co.*, 353 U.S. 586, 593 (1957); *Brown Shoe Co. v. United States*, *supra*, at 324. In this sense, "[t]he criteria to be used in determining the appropriate geographic market are essentially similar to those used to determine the relevant product market." *Brown Shoe Co. v. United States*, *supra*, at 336. Thus, although in some circumstances the geographic market may be as small as a single metropolitan area, the market selected in all cases [52] must "both 'correspond to the

¹⁶ It is my view that the Commission's remand order did not in terms foreclose the state market issue and that, therefore, I was bound to take evidence on this issue.

commercial realities' of the industry and be economically significant," and not "formal" or "legalistic" *id.* at 336-337.

Viewed in this light, the record evidence falls short of demonstrating that any of the seven states designated by complaint counsel constitutes a valid section 7 market. In my view, the record as a whole shows that "there is nothing sacred about the boundary lines of a state" in the operation of fidelity and surety bond businesses. *United States v. Bethlehem Steel Corp.*, 168 F. Supp. 576, 602 (S.D.N.Y. 1958).

First, there appears to be no significant economic or legal barriers "that significantly impede the entry of new competitors" into a state. *United States v. Pabst Brewing Co.* 384 U.S. 546, 557 (1966). Second, the record does not show any discernible pattern of production or distribution peculiar to any state. Third, there is no convincing evidence to show that fidelity and surety rates in fact differ significantly from state to state, although a number of states have adopted "open competition" statutes some years ago. It is true that state data for the fidelity and surety bonds are published by the Surety Association of America (a trade association) and Best's Executive Data Service (a commercial statistical agency which appears to enjoy full cooperation of both the states and the industry) and that the latter data are purchased and used primarily as a management tool by industry members. However, state market shares and rankings appear to fluctuate widely. Furthermore, they are misleading due to substantial distortion incident to the fact that allocation of a large piece of business to one state can substantially overstate a firm's position in that state and thus fails to reflect the true picture accurately and fairly. Therefore, complaint counsel's contention that each of the States in the United States, or each of the seven named states, constitutes a relevant geographic market in this case is rejected. See Fs. 72-73.¹⁷ [53]

C. The Market Structure and the Probable Effect of the Acquisition

Prior to its acquisition of F&D, American General, through one of its operating subsidiaries (Maryland Casualty Company), was engaged in the fidelity and surety bond businesses in direct competition with F&D. Therefore, a direct and immediate result of the challenged acquisition is the elimination of that actual competition between the two firms. *Brown Shoe Co. v. United States*, *supra*, at 335. Section 7, however, does not condemn every merger between competing firms. It merely proscribes those mergers having demonstrable anticompetitive effects.

¹⁷ Even if the seven state markets designated by complaint counsel were to be accepted as relevant geographic markets, it is my determination that the record does not permit formulation of basic findings which may support a conclusion with respect to the legality of the challenged acquisition in any of the seven states.

Id. at 319. Disclaiming any simple quantitative test of illegality, the Court states, *id.* at 334-335, that the effect upon competition of a horizontal arrangement depends on its character and scope, and that its validity will depend on such factors as:

[T]he relative size and number of the parties to the arrangement; whether it allocates shares of the market among the parties; whether it fixes prices at which the parties will sell their product; or whether it absorbs or insulates competitors.

* * *

A year later, however, the Court began its discussion of the legal standard applicable to horizontal mergers by admonishing against "the danger of subverting congressional intent by permitting a too-broad economic investigation" and indicated that "in any case in which it is possible * * * to simplify the test of illegality, the courts ought to do so in the interest of sound and practical judicial administration." *United States v. Philadelphia National Bank*, 374 U.S. 321, 362 (1963). Specifically, the Court ruled that a horizontal merger which creates a firm having an undue share of the market (30 percent) and thereby substantially increases concentration among the leading firms (by at least 33 percent) is a presumptive violation of Section 7. *Id.* at 363-365. The Court's rationale for this clear advancement from *Brown Shoe* need be remembered.

In *Philadelphia National Bank*, the Court reemphasized the need to give full effect to the central purpose of Section 7 by not merely preserving existing competition but also by arresting anticompetitive tendencies in their incipiency. However, the Court was keenly aware of the [54] "complex and elusive" nature of relevant economic data. Therefore, in view of the "intense congressional concern" with the trend toward concentration, elaborate proof of market structure, market behavior, probable anticompetitive effects may be dispensed with in cases where the merger is inherently likely to lessen competition substantially. *Id.* at 362-363. In applying this principle to the case, the Court stressed the economic objection to concentration and relied on the economic theory on oligopoly in condemning the merger. *Id.* at 363-366.

The following year, the Court made it clear that the elimination of significant competition between the merging firms which are major competitive factors in the relevant market, of itself constitutes a violation of Section 1 of the Sherman Act without the need for further economic inquiry into its competitive effect. *United States v. First National Bank & Trust Co. of Lexington*, 376 U.S. 665, 669-673 (1964). In the same year, in *United States v. Aluminum Co. of America*, 377 U.S. 271 (1964) ("*Rome Cable*"), the Court condemned, in a highly concen-

trated industry, an acquisition which added but 1.3 percent to the acquiring firm's 27.8 percent share of the relevant market. In that case, the Court, in addition to economic objections to concentration, emphasized the social objection to concentration trend in the American economy, which the Court had adumbrated earlier in *Brown Shoe, Id.* at 280-281. *Brown Shoe Co. v. United States, supra*, at 315-316.¹⁸ In *United States v. Von's Grocery Co.*, 384 U.S. 270 (1966), the Court elaborated a social theory of concentration and condemned an acquisition by the third ranking grocery store chain of the sixth ranking firm, resulting in 7.5 percent share of the relevant market, against the background of an evident merger trend and a steady decline in the number of firms in the market. *Id.* at 272-278. During the same term, the Court, in *United States v. Pabst Brewing Co., supra*, following the *Von's Grocery* rationale, condemned a horizontal acquisition in the beer industry which made the [55] acquiring firm the fifth largest with 4.5 percent in the national market, the largest with 24 percent in the Wisconsin market and a leading firm with 11.3 percent in a 3-state area. *Id.* at 550-553.

However, in the most recent Section 7 case involving a horizontal acquisition, *United States v. General Dynamics Corp.*, 415 U.S. 486 (1974),¹⁹ the Court upheld a 1959 merger of two leading coal companies which increased the market share of the two largest firms in the two relevant geographic markets from 45 percent to 48.6 percent and from 44 percent to 52.9 percent, respectively, between the period 1959-1967. *Id.* at 495. It was also shown that in one of the markets, the number of coal firms declined from 144 in 1957 to 39 in 1967. *Id.* at 495. Against this background, the Court sustained the trial court's decision which sanctioned "further examination of the particular market." The Court agreed that due to the new peculiarities of coal economy, namely, dwindling coal demands, scarcity of economical coal reserves and long-term requirements contracts, statistical evidence of past coal production was considerably less significant than in other cases, for the focus of competition in the coal industry is not on the sale of coal already produced but is the procurement of new long-term supply contracts, which is limited by a company's uncommitted reserves of recoverable coal. Viewed in terms of present and future reserve prospect, rather than in terms of past production, the acquired company was a far less significant factor than the past production statistics indicated. *Id.* at 498-503. The Court also relied on the trial court's finding that the rapid

¹⁸ See also Bok, *Section 7 of the Clayton Act and the Merging of Law and Economics*, 74 Harv. L. Rev. 226, 247-248 (1960) (hereinafter "Bok, *Mergers and the Clayton Act*").

¹⁹ See Posner, *Antitrust Policy and the Supreme Court: An Analysis of the Restricted Distribution, Horizontal Merger and Potential Competition Decisions*. 75 Columbia L. Rev. 282, 310-311 (1975). Cf. *Kennecott Copper Corp. v. F.T.C.*, 467 F.2d 67 (10th Cir. 1972), cert. denied, 94 S. Ct. 1617 (1974).

and drastic decline in the number of firms occurred "not because small producers have been acquired by others, but as the inevitable result of the change in the nature of demand for coal." The Court characterized this finding as "most significant." *Id.* at 492-493. For the purposes of the instant case, then, *General Dynamics* stands for the proposition that market share statistics and evidence of concentration of the magnitude involved in *Philadelphia National Bank* and *General Dynamics* establish a rebuttable presumption of illegality. See *United States v. Marine [56] Bancorporation*, 418 U.S. 602, 631 (1974); *United States v. Citizen's & Southern National Bank*, 43 U.S.L.W. 4779, 4789 (U.S. July 17, 1975). With these controlling cases and broad principles enunciated therein in mind, I now turn to the evidence in this case.

(1) The Elimination of Direct Competition Between American General and F&D

In 1964, American General established a substantial position in both the fidelity and surety markets by absorbing Maryland Casualty Company (F. 5). To the extent that American General and F&D competed in the fidelity and surety business prior to the challenged acquisition, the acquisition will eliminate that competition, which was substantial by any standard (F. 149). The two firms wrote the same types of bonds (Woodson, Tr. 1031-1032; Shrake, Tr. 1394). They competed directly and through their agents (Robbins, Tr. 2523, 2528-2529).

Competition in fidelity and surety has three elements: service, availability and price. Service embraces a broad range of services bond underwriters perform, utilizing their specialized skills, training and experience. It includes the guidance and counsel given to agents and customers. For example, if an underwriter finds a risk to be marginal, he may endeavor to improve that risk, using his expertise (Sinclair, Tr. 77). Availability involves the speed with which the bond underwriter makes a decision on accepting and writing the bond. In many situations requiring a bond, usually the time is of the essence (Krupp, Tr. 988-989; McVay, Tr. 1379; Shrake, Tr. 1396-1397). Price competition arises in the rates charged by deviating companies, whose rates deviate 15-25 percent from the Surety Association rates. Different companies may charge different rates as experience and judgment factors are applied to effect variations from basic rates (F. 80).

Equally important, the challenged acquisition absorbs F&D, a leading, profitable, prosperous, well-established, independent specialist in the fidelity and surety markets into an insurance holding company with operating subsidiaries in life/health and property/liability insurance lines. Before the acquisition, F&D, for many years, had been

among the top 3 firms in both markets. F&D wrote business nationwide and maintained 51 branch and service offices, which accounted for two-thirds of a total of [57] some 1100 employees (CX 17, pp. 90-91). A conservative and highly service oriented company, its business, earnings and profits showed consistent growth over the years (Fs. 16, 27, 28). Its loss ratios were among the most favorable in the markets (F. 28). To paraphrase the Court's language in *Rome Cable*, preservation of F&D, rather than its absorption by an insurance conglomerate, will keep it as an important competitive factor. *United States v. Alcoa*, *supra*, 377 U.S. at 281.²⁰

(2) The Increase in Concentration in the Fidelity and Surety Markets

Before discussing the structure of the fidelity and surety markets, one issue must be resolved. There is a sharp dispute between the parties as to which of direct premiums and net premiums are the appropriate basis for measuring the market shares of the firms in the relevant markets. In my view, the record amply demonstrates that direct premiums are comparable to sales in other service industries and are the most important indicia of market power and competitive performance of fidelity and surety underwriters. Although net premiums do reflect a firm's financial strength in some measure, they do not reflect accurately the competitive position of the firms in the marketplace. Also, net premiums can be substantially affected by a firm's internal management decision (F. 132). Several insurance executives testified that their companies use direct premiums to measure their performance and position in the market (*e.g.*, Halpin, Tr. 924; Spickard, Tr. 1131; Shrake, Tr. 1402-1403; Wells, Tr. 1588-1589). Furthermore, to the extent that net premium figures exaggerate the importance of reinsurance firms, which admittedly do not compete for the sale of bonds to customers, net premium figures result in serious distortions of market structure and are misleading. For these and other reasons (Fs. 130-136), it is concluded that direct premiums are the more appropriate measure of the market shares of both fidelity and surety bond writers. [58]

(a) The Structure of the Surety Market

In 1969, the year of the acquisition, the total direct surety premiums of all companies were in excess of \$366 million, and the surety industry constituted a substantial economic activity. In terms of direct premiums, American General's 1969 acquisition represented the absorption of

²⁰ See also Bok, *Mergers and the Clayton Act*, *supra* n. 18, at 247-248, 305-306; Brodley, *Oligopoly Power Under the Sherman and Clayton Acts - From Economic Theory to Legal Theory*, 19 Stanford L. Rev. 285, 341 (1967).

the second ranking firm, with 8.0 percent of the market, by the seventh ranking firm, with 4.3 percent of the market, which made the combined American General group the top ranking firm with 12.3 percent of the market (RX 78). In 1970, the year following the acquisition, the combined share increased slightly to 12.4 percent, keeping the combined group in the top place (RX 79).

In 1968, the year preceding the acquisition, the four largest firms accounted for 30.6 percent of the market, and the eight largest, for 49.8 percent. The corresponding figures for 1969, giving effect to the American General-F&D merger, were 35.3 percent and 51.7 percent, respectively, and for 1970, 35.5 percent and 52.2 percent, respectively. Thus, the challenged acquisition substantially increased concentration in the surety market (F. 112).

(b) The Structure of the Fidelity Market

In 1969, the year of the acquisition, the total direct fidelity premium of all firms were in excess of \$177 million. In terms of direct premiums, the challenged acquisition represented the absorption of the fifth ranking firm, with 7.4 percent of the market, by the eleventh ranking firm with 2.9 percent, which made the combined group the top ranking firm, with 10.3 percent of the market (RX 74). In 1970, the year following the acquisition, the combined share declined slightly to 9.7 percent, but still placed the combined group at the top place (RX 75).

In 1968, the year preceding the acquisition, the four largest firms accounted for 31.3 percent of the fidelity market, and the eight largest, for 53.5 percent. The corresponding figures for 1969, giving effect to the American General-F&D combination, were 35.9 percent and 60.5 percent, respectively, and for 1970, 35.7 percent [59] and 59.8 percent, respectively. Thus, the challenged acquisition substantially increased concentration in the fidelity market (F. 111).

(3) The Trend Toward Concentration

The record demonstrates that during the decade preceding the acquisition, both the fidelity and surety markets experienced a clear trend toward concentration and that the adverse trend was exacerbated in the years following the challenged acquisition.²¹ As for fidelity, the four- and eight-firm concentration gradually increased from 26 percent and 47.8 percent, respectively, in 1959,²² to 31.3 percent and 53.5 percent, respectively, in 1968, and to 37.3 percent and 61.4 percent,

²¹ Bok suggests a 5-10 year period for concentration trend analysis. Bok, *Mergers and the Clayton Act*, *supra* n. 18, at 314.

²² See n. 10, pp. 43-44, *supra*.

respectively, in 1973, the most recent year for which data appear in the record.²³ For surety, the picture is just as discouraging. The four-firm and eight-firm concentration gradually increased from 25.6 percent and 43.4 percent, respectively, in 1959,²⁴ to 30.6 percent and 49.8 percent, respectively, in 1968, and to 31.8 percent and 48.9 percent, respectively, in 1973 (F. 145).

In addition, the record shows that a substantial number of fidelity and surety bond underwriters were absorbed by their competitors or by other firms during the 1957-1969 period (CX 22, 25). In any event, the record indicates that the fidelity and surety markets are among the most highly concentrated in the various segments [60] of the insurance industry (Backman, Tr. 2303). And the challenged acquisition intensified the existing concentration. Respondent's contentions that the number of firms in the relevant markets has substantially increased during the recent years are not borne out by the record (Fs. 114, 147-148).

In conclusion, against the once moderately concentrated structure of the surety and fidelity markets now approaching advanced oligopolies, the challenged acquisition cannot be sanctioned without doing grave violence to the clear congressional mandate that the Commission should arrest anticompetitive tendencies in their incipiency. Should the Commission approve the instant acquisition, it would no doubt be called upon to approve similar horizontal acquisitions by American General's competitors in the future. "The oligopoly Congress sought to avoid would then be furthered and it would be difficult to dissolve the combinations previously approved." *Brown Shoe Co. v. United States*, *supra*, at 343-344.

D. Respondent's Defense

In its defense, respondent first contends that, because of the incompleteness and inaccuracies of market share statistics in the record, complaint counsel failed to carry their burden of establishing the illegality of the challenged acquisition. More specifically, respondent argues that the surety market analysis must include various substitutes for corporate surety, such as bank letters of credit and personal surety (RRB, pp. 26-27). However, the record evidence indicates that these substitutes have historically been subjected to various restrictions, their use is "dying out," and that their effect, if any, upon the conclusion to be reached with respect to the competitive

²³ On the basis of a 3-year cycle commonly used by the fidelity industry, the appropriate year for which to examine the post-acquisition results would be 1971. For that year, the four-firm and eight-firm concentration were 38.5 percent and 60.4 percent, respectively.

²⁴ See n. 10, pp. 43-44, *supra*.

effect of the challenged acquisition would be negligible. For example, F&D's president could not name a single account which had been lost to any of these "substitutes" in his experience (Fs. 41-45).

As for the fidelity market, respondent argues (1) that fidelity should include all forms of the so-called "dishonesty insurance," such as burglary insurance, and (2) that the record evidence regarding fidelity is totally unreliable because of its failure accurately to account [61] for the fidelity portion of the commercial multi-peril insurance ("CMP") (RRB, pp. 27, 35, 99-106; RPF III-50). The function of fidelity is so obviously distinct from the other lines of "dishonesty insurance" (e.g., burglary insurance) that the argument is patently unsupportable. Furthermore, the record evidence does not show that trade realities in the marketing of fidelity bonds require fidelity to be lumped together with the other lines of property/liability insurance.

Respondent's second argument regarding the reliability of record evidence on the size of fidelity market is rejected. It is true that available industry statistics introduced by complaint counsel do not purport to show accurately *all* CMP-related fidelity volume. However, they are sufficiently reliable for the purposes of this proceeding. The 1963-1970 data compiled by The Surety Association show a range of percentages (of fidelity within CMP) to be between .9 and 1.5 percent (CX 151; Hepburn, Tr. 1214-1216, 1227, 1229, 1466-1467). The 1969 data compiled by The Insurance Service Office (ISO) was .8 percent (Gallant, Tr. 3202-3205, 3207, 3215-3216). These data appear to be generally consistent with individual estimates given by several industry executives at trial (Ruesch, Tr. 467-468; Spickard, Tr. 1135; McVay, Tr. 1372-1373; Wells, Tr. 1606-1607). On the other hand, respondent's projection based on 3-firm data is patently unreliable. Although it would have been possible to secure more accurate and complete data with respect to CMP-related fidelity volume from individual firms, it would have been expensive and time-consuming. In any event, the record is sufficiently clear that the distortions in the fidelity market share figures incident to CMP-related fidelity are not of such magnitude as to affect materially the basic conclusions with respect to the market structure and concentration trend of the fidelity market²⁵ (see Fs. 142-143).

[62] Respondent's next argument is that F&D, because of its inability fully to participate in the CMP and the so-called package- and account-selling techniques, had been losing its grounds rapidly before the acquisition. This argument is in essence an analogue of the Failing Company Doctrine. Respondent asserts in effect that since the acquired

²⁵ It is well settled that technical flaws in market share statistics are less important than the accuracy of the broad picture presented. *Brown Shoe Co. v. United States*, *supra*, at 341-342, n. 69. Also see *Luria Bros. & Co. v. F.T.C.*, 389 F.2d 847, 858 (3rd Cir. 1968, *cert. denied*, 398 U.S. 829; *The Papercraft Corp.*, 78 F.T.C. 1352, 1405-1406 (1974), *aff'd*, 472 F.2d 927 (7th Cir. 1973).

firm was no longer a viable competitor, its absorption by a competitor is incapable of producing substantial anticompetitive effects. However, the record evidence refutes this argument. First, F&D devised and successfully marketed special multi-peril policies ("SMP") in an attempt to counter the inroads of CMP into its fidelity business (F. 102). Furthermore, surety was not affected by either CMP or package-selling (Fs. 99, 139). Even with respect to fidelity, the record evidence shows that F&D was able to participate in this marketing device through its agents and offered discounts as an inducement (Culbertson, Tr. 1818). Most importantly, the record clearly shows that F&D was able to maintain its leading market position as well as its enviable record of overall growth, profitability and low loss ratios during the period before and after the acquisition in question (Fs. 26-29). Suffice it to say that this merger involves neither small companies nor failing companies. See *Brown Shoe Co. v. United States*, *supra*, at 331. For the same reasons, respondent's related argument that F&D had to seek an affiliation with a full-line insurance firm, such as American General, in order fully to participate in the CMP, package- and account-selling and to compete more effectively with its full-line competitors likewise lacks merit.

In its defense, respondent next argues that the relevant markets are characterized by ease of entry, that in fact there have been numerous entrants in recent years, and that there are numerous potential entrants, including large property/liability and life/health insurance companies. Therefore, it argues, the absorption of only one fidelity and surety underwriter by another is not likely to have the proscribed anticompetitive effect (RRB, pp. 115-129; RPF V-43 - V-47). In my view, the record evidence demonstrates the contrary. First, F&D was a leading, independent, long established fidelity and surety underwriter. There is nothing in the record which would indicate that an independent fidelity and surety firm of F&D's stature and ability is likely to enter the relevant markets to take [63] its place. Secondly, viewed against the size and profitability of the markets involved, both fidelity and surety are characterized by a remarkable paucity of new entries during the past three decades. Coupled with the evidence showing that only a few of the entrants have become a significant factor over a long period of time and that it took them so long to get established, the record conclusively refutes respondent's contentions in this regard (Fs. 147-148).

Generally speaking, in a horizontal merger case involving elimination of substantial actual competition, as is the case here, it is not incumbent upon the government to establish the existence of high entry barriers as a part of its case. See *Ekco Products Co.*, 65 F.T.C. 1163, 1208 (1964),

aff'd, 347 F.2d 745 (7th Cir. 1965). In any event, in the instant case, in view of clear evidence showing that concentration in the relevant markets steadily increased despite new entries, new entrants cannot be counted upon to replace the actual competition eliminated by this merger, much less to bring about deconcentration in the markets. Therefore, respondent's ease of entry argument may be safely discounted. Indeed, there is convincing evidence in the record which indicates that fidelity and surety underwriters require long years of specialized training, established underwriter-agent or customer relationships are difficult to overcome, and that there are fairly strict licensing and financial requirements at the state and federal levels (Fs. 103-107). All of the above compels the conclusion that entry barriers into the relevant markets are substantial. Most importantly, the relevant markets have not shown a deconcentration trend. On the contrary, concentration substantially increased over the last 15 years.

Respondent's suggestion that the fidelity and surety industries remain competitive at present is not a valid defense. "[R]emaining vigor cannot immunize a merger if the trend in that industry is toward oligopoly." *Brown Shoe Co. v. United States*, *supra*, at 333. Respondent's argument that there are numerous potential entrants is likewise invalid. First, this case involves a horizontal acquisition and consequent elimination of actual competition. Secondly, the argument that the major property/liability and life/health insurance firms are potential entrants into the fidelity and surety markets must be rejected for [64] the same reasons discussed in the preceding paragraphs. Respondent's reliance on *Beatrice Foods Co.*, Trade Reg. Rep. [1970-1973 Trans. Binder] ¶ 20,121 ([81 F.T.C. 481] F.T.C. 1972), a potential competition case, is entirely misplaced.

Respondent's argument that its acquisition of F&D is beneficial to competition because it would enable F&D to compete more effectively with the larger full-line firms is likewise rejected. First, F&D was, at the time of its "friendly" takeover by American General, a vigorous, growing and profitable company and a leading factor in the relevant markets (Fs. 16, 27, 28). See pp. 56-57, *supra*. Secondly, respondent's argument in essence amounts to a business justification argument long discredited by the Supreme Court. *United States v. Philadelphia National Bank*, *supra*, at 370-371. Furthermore, should the Commission accept respondent's argument in this regard and approve this merger, it may be called upon to approve similar acquisitions of non-full-line firms by American General's competitors in the future, and the independent bond specialist firms will soon become extinct. Section 7 was designed to prevent such developments. See p. 54, *supra*.

A few words need be said about the concentration data in the record.

First, it is my view that the concentration analysis in this case does not require an examination of the period reaching as far back as the 1940's as respondent claims.²⁶ Secondly, respondent's exhibit purporting to reflect the concentration trend in the relevant markets (RX 214B-C), is confusing and possibly seriously misleading in that it is based on net premium figures, includes reinsurance firms, and does not consistently group operating companies under the same control or management (Fs. 129-136). As regards the interpretation of concentration data, the Administrative Law Judge is bound by the general economic theory of oligopoly espoused by the Supreme Court and economic literature relied on by the Court in its Section 7 decisions since *Brown Shoe*. See pp. 53-55, *supra*.²⁷

[65] Finally, respondent's argument that the challenged merger was a defensive move on the part of F&D compelled by the attempted takeover by Security Corporation through a tender offer and that these circumstances exonerate this acquisition is rejected (RPF II-1 to II-33). Also, the record does not support respondent's argument that a successful takeover of F&D by Security Corporation would have brought about certain dismemberment of F&D and dissipation of its financial resources. Respondent's argument that but for this acquisition F&D would have faced a certain demise is not persuasive. In my view, this is another business justification argument. In any event, it is equally well settled that a benign intent of the merging firms does not save a merger having demonstrable anticompetitive effects. H.R. Rep. 1191 on H.R. 2734, 81st Cong., 1st Sess. 8 (1949); *Brown Shoe Co. v. United States*, *supra*, at 329, n. 49.

[66] As shown hereinabove, the challenged acquisition not only eliminated the substantial actual competition existing between F&D and American General, but also eliminated a long established, prosperous speciality firm as an independent business entity, and substantially

²⁶ See Bok, *Mergers and the Clayton Act*, *supra* n. 18, at 314.

²⁷ Also see chapter 4 entitled "The Concentration and Profits Issue," in Goldschmid, Mann & Weston, eds., *Industrial Concentration: The New Learning* 162-245 (1974). I share Dean Neal's view that the work of revisionists like Yale Brozen and others have failed to refute the basic tenets of the oligopoly theory and that such studies as the Weiss and Scherer papers contained in *Industrial Concentration: The New Learning*, *supra*, have reenforced them. See *id.* at 377, 408-409. Also see Bain, *Industrial Organization* 448 (2d ed. 1968); Scherer, *Industrial Market Structure and Economic Performance* 132-157, 183-186, 231-232 (1970); Collins and Preston, *Price-Cost Margins and Industrial Structure*, 51 *Rev. Econ. & Stat.* 271 (1969); Brodley, *Oligopoly Power Under the Sherman and Clayton Acts - From Economic Theory to Legal Policy*, *supra* n. 20, at 297-298, 338-342.

And, there is no reason to think that concentration is less inimical to the free play of competition in fidelity and surety than in other service industries. *Cf.*, *United States v. Philadelphia National Bank*, *supra*, at 368-369.

Dr. Backman's contention that the fact that the composition and ranking of the four top firms in the relevant markets were not identical for every year establishes the existence of vigorous competition is not persuasive. Plainly, if a small number of firms dominate the market over time, accounting for an increasing share of the market, as is the case here, that fact is hardly consistent with vigorous competition. Also, the vigor of remaining competition is not a valid defense of an acquisition which eliminates a substantial competitive factor.

increased the concentration in the relevant markets. It is thus doubly objectionable, from both economic and social points of view.²⁸ In view of the clear congressional mandate to arrest anticompetitive tendencies in their incipiency and the controlling principles enunciated by the Supreme Court in its Section 7 decisions discussed hereinabove, the challenged acquisition cannot be allowed to stand.²⁹

Respondent's reliance on *United States v. General Dynamics Corp.*, *supra*, is misplaced (RB, pp. 56-93). In essence, respondent argues (1) that the complaint counsel presented a "bare-bone" statistical case herein, and (2) that further examination of the particular markets sanctioned by the Court in *General Dynamics* will show that the challenged acquisition in the instant case lacks the proscribed effect. Neither of the contentions is supported by the record. A cursory examination of the record will conclusively refute the first contention. *General Dynamics* surely does not require an unbounded economic inquiry beyond what is contained in this record. In any event, one of the central congressional objectives in adopting [67] the 1950 amendment to Section 7 was to reject the unwieldy "rule of reason" approach in Section 7 enforcement. See *Brown Shoe Co. v. United States*, *supra*, at 317-319. It is the Administrative Law Judge's opinion that the early misgivings over a too-broad economic investigation in Section 7 cases expressed by the Court and commentators have been reinforced by experience. This is especially true in a case involving, as here, a horizontal acquisition in markets trending toward higher concentration.³⁰ As for the second argument, the record does not show, as it clearly did in *General Dynamics*, that the market share and concentration statistics based on past performance are an entirely unreliable basis on which to ground a prediction as to what the probable effect of the merger may be. The ultimate rationale of the Court's majority in *General Dynamics* in not disturbing the trial court's conclusion approving that merger was that new realities of competition in the coal industry rendered the acquired firm an ineffective competitor for the foreseeable future and that, therefore, its disappearance as an indepen-

²⁸ *Brown Shoe Co. v. United States*, *supra*, at 315-316, 333, 344; *United States v. Philadelphia National Bank*, *supra*, at 362, 370-371; *United States v. Alcoa*, *supra*, at 280-281; *United States v. Von's Grocery Co.*, *supra*, at 274, 278; *United States v. Pabst Brewing Co.*, *supra*, at 552; Bok, *Mergers and the Clayton Act*, *supra*, at 247-248, 305-306; Brodley, *Oligopoly Power Under the Sherman and Clayton Acts - From Economic Theory to Legal Policy*, *supra* n. 20, at 341.

²⁹ It should be noted that the Court struck down horizontal acquisitions involving market shares smaller than those involved in this case. *E.g.*, *United States v. Alcoa*, *supra*; *United States v. Von's Grocery Co.*, *supra*; *United States v. Pabst Brewing Co.*, *supra*. See also S. Rep. No. 1775, 81st Cong., 2d Sess. 6 (1950); *Brown Shoe Co. v. United States*, *supra*, at 322-323, 346; *United States v. Philadelphia National Bank*, *supra*, at 367; Bok, *Mergers and the Clayton Act*, *supra* n. 18, at 247-248, 305-306.

³⁰ *United States v. Philadelphia National Bank*, *supra*, at 362; *Von's Grocery Co. v. United States*, *supra*; *Pabst Brewing Co. v. United States*, *supra*; *Stanley Works v. F.T.C.*, 469 F.2d 498 (2d Cir. 1972), *cert. denied*, 412 U.S. 928 (1973); Bok, *Mergers and the Clayton Act*, *supra* n. 18, at 273, 295-296; Turner, *Conglomerate Mergers and Section 7 of the Clayton Act*, 78 Harv. L. Rev. 1313, 1318-1319, 1920-1921 (1965); Brodley, *Oligopoly Power Under the Sherman and Clayton Acts - From Economic Theory to Legal Policy*, *supra* n. 20, at 346-347.

dent firm did not matter. In the instant case, there are no new competitive realities which may have rendered F&D an ineffective competitor whose disappearance from the markets would hardly matter. On the contrary, despite its lack of full-line, F&D remained a leading, prosperous, highly profitable and vital competitor both before and after the acquisition. And, there is nothing in this record to cast any doubt upon F&D's continued success and viability in the future (Fs. 26-29). Nor is there any indication that the market share statistics and concentration analysis give an unreliable account of the acquisition's probable effects on competition in the relevant markets. In these circumstances, the challenged [68] acquisition cannot be approved without doing grave violence to the clear congressional mandate embodied in Section 7. See p. 60, *supra*.

E. Order

It is now axiomatic that the normal remedy in Section 7 cases is the divestiture of what was acquired unlawfully. Indeed, divestiture is the remedy specified by Section 11(b) of the Clayton Act. And complete divestiture is "peculiarly appropriate" in cases of stock acquisitions which violate Section 7. *United States v. E.I. du Pont de Nemours & Co.*, 366 U.S. 316, 330-331 (1961). It is also well established that the enforcement agency's panoply of remedial sanctions includes the power to bar unauthorized future acquisitions as well as other ancillary measures reasonably calculated to restore competition in the relevant market. *Ekco Products Co.*, *supra*, 65 F.T.C., at 1212-1217, 1222-1223, 1227-1228; *F.T.C. v. Dean Foods Co.*, 384 U.S. 597, 607, n. 5, 609, n. 9 (1966); *Luria Bros. & Co. v. F.T.C.*, 389 F.2d 847, 865 (3rd Cir. 1968); *Abex Corp. v. F.T.C.*, 420 F.2d 928 (6th Cir. 1970), *cert. denied*, 400 U.S. 865 (1970); *Ford Motor Co. v. United States*, 405 U.S. 562, 571-578 (1972); *OKC Corp. v. F.T.C.*, 455 F.2d 1159 (10th Cir. 1972); *Avnet, Inc. v. F.T.C.*, 511 F.2d 70 (7th Cir. 1975). And, there is no indication in this record that the required divestiture may bring about a loss of substantial efficiencies or important benefits to the consumer. Therefore, respondent will be required to divest the F&D stock and also will be prohibited from making any unauthorized acquisition in the fidelity and surety markets for a period of 10 years.

Respondent's argument that an undertaking to keep F&D as an independent operating entity would be an adequate remedy in the circumstances of this case, is rejected (RRB, pp. 146-149). First, there is no assurance that such an undertaking will effectively insulate F&D from the subtle and pervasive influence of its outright owner. To expect otherwise would be to ignore business realities and common experience and to indulge in wishful conjecture. Secondly, such an

undertaking would inevitably require continuing surveillance on the part of the Commission, embroiling it in interminable administrative chores, and may even lead to further [69] litigation. Such a course should clearly be avoided. Therefore, respondent's argument in this regard is totally unacceptable.

Complaint counsel's argument that respondent should be required to divest dividends received from F&D since the acquisition, including the \$20 million upstream dividend, is likewise rejected. Complaint counsel do not claim that an infusion of additional funds or the return of received dividends is necessary in order to restore competition in the relevant markets or to ensure the continued viability of F&D after divestiture. Nor would the record support such a claim. Indeed, complaint counsel admit that F&D remains a prosperous and profitable company with ample financial resources. In the absence of any evidence of a wanton raid on F&D's corporate treasury by American General, there appears to be no need for such an extraordinary requirement in this case.

CONCLUSIONS

1. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of respondent American General Insurance Company ("American General").
2. On or about July 1, 1969, American General acquired substantially all of the shares of stock of Fidelity & Deposit Co. of Maryland ("F&D").
3. At all times relevant to this proceeding, American General and F&D were engaged in commerce within the meaning of the Clayton Act.
4. For the purposes of assessing the legality of the acquisition under Section 7 of the Clayton Act, the appropriate lines of commerce are the fidelity bond business and the surety bond business.
5. The appropriate section of the country within which to test the effect of the acquisition is the United States as a whole.
6. Prior to and at the time of the acquisition, American General and F&D were direct competitors in the fidelity and surety bond markets.
- [70] 7. The acquisition eliminated the substantial competition between American General and F&D in the relevant markets to the detriment of competition.
8. The acquisition substantially increased the concentration in the relevant markets to the detriment of competition.
9. The effects of the acquisition of F&D by American General may substantially lessen competition in the fidelity and surety bond markets in the United States, in violation of Section 7 of the Clayton Act.

10. Divestiture of the acquired stock is both necessary and appropriate to remedy the probable anticompetitive effects of the unlawful acquisition.

ORDER

It is ordered, That:

I

Respondent, American General Insurance Company (hereinafter "American General"), a corporation, and its officers, directors, agents, representatives, employees, subsidiaries, affiliates, successors and assigns, within six months from the date this order becomes final and subject to prior approval of the Federal Trade Commission, divest absolutely and in good faith, all stock, assets, title, properties, interest, rights and privileges, of whatever nature, tangible and intangible, acquired by American General as a result of its acquisition of Fidelity and Deposit Company, together with all contract rights, premiums payable, buildings, improvements, equipment, [71] additions and other property of whatever description which has been added since that acquisition or hereafter shall be added to the property or assets of Fidelity and Deposit Company of Maryland ("Fidelity and Deposit"), so as to restore Fidelity and Deposit as a going concern and effective competitor in the fidelity and surety bond businesses.

II

By such divestiture none of the assets, properties, title, interest, rights or privileges described in Paragraph I of this order shall be sold or transferred, directly or indirectly, to any person who is at the time of divestiture an officer, director, employee or agent of or under the control or direction of American General or any of its subsidiary or affiliate corporations, or who owns or controls, directly or indirectly, more than one (1) percent of the outstanding shares of common and/or preferred stock of American General.

III

No method, plan or agreement of divestiture to comply with this order shall be adopted or implemented by American General save upon such terms and conditions as first shall be approved by the Federal Trade Commission. [72]

Initial Decision

89 F.T.C.

IV

Pending divestiture, the assets and business acquired from Fidelity and Deposit shall be maintained and operated as a separate corporation with separate books of account, separate management, separate assets, and separate personnel.

V

Pending divestiture, no substantial property or other assets of the separate corporation referred to in Paragraph IV herein shall be sold, leased, otherwise disposed of or encumbered, other than in the normal course of business, without the consent of the Federal Trade Commission, and American General shall not commingle any assets owned or controlled by such separate corporation with any assets owned or controlled by American General.

VI

For the period of three years from the date on which this order becomes final, no individual employed by Fidelity and Deposit or the separate corporation referred to in Paragraph IV herein shall be employed by American General.

VII

Pending divestiture, the underwriting departments and selling and management personnel of the separate corporation [73] referred to in Paragraph IV herein and American General shall be conducted independently of each other.

VIII

Pending divestiture, American General shall maintain the separate corporation referred to in Paragraph IV herein as an independent entity and take no steps to impair such corporation's economic and financial position.

IX

American General shall forthwith cease any and all representation on the board of directors of Fidelity and Deposit and cease and desist from taking any steps to nominate, seat, or admit any representative of Fidelity and Deposit to the board of directors of American General.

X

Fidelity and Deposit shall forthwith cease any and all representation on the board of directors of American General and cease and desist from taking any steps to nominate, seat, or admit any representative of American General to the board of directors of Fidelity and Deposit.

XI

American General shall forthwith cease and desist from acquiring, directly or indirectly, for a period of ten (10) years from the date on which this order becomes final, without the prior approval of the Federal Trade [74] Commission, the share capital, assets or interest of any corporation engaged in fidelity and/or surety underwriting in the United States.

The provisions of this paragraph shall include any arrangement pursuant to which American General acquires the market share, in whole or in part, of any concern, corporate or noncorporate, which is engaged in fidelity and/or surety underwriting in the United States, (a) through such concern's discontinuing the underwriting of such product lines or (b) by reason of such concern's discontinuing the underwriting of such product lines and thereafter transferring to American General customer and account lists or in any other way making available to American General access to customers or customer accounts.

XII

Within thirty (30) days from the effective date of this order and every sixty (60) days thereafter until it has fully complied with Paragraph I of this order, American General shall submit a verified report in writing to the Federal Trade Commission setting forth in detail the manner and form in which it intends to comply, is complying or has complied therewith. All such reports shall include, in addition to such other information and documentation as may hereafter be requested, (a) a specification [75] of the steps taken by American General to make public its desire to divest Fidelity and Deposit, (b) a list of all persons or organizations to whom notice of divestiture has been given, (c) a summary of all discussions and negotiations together with the identity and address of all interested persons or organizations, and (d) copies of all reports, internal memoranda, offers, counteroffers, communications and correspondence concerning said divestiture.

XIII

American General shall notify the Commission of any propose

change at least 30 days prior to the proposed change in the corporate respondent, American General, such as dissolution, assignment or sale resulting in the emergence of a successor corporation(s), the creation or dissolution of subsidiaries or any other change in the corporation which may affect compliance obligations arising out of this order.

OPINION OF THE COMMISSION

JUNE 28, 1977

BY COLLIER, *Commissioner*:

[1] The complaint in this case charged American General Insurance Company ("American General") with violating Section 7 of the Clayton Act, as amended, (15 U.S.C. 18) by acquiring Fidelity & Deposit Company of Maryland ("F&D") in 1969. More specifically, it alleged that the acquisition's effect 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 other markets.

A surety bond is an agreement by which one party (the surety) undertakes to guarantee the performance of an obligation by a second party (the principal) to a third party (the obligee). If the principal fails to perform, the surety must either discharge the obligation or indemnify the obligee. The most common type of surety bond covers construction contracts, and guarantees performance according to [2] the terms of the contract. Other kinds of surety bonds include license and permit bonds, fiduciary bonds, and judicial bonds (ID f. 32-33).¹

A fidelity bond represents an undertaking by the bond writer to indemnify an employer against losses suffered through the dishonesty of bonded employees (ID f. 48).

American General is an all-lines diversified insurance company, based in Houston, Texas, with combined income of \$527 million and admitted assets of \$1.5 billion in 1968, the year before its acquisition of F&D. Its fidelity and surety business was modest until 1964, when it acquired Maryland Casualty Company ("Maryland Casualty"), a

¹ The following abbreviations will be used in this opinion:

ID f.	—	Initial Decision finding no.
ID p.	—	Initial Decision page no.
Tr.	—	Transcript page no.
CX	—	Complaint counsel's exhibit no.
RX	—	Respondent exhibit no.
RAB	—	Respondent's appeal brief
CAB	—	Complaint counsel's appeal brief
R. Ans.	—	Respondent's answering brief
C. Ans.	—	Complaint counsel's answering brief
RRB	—	Respondent's reply brief
CRB	—	Complaint counsel's reply brief
RPF	—	Respondent's proposed finding no.
CPF	—	Complaint counsel's proposed finding no.

