

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. Bokar 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	
	<i>Fidelity</i>	<i>Surety</i>
	<i>Direct Premium</i>	<i>Direct Premium</i>
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%

	<i>Industry</i>	
	<i>Fidelity</i>	<i>Surety</i>
	<i>Direct Premium</i>	<i>Direct Premium</i>
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 Compared With Industry

	<i>Fidelity</i>	
	<i>F&D's Loss Ratio</i>	<i>Industry</i>
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

	<i>Surety</i>	
	<i>F&D's Loss Ratio</i>	<i>Industry</i>
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. Expeditious 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						
<i>Concentration in Fidelity and Surety Industries In Terms of Net Premiums Written</i>						
	<i>Fidelity</i>					
	(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)
<i>Surety</i>						
	(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]	25.6 [23.7]	43.4 [41.0]
1960) ¹¹	27.5 [26.0]	49.3 [46.3]	25.6 [23.8]	44.6 [42.0]
1961)	26.2 [24.7]	47.7 [45.2]	26.0 [24.2]	44.6 [42.0]
1962	24.2	45.1	25.2	42.7
1963	26.4	47.6	25.9	42.1
1964	27.9	48.7	25.5	40.8
1965	26.3	46.5	25.7	41.1
1966	28.5	51.2	27.5	44.8
1967	30.2	51.4	29.7	48.7
1968	31.3	53.5	30.6	49.8
1968 combined*	*34.6	*56.8	*35.0	*53.6
1969 not combined	33.0	57.6	31.0	48.0
1969*	*35.9	*60.5	*35.3	*51.7
1970*	*35.7	*59.8	*35.5	*52.2
1971*	*38.5	*60.4	*35.0	*52.6
1972*	*37.9	*62.1	*33.3	*50.3
1973*	*37.3	*61.4	*31.8	*48.9

*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 incipency. 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 incipency. 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*, 393 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 incipency 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.

multiple lines company that was a significant factor in both the fidelity and surety fields (ID f. 1, 2, 5, 10). Thus, American General became a significant competitor in both the fidelity and surety markets, ranking sixth nationally in surety in 1968 with over \$15 million in direct premiums, and twelfth the same year in fidelity with about \$4.5 million in direct premiums (ID f. 113).

Unlike the more diversified American General, F&D had grown and prospered primarily as a bonding specialist since its formation in 1890. Eighty-eight percent of its premiums in 1968 were derived from the sale of surety and fidelity bonds (ID f. 12, 14). In 1968, F&D was the second ranked surety underwriter in the U.S. with about \$27.5 million in direct premiums, and held third place in fidelity, with about \$10.4 million in direct premiums (ID f. 113).

[3] In July, 1969, assertedly fearful that a tender offer by the Security Corporation for F&D's stock might succeed and lead to the company's demise, F&D's management instead arranged for the sale of virtually all its stock to American General in exchange for American General stock valued at about \$107.5 million (ID pp. 2, 65).

The Commission's complaint was issued on June 17, 1971. The following year, the hearing examiner dismissed the complaint on the theory that the Commission lacked jurisdiction because of the McCarran-Ferguson Act (15 U.S.C. 1012(b)). The Commission reversed and remanded the case for trial. *American General Insurance Co.*, 81 F.T.C. 1052 (1972). Following an unsuccessful attempt by the respondent to enjoin the proceeding,² a hearing on the merits culminated in a finding on August 9, 1975, by Administrative Law Judge ("ALJ") Montgomery K. Hyun that the acquisition violated Section 7. He entered an order to divest F&D.

The respondent (and F&D, as an intervenor) appealed both the finding of liability and the terms of the divestiture order, while complaint counsel appealed the ALJ's refusal to order divestiture of dividends that were paid to American General by F&D. The appeal was argued on January 14, 1976; the Commission ordered reargument, which was heard on July 21, 1976.

Preliminarily, we reaffirm our earlier holding that the McCarran-Ferguson Act does not exempt this acquisition from Section 7 or remove it from the Commission's jurisdiction. Subsequent interpretations of the McCarran-Ferguson exemption by the courts have strengthened our conviction in the correctness of that conclusion.

For example, in *American Family Life Assurance Co. of Columbus v. Planned Marketing Associates, Inc.*, 389 F. Supp. 1141 (E.D. Va. 1974), the court denied motions to dismiss a Sherman and Clayton Act

² *American General Insurance Co. v. FTC*, 359 F. Supp. 887 (S.D. Tex. 1973), *aff'd*, 496 F.2d 197 (5th Cir. 1974).

complaint filed by one insurer against another, alleging a variety of practices aimed at diverting the plaintiff's business to the defendant. The court said that the phrase "business of insurance" as construed in *SEC v. National Securities, Inc.*, 383 U.S. 453 (1969) "compels this Court to conclude that a complaint based upon the Sherman Act and the Clayton Act involving interactions between two insurance companies, as distinguished [4] from transactions between an insurance company and its policy holders, is not barred from federal jurisdiction by the McCarran-Ferguson Act." 389 F. Supp. at 1146. Other courts have reached the same conclusion in antitrust litigation between an insurance company and its agent³ and between an insurance company and a marketing agent.⁴

I. DATA SOURCES

Before considering the effect of this acquisition on competition in the relevant markets, we must resolve several objections raised by the respondent to the data relied on in the initial decision.

The respondent's first objection is to the ALJ's use of direct premiums rather than net premiums to measure market share and concentration in the fidelity and surety markets. The total premiums paid to a bond company are known in the industry as direct premiums. The bond company may, however, cede a portion of the coverage on a bond to a reinsurance company, which accepts part of the risk in return for a portion of the premium. Net premiums represent the amount of premiums the primary writer retains after having ceded some of the direct premiums to the reinsurer, (ID f. 130-131) plus whatever reinsurance the company itself accepts.

The respondent argues that net premiums are a better measure of a bonding company's "competitive strength" than direct premiums because only net premiums accurately reflect the company's capacity to write bonds. A bond writer's capacity to accept a single bond of a given size is limited to a percentage of its capital and surplus (ID f. 132). Because F&D is assertedly capacity-short in comparison to [5] its competitors, the respondent contends that F&D must reinsure more heavily than they do, essentially by purchasing capacity from other firms (RAB 13).

We believe the ALJ was correct in adopting direct premiums as an appropriate measure of competitive effects. That is not to say that net

³ *Allied Financial Services, Inc. v. Foremost Insurance Co.*, 418 F. Supp. 157, 161 (D. Nebr. 1976) ("* * * [T]he Court declines to extend the McCarran Act exemption to a dispute which should have little or no effect on the interests of policyholders and which primarily involves an agency agreement, not 'the contract of insurance.' ")

⁴ *De Voto v. Pacific Fidelity Life Insurance Co.*, 354 F. Supp. 874, 877 (N.D. Calif. 1973), *rev'd on other grounds*, 516 F.2d 1 (9th Cir.), *cert. denied*, 423 U.S. 894 (1975). Compare *Schwartz v. Commonwealth Land Title Insurance Co.*, 374 F. Supp. 564, 572-3 (E.D. Pa. 1974); *Dexter v. Equitable Life Assurance Society*, 527 F.2d 233 (2d Cir. 1975).

premiums lack significance; the ALJ found that they are the measure generally relied on for internal reports to a bond company's management (ID f. 133). But the ALJ found, and the respondent concedes, that direct premiums are the best measure of market penetration by a bond company (ID f. 134; RPF IV-36). They are the closest analogue to sales in the bonding business; F&D, in its 1966 annual report, described direct fidelity premiums as "the real measure of production on [sic] this business." (CX 13, p. 4). Direct premiums represent the state of the market at the agency level, where bonds are purchased. Direct premiums measure a bonding company's success in convincing customers to buy its product. There is nothing in the record to indicate that agents care whether a primary writer may reinsure a bond to a greater or lesser degree.

Moreover, reinsurance is, of course, only one means of accumulating capacity to write additional insurance. We do not understand respondent to argue that F&D was foreclosed from conventional sources of capital. Nor can respondent gain comfort from *United States v. General Dynamics Corp.*, 415 U.S. 486 (1974). In that case the Court found and relied on the facts not only that the firm's reserves were committed but that coal is a finite and exhaustible natural resource, 415 U.S. at 509.

The record also reflects that enhancement of capacity is not the only reason that bonding firms seek reinsurance arrangements.⁵ They do so to spread their own risks, as F&D's president testified: [6]

If I had unlimited resources on business *that I would consider to meet every single underwriting requirement*, I would keep every dime of it. In other words, *I reinsure on a surety risk or on a fidelity risk according to the degree of risk that I believe the company is assuming*. Furthermore, there are limitations on how much I can keep with respect to my capital and surplus. (Emphasis added.) (Tr. 797)

Indeed, F&D's ability to reinsure may depend upon its successful record of selecting good risks and reducing those it does select. In other words, F&D's competitive strength in the industry is partially reflected by the extent of its reinsurance rather than diminished by it.

American General's emphasis on F&D's capacity limitations rings all the more hollowly in light of its handling of F&D's capital and surplus since the acquisition.

In 1973, F&D paid American General a special "upstream" dividend of \$20 million, which reduced F&D's capital and surplus by more than 20 percent at the time. American General evidently regarded F&D as having, if anything, excess capacity (Tr. 1532).

⁵ The chief examiner of the New York State Insurance Department's fire and multi-line bureau, whose responsibilities included fidelity and surety, said of direct premiums:

Well, we feel it is a better barometer of a company's business transactions. When you get into net you are getting into internal management decisions as far as reinsurance which would not really reflect the company's direct business transactions (Tr. 1096).

The respondent's second major objection to the market share and concentration data relied on in the initial decision relates to the treatment of commercial multi-peril policies, known as "CMP." CMP, offered by many insurance companies, combines a number of coverages into one package policy. CMP often includes a fidelity component, which the ALJ found is functionally equivalent to a fidelity bond purchased separately. The data problem arises because many insurance companies do not report the fidelity component of CMP independently, so market share figures for straight fidelity omit some percentage of the market accounted for by the fidelity slice of CMP. Even though F&D has a package policy of its own (denominated special multi-peril or "SMP"), it does report the fidelity portion of the policy separately, so that its fidelity share of its own package is included in its market share figures.⁶ Thus, any missing fidelity [7] share of CMP, if added to the total fidelity market, would serve to depress the market share achieved by the American General-F&D acquisition (ID f. 99-102, 137-141).⁷ The CMP dispute is irrelevant to the surety market; surety bonds are not sold in packages including other coverages (ID f. 139).

The respondent argues that the unaccounted-for fidelity portion of CMP would have amounted to 13.6 percent of the straight fidelity total for 1969, the acquisition year, and significantly reduced F&D's market share. (For the post-acquisition year 1973, the respondent estimates the CMP/fidelity portion at 25.2 percent of straight fidelity.) Complaint counsel, on the other hand, derived estimates that the fidelity portion of CMP falls between 3.3 percent and 10.9 percent of the fidelity total. The ALJ accepted complaint counsel's estimates and dismissed the CMP figures as not materially affecting market data at the time of the acquisition. If the respondent's data were correct, F&D's market share would have been reduced by 1.1 percent in 1969 (7.6 to 6.5 percent), and by 1.3 percent in 1973 (6.3 percent to 5 percent). Even if these data were used the combination of American General and F&D still would have produced the number one ranked firm in the industry in 1969, and the fourth ranked firm in 1973 (ID f. 142, 143).

In a Section 7 case, of course, the governing principle is that "precision in detail is less important than the accuracy of the broad picture presented." *Brown Shoe Co. v. U.S.*, 370 U.S. 294, 341 at n. 69 (1962). Where the size of the product market is at issue, a "rough

⁶ No consideration was given at trial, apparently, to the possibility that free-standing fidelity bonds and packages policies may be in different markets, or that free-standing fidelity coverage and fidelity coverage as part of a package policy may be distinct submarkets.

⁷ Curiously, neither party has cited to any portion of the record that would tell us whether American General, either through Maryland Casualty or otherwise, sold fidelity coverage in a CMP policy, and if so, how that coverage was reported and how significant it might be in considering the combined market share achieved. American General was evidently the 17th ranked CMP writer nationally in 1969, with over \$22 million in premiums (RX 296).

approximation" has been held to make out a prima facie case. *Avnet, Inc. v. FTC*, 511 F.2d 70, 77 at n. 19 (7th Cir. 1975).

[8] The estimates in the record of the fidelity portion of CMP premiums as a percentage of total CMP premiums are:⁸

Individual companies

1. Continental	2.7%	1.7-1.8%	(RAB 21) "SMP" policy (Tr. 468)
		4.5%	"CBP" policy (Tr. 468)
2. F&D	1.65%-1.60%		(Tr. 1716-1718)
3. Fireman's Fund	1.5%		(Tr. 1606)
4. Hartford	1.5%		(RAB 21)
5. Safeco	.5%-6%		(Tr. 1135)

Agencies

1. James J. Riley Agency	.5%		(Tr. 1372-1373)
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Industry sources

1. Surety Association	.9%-1.5%		(Tr. 1229)
2. Insurance Services Office (ISO)	.8%		(CPF 151)

The 3.3-10.9 percent range for the size of CMP fidelity in relation to the straight fidelity market, accepted by the ALJ, was based in turn on a .5-1.8 percent range for fidelity within CMP. The latter range was taken from the above-listed figures. The respondent computed an average of 1.9 percent and a median of 2.1 percent based only on the figures for Fireman's Fund, Hartford, and the 2.7 percent overall figure for Continental. The respondent contends that none of the other figures (including F&D's own) is reliable.⁹

[9] What is striking, in an initial perusal of these numbers, is that the range adopted by the ALJ is wide enough to encompass *every* estimate in the record except for Continental's overall figure (as calculated by the respondent), and the 4.5 percent figure for the CBP ("comprehensive business") policy which, to all appearances, tugs the overall Continental number upward. Complaint counsel questioned Witness Reusch of Continental about the relationship between Continental's SMP and CBP policies, and the policies generically referred to as CMP:

Q: Are these of the same type that is generally referred to as a CMP?

A: The SMP is probably very similar to the generally referred to CMP.

Q: Was the other one CPB?

A: CBP.

⁸ These percentages were then applied by the parties to total CMP writings to give a dollar figure for the fidelity component of CMP. That dollar figure was used to calculate a percentage for CMP fidelity as compared to straight fidelity.

⁹ Complaint counsel had also computed an average, but the initial decision did not rely on it.

Q: I am sorry. How does that compare with the general CMP policy?

A: Well, it is a very specially designed form of coverage that is very broad and includes coverage that otherwise might be in a doubtful area between the two specific lines if those specific lines were written conventionally. CBP is a very sophisticated package policy. (Tr. 467)

The witness' testimony, taken as a whole, indicates that the CBP policy is atypical, and we believe the ALJ was correct in accepting an estimate for the Continental policy (SMP) specifically identified as being analagous to the package policy in use by the rest of the industry.¹⁰ The respondent's insistence on inclusion of this policy is particularly incongruous in light of its refusal to accept the Safeco estimate, on the ground that the company was too small a [10] factor in the industry (20th in CMP) to be representative. Yet the respondent points to nothing in the record that suggests that Safeco's policies were in any way unusual in their composition, while there is unambiguous testimony that Continental's CMP writings included a policy that was quite unlike other CMP. On the face of these estimates, the ALJ's finding of the 1.8 percent figure as an upper limit is consistent with the weight of the evidence.

Data collected by industry associations confirmed the testimony of company executives on the .5-1.8 percent range for the fidelity component of CMP. Over the period 1963-1970, the Surety Association, the national trade association for fidelity and surety bond writers, queried its affiliates annually on the percentage of fidelity attributable to their CMP premiums, and their replies (computed as a weighted average that corrected for variations in company sales) ranged between .9 and 1.5 percent (Tr. 1229, 1467). Substantial numbers of companies (or groups) responded; 97 answered in 1969 (CX 151).

The respondent attacks the Surety Association sample as unreliable, but we cannot agree. The respondent makes much of the fact that some sellers of CMP were not affiliated with the Surety Association, and some affiliates failed to respond, allowing the Association (which put out the call for information in order to assess dues) to estimate their shares based on the factor computed for the companies that actually responded. But the missing companies do not taint the Surety Association figures insofar as they apply to the sizeable number of firms who *did* reply, and on whose answers the .9-1.5 percent range was based (Tr. 1466).¹¹ The respondent suggests that the absent companies would have had higher fidelity components in their CMP policies, but

¹⁰ The respondent argues that Continental's CBP policy is "comparable" to other financial institution package policies offered by F&D and its competitors, because there is evidence that F&D had lost some accounts to the CBP policy and feared the loss of others (RAB, p. 21, n. 16). But the fact that CBP competes with other package policies tells us very little, if anything, about whether its makeup is typical of the bulk of other package policies. Mr. Ruesch's testimony suggests strongly that it is not.

¹¹ The respondent did establish that the Surety Association's figure for INA in 1969 was seriously understated, and

has produced no specific examples, with the exception of Continental, previously discussed. Because the reported figures were used to assess dues, the respondent contends, even the [11] companies who submitted data had an incentive to minimize their fidelity components. We cannot speculate, however, that the reporting firms falsified their submissions; the Association official responsible for collecting the data found the suggestion unimaginable, and some members were already paying maximum dues, anyway (Tr. 1464-65).

The Surety Association depended upon these data for dues. It would be unreasonable to think that the Association would stick with a dues assessment procedure containing a serious bias toward underreporting for eight years, since its own income was involved. Moreover, it is worth noting that two of the three companies whose CMP/fidelity estimates the respondent itself relied on, and who were at the high end of the range, did in fact report their figures in response to the Surety Association's call (Fireman's Fund and Hartford) (Tr. 1425).

Some additional support for the initial decision's estimate came from data collected by the Insurance Services Office, an industry statistical service. The ISO enlisted companies in a statistical reporting plan, which generated figures on the portion of CMP premiums the companies deemed attributable to fidelity coverage. For 1969, the year of the acquisition and the first year under the plan, the fidelity component of CMP was reported to be .8 percent (ID 61). Cross-examination revealed sizeable discrepancies between total CMP premiums reported under the ISO plan and total CMP premiums reported elsewhere, which were considerably larger (Tr. 3234-3247). Part but not all of the gap appears to be attributable to the fact that only new or renewal premiums were reported to ISO in 1969, the plan's start-up year (Tr. 3251-52, 3262-63). Because the discrepancies were never completely explained, we do not over-weigh the ISO figure for the fidelity slice of CMP. But the ISO report is generally consistent with, and tends to support, the estimates of company executives and the data given to the Surety Association.¹²

[12] In summary, the preponderance of the evidence supports the ALJ's estimates of the fidelity portion of CMP.

that Hartford and INA did not separately report the fidelity portion of homeowners' multiple peril policies (Tr. 1427-1433). But the INA understatement only affected one year of the eight for which the figures were compiled, and even then to an unknown degree. Fidelity in homeowners' policies, we suppose, covers servants; there is no reason to think its omission is significant.

¹² In addition, the importance of the missing fidelity portion of CMP is tempered by the facts that not all CMP policies contain fidelity protection (Tr. 112, 354, 477), and that a few CMP writers report their CMP fidelity as straight fidelity (Tr. 1468).

widely accepted typologies of market structure, the markets exhibit "low-moderate concentration"¹⁴ and qualify as a "loose oligopoly."¹⁵

Even if the fidelity and surety markets were unconcentrated, the cases teach that a trend toward concentration of sufficient strength and duration would still render a combination between a pair of substantial competitors illegal under Section 7. "Although there is no single test, an important consideration * * * is whether there is a market trend that threatens to transform an unconcentrated market into a concentrated market or whether the merger significantly adds to or threatens to entrench existing concentration." *Sterling Drug Co.*, *supra*, 80 F.T.C. at 598. A "loose oligopoly," while not in itself a critical level of concentration,¹⁶ still can threaten competition if propelled strongly toward higher levels.

[14] Both the fidelity and surety markets exhibit trends toward concentration, although the trend is stronger in the former than in the latter. The ALJ correctly found a trend toward concentration in fidelity and surety (ID f. 145). In the 1962-1968 period, using direct premiums, the four- and eight-firm fidelity concentration ratios increased by 7.1 percent and 8.4 percent of the market, respectively. Taking the ten-year period prior to the acquisition (1959-1968), the four-firm ratio increased 5.3 percent and the eight-firm ratio, 5.7 percent. In surety, between 1962 and 1968, the four-firm ratio rose 5.4 percent and the eight-firm ratio increased 7.1 percent. In the decade preceding the acquisition, the four-firm ratio gained 5.0 percent and the eight-firm ratio, 6.4 percent.¹⁷

Nothing in the post-acquisition history of these markets negates these trends. In the fidelity market, concentration continued to climb until, in 1973, it had reached 11.3 percent above 1959 at the four-firm level, and 13.6 percent above 1959 at the eight-firm level. In surety, neither concentration ratio has changed significantly since the [15]

¹⁴ Bain, *Industrial Organization* 143 (1959) (RAB at 25).

¹⁵ Kaysen and Turner, *Antitrust Policy: An Economic and Legal Analysis* 72 (1959), *Id.* American General argues that the Commission itself has defined an industry with a 4-firm ratio of less than 40 percent as unconcentrated. *Economic Report on Corporate Mergers* 17 (1969). What that staff report said, however, was that an industry with a 4-firm ratio exceeding 40 percent is *concentrated*, not that anything below that level is unconcentrated. Concentration, obviously, is not an all-or-nothing proposition.

¹⁶ *Warner-Lambert Co.*, 87 F.T.C. 812, 869 (1976).

¹⁷ American General seeks to rely on Department of Justice' merger guidelines, but it misstates them. The respondent quotes the guidelines correctly to the effect that a trend can be found where the market share of leading firms increases by approximately seven percent or more. Then paraphrasing, the respondent states that the change must occur "during the ten or so years prior to the merger." (RAB at 26). What the guidelines actually say is that the approximate seven percent or greater shift in market share must occur "over a period of time extending from any base year 5-10 years prior to the merger (excluding any year in which some abnormal fluctuation in market shares occurred) up to the time of the merger." (Emphasis added.) 1 CCH Trade Reg. Rep. ¶4510. American General then proceeds to cite concentration ratios reaching back to 1923, which are irrelevant under the merger guidelines and in the context of this case, and were properly excluded by the ALJ. If we apply the guidelines correctly, we see that they were exceeded at both the four- and eight-firm level in fidelity between 1962 and 1968, and at the eight-firm level in surety over the same period.

acquisition, with the top four holding a little more of the market than in 1968, and the top eight a little less. Both ratios, however, still substantially exceed 1959 levels.¹⁸

The respondent also argues that the period during which concentration ratios should be examined ought to extend back to 1955, and points out that the level of concentration in both the fidelity and surety markets dipped slightly during the late 1950's. Even if this is so, the earlier period has less relevance to analysis of the acquisition than the later.¹⁹ Here, even if we consider the 1955-1958 data, the concentration figures advanced by American General show a modest decline in concentration that was abruptly arrested around 1960, yielding to a steady increase in concentration that held sway through the succeeding decade and beyond. The fact that a trend toward deconcentration reversed itself hardly provides the comfort on which respondent urged us to rest.

In summary, American General's acquisition of F&D created the leading firm in both the fidelity and surety markets through the combination of two substantial actual competitors. The two markets were moderately concentrated, and the acquisition substantially increased that concentration in both instances. Both markets were characterized by a trend toward concentration in the eight years immediately prior to the acquisition.

These measures of the changes in market structure provide persuasive proof that this horizontal acquisition had the probable effect of substantially lessening competition. The acquisition and its effect on the appropriate markets are well within the range of similar factual situations in other Section 7 cases that have led to findings of illegality, as the following table illustrates: [16]

¹⁸ If we consider trends through 1973, as American General urges us to, we see that the fidelity market had attained the degree of concentration that the Commission found in Beatrice Foods to be "concentrated." *Beatrice Foods Co.*, 86 F.T.C. 1, 68-69 (1975) (four-firm ratio of 41.3 percent, eight-firm ratio of 62.5 percent).

¹⁹ In *Sterling Drug*, the Commission examined concentration trends for 1958-66, the eight years preceeding the acquisition. In *Warner-Lambert*, where an acquisition occurred in the same markets in 1970, four years later, the Commission noted that a later base year than that chosen in *Sterling* should be used in order to focus attention on the "recent trend". *Warner-Lambert*, *supra*, at 872, n. 16 (emphasis in original).

[17] American General argues that the statistical portrait of this acquisition and its probable effects is erroneous or misleading with respect to the elimination of actual competition, increases in concentration, and contribution to a trend to concentration. We will consider these arguments in turn.

Elimination of Actual Competition

The ALJ relied in part for his conclusion that the acquisition would lessen competition on the elimination of competition between American General and F&D. The respondent argues that mere elimination of competition between the acquiring and acquired firms cannot invalidate a horizontal merger. While it is obvious that horizontal mergers are not illegal *per se*, it is equally obvious that the loss of competition between the parties to the acquisition is a factor to be considered in assessing its legality under Section 7.²⁰

American General maintains that little effective competition has ever existed between American General and F&D because few agents include both companies in the "stable" of bond writers to which they turn in the first instance to meet their clients' needs, and because the two firms do not compete on the basis of price, agents' compensation, or the amount of discretionary authority conferred on agents (RAB 36-39). It is a sufficient answer to the first of these arguments merely to observe that the firms operate in a concededly national market, and sell the same products to the same classes of customers (I.D. f. 59, 62; p. 56). In the face of consensus on these points and the ALJ's findings it is not necessary to prove that parties to a horizontal merger sell identical services on identical terms to identical customers.²¹

[18] Moreover, there is ample additional evidence in the record of actual competition (Tr. 1281; RX 161, p. 2). An official of a large, multi-state agency testified that both American General and F&D are in fact included in his firm's "stable." (Tr. 1394). Agents resort to underwriters outside of their stable if their accustomed bond writers cannot handle the job (Tr. 784). Agents representing different bond writers compete with each other for accounts (Tr. 2528-29), and the bond writers themselves compete for inclusion within an agent's stable. The president of F&D testified that agents are widely courted by bond companies over the "long run." (Tr. 783). Both F&D and Maryland Casualty place advertisements soliciting business directly, without an agent's mediation (Tr. 2523).

As for the second argument—that F&D and American General

²⁰ *United States v. Aluminum Co. of America*, 377 U.S. 271, 280-281 (1964).

²¹ *RSR Corp.*, F.T.C. Dkt. 8959 (Dec. 2, 1976) [88 F.T.C. 800], *appeal pending*, No. 77-1413 (9th Cir.), 3 CCH Trade Reg. Rep. ¶21,252, at p. 21,154.

compete only in, the “minor” aspects of service and underwriting attitudes—we cannot accept the characterization of service competition as minor even if we were to accept that competition between the two firms is so narrowly confined. F&D’s president testified that service is his company’s strong suit in defending its accounts (Tr. 741); at least to one agent, service is considerably more important than price (Tr. 1401). In any case, the ALJ found that price competition in fact occurs (ID f. 80). The respondent does not contest this finding, and indeed, F&D’s president testified that his firm’s rates do vary from those suggested by the Surety Association of America (Tr. 1711-13), casting doubt on respondent’s argument that mutual adherence to the suggested rate structure vitiates price competition.

American General relies on *United States v. Trans Texas Bancorporation, Inc.*, 1972 CCH Trade Cases ¶74, 257 (W.D. Tex. 1972), *aff’d without opinion*, 412 U.S. 946 (1973), and *United States v. Citizens and Southern National Bank*, 422 U.S. 86 (1975), for the proposition that mergers between companies not in significant competition with each other do not violate Section 7. But in both of the cited cases, the acquired banks were effectively appendages of their acquirers, created as virtual puppets to escape state banking law restrictions on branching and entry. The cases are obviously far removed from the combination of two firms who were completely independent prior to the challenged acquisition.

American General additionally argues that its competition with F&D will not be affected, because F&D has been and always will be operated with complete autonomy. American [19] General has offered to formalize its assurances of the continued independence of F&D in a consent order.²² The Commission has rejected just such arguments, pointing out that the competitive independence of the acquired company is the sort of post-acquisition evidence that is completely dependent on the grace of the acquirer.²³ The Commission has given the argument “no weight”:

We have no guarantee Perk will continue to retain whatever freedom a “profit center” has, nor do we have any way of knowing what the effect of being held separate as a “profit center” is. Does Perk have as much access to capital from its parent corporation, does it have as much positive pressure on it to develop new products and defend its old products, does it have as much an infusion of aggressive

²² In a motion to reopen the record, discussed *infra*, the respondent represents that it has terminated Maryland Casualty’s bond writing operations. If true, this would make the tendered consent order academic, to say the least.

²³ *Liggett & Myers Inc.*, 87 F.T.C. 1074, 1173 (1976), *appeal pending*, No. 76-1771 (4th Cir.), citing *United States v. General Dynamics Corp.*, 415 U.S. 486, 504-505 (1974).

II. PROBABLE EFFECT

There is no dispute here concerning the appropriate product and geographic markets within which the competitive effect of this acquisition should be measured. The geographic market is the Nation (ID f. 69); the product markets are fidelity bonds and surety bonds (ID f. 30).

Changes in Market Structure

We begin as is customary in these cases with a review of the changes that this merger worked on the structure of the relevant markets, keeping in mind the legislative purpose of Section 7 of the Clayton Act "to prevent a rising tide of economic concentration *** when the trend to a lessening of competition in a line of commerce was still in its incipency," *Brown Shoe Co. v. United States*, 370 U.S. 294, 317-318 (1962).

Measured by direct premiums, the acquisition combined F&D, the third ranking firm in the national fidelity market in 1968 with a 7.4 percent share, and the twelfth ranking firm, American General/Maryland, with a 3.3 percent share. The resulting firm ranked first in the fidelity market with a share of 10.3 percent in 1969 (ID f. 108-110, p. 58). In surety, F&D ranked second in 1968 with 8 percent of the market, and American General/Maryland ranked sixth with 4.4 percent. After the acquisition, the firms held first place in the surety market with 12.3 percent (ID f. 108-110, p. 58).

Concentration ratios in the fidelity and surety markets were as follows, before and after the acquisition:

	<i>Fidelity</i>		<i>Surety</i>	
	<i>1968</i>	<i>1969</i>	<i>1968</i>	<i>1969</i>
4-firm	31.3%	35.9%	30.6%	35.3%
8-firm	53.5%	60.5%	49.8%	51.7%
15-firm	75.5%		69.8%	

(Source: ID f. 113, p. 58)

[13] The Commission has regarded similarly structured markets as moderately concentrated.¹³ American General properly contests the ALJ's characterization of the fidelity and surety markets as "approaching advanced oligopolies." (ID p. 60). But it concedes that, under two

¹³ *Sterling Drug, Inc.*, 80 F.T.C. 477, 596 (1972) (4-firm asset ratio of 31 percent, 8-firm ratio of 48 percent, 20-firm ratio of 75 percent).

managerial talent as it might have were it still in the hands of its former owners or of an acquirer with whom it did not compete?²⁴

These objections are not cured by a consent agreement that would institutionalize a hold-separate arrangement. The ALJ rejected the proffered agreement, correctly noting that no order can insulate the acquired company from the subtle anticompetitive incentives that flow from common ownership, and that such an agreement would involve the Commission in the burdensome policing of the company's daily operations. Hold-separate orders are obviously stopgap measures, intended only to preserve the potential for ultimate relief. Finally, a hold-separate order is simply illogical. If there is a violation, divestiture is obviously and statutorily the remedy of choice, and half-measures cannot match it for returning the market as closely as possible to its preacquisition state. If there is no violation, a hold-separate order may promote inefficiency; the acquiring firm *should* be able to exercise its business judgment in integrating its own operations and those of the acquiree where competition would not be substantially lessened.

[20] In short, the ALJ's conclusion that the acquisition extinguished substantial competition between American General and F&D is fully supported by the evidence.

Increase in Concentration

American General argues that the increase in concentration resulting from its acquisition of F&D must be discounted in view of the post-acquisition decline in the combined market share of the two companies. But like the post-merger "independence" of the acquired firm, discussed *supra*, a post-acquisition fall in market share is of little probative value. While post-acquisition evidence is admissible in exceptional circumstances, it is well established that a finding of a violation will not be excused by proof of facts that were within the power of the accused to manufacture.²⁵ In *United States v. General Dynamics Corp.*, 415 U.S. 485 (1974), on which the respondent relies, the Supreme Court took care to emphasize the reasons why post-acquisition evidence rarely has value, with the clear implication that those reasons

²⁴ *Id.*

²⁵ *United Brands Co.*, 83 F.T.C. 1614, 1703 (1974).

would continue to control most Section 7 cases 415 U.S. at 404-405. Both before²⁶ and after²⁷ *General Dynamics*, the Commission has given little weight to post-acquisition declines in market share, and we see no reason why such evidence in this case should be regarded any differently.

[21] The respondent also points to the testimony of competitors and agents that the acquisition has not lessened competition. We likewise accord little weight to such evidence, especially where the operations of the two companies—at least for the moment—have not been completely integrated. As the Commission noted in *Liggett & Myers, supra*, competitors' testimony must be evaluated in light of their potentially hospitable attitude toward increased concentration, and their interest in making similar acquisitions of their own 87 F.T.C. 1173-1174. The testimony of customers, while sometimes of use, is too easily influenced by the natural aversion to alienation of their suppliers.

Trend Toward Concentration

The respondent notes that the ALJ failed to find that the horizontal mergers which took place in the fidelity and surety markets prior to the instant acquisition contributed to an increase in concentration, arguing: "[E]ven those increases in concentration that did occur during the 1960's were not the result of mergers (other than this one) and are therefore irrelevant to the decision of this case." (RRB 22).

Quite to the contrary, a trend to concentration is not to be disregarded simply because it might not be attributable to mergers. Complaint counsel did not have to prove that the trend owed its existence primarily or even partially to mergers. American General has advanced precisely the argument the Supreme Court dismissed in *Pabst*:

We have not overlooked Pabst's contention that we should not consider the steady trend toward concentration in the beer industry because the Government has not shown that the trend is due to mergers. There is no duty on the Government to make such proof. It would seem fantastic to assume that part of the concentration in the beer industry has not been due to mergers but even if the Government made no such proof, it would not aid Pabst. * * * [I]t is not for the courts to review the policy decision of Congress that mergers which may substantially lessen competition are forbidden, which in effect the courts would be doing should they now require proof of the congressional premise that mergers are a major cause of concentration.

[22]

²⁶ *The Seeburg Corp.*, 75 F.T.C. 561, 665 (1969), *aff'd*, 425 F.2d 124 (6th Cir.), *cert. denied*, 400 U.S. 865 (1970). The respondent attempts to distinguish *Seeburg* because, assertedly unlike the situation here, the markets in that case continued to increase in concentration after the acquisition. Not only is the respondent incorrect about the post-acquisition trend in fidelity and surety, but it omits to mention that the Commission in *Seeburg* said in the next breath that even a decline in concentration could not compensate for the loss of actual competition 75 F.T.C. 665.

²⁷ *Liggett & Myers Inc.*, 87 F.T.C. 1074, 1180-1181 (1976), *appeal pending*, No. 76-1771 (4th Cir.).

We hold that a trend toward concentration in an industry, whatever its causes, is a highly relevant factor in deciding how substantial the anticompetitive effect of a merger may be. [384 U.S. at 552-553]

Neither have respondents demonstrated that the trend toward concentration has been the result of increasing efficiencies of large scale production or technological change.

American General also argues that because seven of the top eight fidelity bond writers in 1973 had straight fidelity market shares that were higher than their CMP shares, due consideration for the fidelity portion of CMP would cancel out the increases in concentration shown in the record. But as we have already found, the fidelity portion of CMP is too small to affect the analysis of this acquisition. Besides, the respondent has offered figures for a post-acquisition year, using net rather than direct premiums, and acknowledging that the argument depends on a double assumption: that all the top eight companies have roughly equal fidelity components of their CMP policies, and that fidelity within CMP increases in direct proportion to total CMP premiums. We agree with complaint counsel that this line of argument is far too speculative to cast doubt on the clear trends toward concentration that are quantified on the record.

III. QUALITATIVE ANALYSIS

American General argues that other factors at work in these two markets neutralize whatever probable anticompetitive effect can be predicted from the statistical evidence.²⁸ We have considered these arguments with care.

A. Entry Barriers

There are significant (though not insuperable) obstacles to entry into the surety and fidelity markets. American General contends, however, that they pose no substantial [23] deterrent to the large property-liability insurance companies which are assertedly the most likely entrants, and that ease of entry must be balanced against the immediate effect of the acquisition.

The key to success in the contract surety field is skilled underwriters to evaluate the complex risks attending the writing of a surety bond (ID f. 104, Tr. 223, 1127). Witness after witness testified that such people are hard to find and hard to train, even for the larger property-liability firms with ambitions to enter the surety business (Tr. 106, 206,

²⁸ "Statistics reflecting the shares of the market controlled by the industry leaders and the parties to the merger are, of course, the primary index of market power; but only a further examination of the particular market—its structure, history, and probable future—can provide the appropriate setting for judging the probable anticompetitive effect of the merger." *Brown Shoe Co. v. United States*, 370 U.S. 294, 322, n. 38 (1962).

224, 883, 921). An entrant can hire a few experienced underwriters and use them to train others, but the training process is time-consuming, requiring about two years for reasonable competence and several years more before the underwriter can be regarded as a good investment (Tr. 105, 156, 1116, 1400). The need for numbers of skilled underwriters is particularly acute because contract bond customers need quick responses, which can best be provided by an underwriter who is stationed in the area and has the ability and authority to commit his firm to the bond without having to consult the home office (Tr. 988). With time and money, underwriters can of course be obtained, but the process slows up entry substantially. Although fidelity underwriters also need specialized training, they do not require the same level of skill as a contract surety underwriter.

Building a network of contract surety agents presents a second hurdle. While established property-liability companies start with agents of their own who can furnish leads to customers, severing the close relationship that customarily develops among surety bond customers, agents, and bond writers is not an easy task (ID f. 106, Tr. 1388-89). This is particularly so because construction bonds must be written quickly, and unfamiliarity breeds delay (ID f. 106). Taking on a contract bond customer requires a searching evaluation of the customer's entire business operation (ID f. 79), a process that most customers do not submit to lightly (Tr. 989).²⁹ A pre-existing commercial agency network can provide a foothold, but most successful surety agents have to be specialists with their own peculiar skills (Tr. 1389).

[24] We decline to rely on the uncertain possibility that new entry may occur at some unspecified date in the future to reverse the immediate loss of substantial competition caused by this merger. Potential competition is an inadequate substitute for the substantial actual competition that the American General-F&D acquisition eliminated. Entry takes time, especially in these markets where there are impediments to overcome. Moreover, an entry-discouraging level of price, availability and service competition is not necessarily as good as what healthy actual competition would assure. *Ekco Products Co.*, 65 F.T.C. 1163, 1208 (1964), *aff'd*, 347 F.2d 745 (7th Cir. 1965).³⁰

B. Number of Competitors

American General argues that the standards of *United States v. Von's Grocery Co.*, 384 U.S. 270 (1966) and *United States v. Pabst*

²⁹ Complaint counsel argue that both capital and the need to obtain state licenses also impede entry. While that may be true for a small potential entrant, the record is clear that neither factor presents substantial problems for a large insurance company with ample resources and pre-existing licenses in the states for other lines of insurance.

³⁰ See also *RSR Corp.*, F.T.C. Dkt. 8959 (Dec. 2, 1976) [88 F.T.C. 800], *appeal pending*, No. 77-1413 (9th Cir.), 3 CCH Trade Reg. Rep. ¶21,252, at p. 21,154.

Brewing Co., 384 U.S. 546 (1966) are inapplicable to this case because in both those cases the relevant markets had seen a precipitous drop in the number of individual competitors. In contrast, the respondent maintains, the fidelity and surety markets have experienced an expansion of the number of competitors, which is assertedly inconsistent with a trend toward concentration. While the ALJ found that the data of record would not permit a conclusion as to the number of bond writers over the years relevant to this case, he appeared to accept one data source that showed an increase in fidelity writers from 163 in 1967 to 166 in 1968 and to 167 in 1972, and an increase in surety writers from 190 in 1967 to 211 in 1968 to 246 in 1972 (ID f. 114 at p. 34).

Contrary to the respondent's position:

* * * [N]either *Von's Grocery* nor any other case conditions the finding of a section 7 violation on the presence of a continuous decline in the number of competitors in a market. Merely because the market under scrutiny in *Von's Grocery* was "characterized by a long and continuous trend toward fewer and fewer owner-competitors," [384 U.S. at 278] does not require the presence of that characteristic in a market before concentration and a violation of section 7 may be found. * * * [25]

Even if the market here had more competitors in 1970 than it had in 1950, as Beatrice contends, the record clearly demonstrates that the acquisition of Essex aggravated an already concentrated market. (Citations omitted.)³¹

We see no distinction for this purpose between a Section 7 violation bottomed on contribution to a trend toward concentration and a violation dependent on an already concentrated market.³² Whether concentration at the top has already occurred or whether it simply threatens to occur, its existence does not depend on the reduction of the total number of competitors. That may be an additional symptom of a lessening of competition, but it is not a necessary condition. Indeed, there is no inconsistency between a competition-injuring trend toward concentration and an *increase* in the number of individual competitors. New entrants may simply be prospering under the umbrella of weakened competition or responding in small part to rapidly increasing demand, without posing an immediate or certain threat to the leaders.³³

C. Individual Entrants

The respondent also contends that new entrants have appeared who can counterbalance the anticompetitive effect of the American General-F&D acquisition. In a way, of course, the concentration ratios rebut the contention: even after the acquisition, fidelity concentration has

³¹ *Beatrice Foods Co. v. FTC*, 540 F.2d 303, 312 (7th Cir. 1976).

³² As previously noted, concentration levels in fidelity and surety are not substantially lower than in the *Beatrice* brush-and-roller market, in any case.

³³ Bok, *Section 7 of the Clayton Act and the Merging of Law and Economics*, 74 Harv. L. Rev. 226, 312, n. 261 (1960).

continued to grow unabated, and surety concentration has not declined, despite whatever new entry may have taken place. All the same, we will consider the most prominent examples of new entry offered by the respondent.

[26] 1. *Employers of Wausau*. The head of Employers' new surety department testified that his company expected to write \$1-1.2 million in direct surety premiums in 1974, after having entered the field in the summer of 1973. He expected Employers' surety operations to be nationwide about six years after their inception, with a projected premium volume of about \$5 million (Tr. 876-879). It is evident that even if it meets its projections, six years after entry, Employers would still have a long way to go before it would approach the significance of the firms combined by this acquisition. Moreover, Employers' asserted status as a significant entrant rests almost entirely on projections; given the checkered history of other surety entrants, its predictions cannot be greeted without skepticism.³⁴

2. *Safeco*. Safeco appears to have expanded its surety writings considerably in the East and Southeast since 1967 (Tr. 1112-1115), but not from a standing start. Safeco or its parent was a significant factor in the surety industry as long ago as 1955 (RX 203-revised). Safeco had years of surety experience and a considerable foothold east of the Mississippi in 1967; it is a new entrant only under a rather liberal definition of the term.

3. *Travelers*. Travelers entered surety bonding in 1940 or 1941, and in 1973 was ranked third in the nation. Travelers' 30-year struggle to reach top ranking in the surety market, offered by the respondent as an example of *ease* of entry, is persuasive evidence of the opposite (ID f. 148a).

4. *Argonaut*. After a rather rapid expansion of its surety writings since entering the field in 1959, Argonaut encountered serious losses in 1973 and 1974. Argonaut's vice president in charge of bonding operations testified that the company had expanded too quickly, and hired underwriters who—despite prior experience—wrote bonds that went sour. As a consequence, four of Argonaut's nine district managers were removed, and the company made substantial changes in its underwriting policy (ID f. 148c; Tr. 1672-1680). Like Travelers, Argonaut's experience tends to confirm the existence of entry hurdles rather than to disprove them.

[27] 5. *Great American*. Great American "reactivated" its surety operations in 1965. The record does not reveal what role its prior experience may have had in its return to the field, or whether it may

³⁴ When asked about Employers' loss experience, a competitor testified: "It is probably very good. They haven't been in business long enough to have bad experience." (Tr. 1667).

fairly be considered a new entrant. In any case, its premium writings were virtually flat between 1968 and 1972, and a major agency has abandoned it as a source of bonds because of slow response time (ID 148b).³⁵

In short, the history of entry corroborates the existence of barriers.

D. Leading-firm Symmetry and Turnover

American General advances a pair of related arguments to escape the market structure data. The data are misleading, the respondent maintains, because (1) the top ranking firms are relatively equal in size to each other, and thus able to limit each other's market power, and (2) significant changes in the composition and rank of the market leaders reveal a degree of competitive intensity that belies the concentration ratios.

Symmetry in size among the market leaders is a factor the Commission has taken into account in assessing the competitive impact of a merger: "A given level of concentration measured by aggregate market shares held by top firms may portend different market conditions depending upon whether firms within the grouping are relatively equal or quite disparate in size, with equality of size evidencing a more favorable climate for competition." *Warner-Lambert Co.*, 87 F.T.C. 812, 870 (1976).³⁶

[28] An asymmetrical oligopoly may aggravate whatever lessening of competition may result from a merger; but a symmetrical oligopoly hardly means that no injury to competition is likely to occur.

It is also worth noting that, in both the surety and fidelity markets, concentration ratios and the market share of the leading firms were higher than in the ethical drug market in *Warner-Lambert*. In addition, unlike *Warner-Lambert* in which the challenged merger created merely the fifth ranking firm in the ethical drug market, this acquisition assembled a leading firm in both markets, and produced a considerably greater asymmetry between the first and second ranked firms than had existed before:

³⁵ The respondent also cites Kemper, Western Surety and Allegheny Mutual, all of which are veterans in surety (albeit license and permit bonds rather than contract bonds, in Kemper's case). None of the three was among the top 15 surety writers in 1973 (RX 233; CPF 233).

³⁶ The economic authorities cited by the respondent recognize this point, e.g.: "Generally, an asymmetrical oligopoly, dominated by one firm rather than having relatively equal-size leading firms, would involve a higher degree of market power. Although equal-size oligopolists might expect to attempt and possibly achieve considerable joint maximizing of profits, more definite control would be likely under and within a single dominant firm. Equal size among the market leaders makes cooperation riskier and its rewards smaller for each firm, compared with asymmetry." (First emphasis added.) W. Shepherd, *Market Power and Economic Welfare* 40 (1970). ["Respondent's Brief in Support of Proposed Findings," Appendix I, at 2 (March 7, 1975)]. Accord: Scherer, *Industrial Market Structure and Economic Performance* 183 (1970).

	<i>No. 1</i>	<i>No. 2</i>	<i>No. 2/No. 1</i>
ethical drugs			
pre-acquisition	7.37	6.52	.88
post-acquisition	(no change)		
fidelity			
pre-acquisition	8.9	7.6	.85
post-acquisition	10.7	8.9	.71
surety			
pre-acquisition	8.2	8.0	.98
post-acquisition	12.4	8.2	.66

(Source: 87 F.T.C. 910; ID f. 110,113)

in short, while we have considered the comparative size of leading firm shares in these markets, their arguable symmetry is nevertheless consistent with a probable lessening of competition (especially in view of the acquisition's effect on disparity between the leaders).

[29] Neither do we find changes in composition, rank or market share among the leaders that cast doubt on the ALJ's conclusion. In surety, in fact, measured by direct premiums, the market leaders moved in virtual lockstep through the decade preceding the American General-F&D acquisition. In 1959, U.S. Fidelity & Guaranty led the way, followed by (respectively) F&D, Aetna and Travelers (RX 236a). In 1968, the year of the acquisition, they were arrayed in exactly the same order, although each (with the exception of U.S. Fidelity & Guaranty) had increased its market share (ID f. 113). The top four consisted of the same companies from 1959 to 1968 and indeed (the ALJ found) through 1973 (ID f. 146). In other words, what the respondent characterizes as the "raw concentration data" (RAB 61) lose none of their significance even if these additional factors are assessed.

The fidelity market was not as stagnant as the surety market in the pre-acquisition period, but it still displayed convincing indicia of stability. The following table traces the history of the 1959 industry leaders:

	<i>Rank</i>	<i>1959 Share (%)</i>	<i>Rank</i>	<i>1963 Share (%)</i>	<i>Rank</i>	<i>1968 Share (%)</i>
F&D	1	7.3	1	7.7	3	7.4
Hartford	2	6.5	3	6.2	5	6.7
U.S. Fidelity and Guaranty	3	6.3	2	6.3	8	5.0
Fireman's Fund	4	5.9	5	5.6	6	5.3
		26.0		25.8		24.4

(Sources: RX 235a, CX 96-D, ID f. 113)

While each of the 1959 leaders slipped moderately in terms of rank, the

striking fact about their fates is that the group did not suffer significant losses in market share. Individually, only U.S. Fidelity & Guaranty experienced so much as moderate loss of share. The new leaders, in other words, have made their gains primarily at the expense of the smaller members of the industry, which is apparent from the substantial increase in four- and eight-firm concentration over the period. In addition, we find nothing to cast doubt [30] on the ALJ's conclusion that the fidelity market, like the surety market, was led by a small group of companies throughout the relevant period, or that the concentration ratios and concentration trends do not misstate the degree of competition present.

E. F&D's Multiline Competitors

The respondent advances a constellation of arguments all bottomed on the same general premise: that F&D on its own faces a bleak future in contending with its larger and more diversified competitors. Several of these arguments carry little weight, however. The respondent contends that the sheer disparity in assets and premium volume in non-bonding lines (*i.e.*, insurance) between F&D and its major competitors should be taken into account in assessing the acquisition's impact. Similarly, it is argued that the big property-liability insurance companies gain a competitive advantage over F&D through their large networks of agents and brokers, and because they sell their other lines of insurance to the same classes of consumers who are F&D's bond customers.

The problem with all of these points is the same. F&D has been competing successfully for decades with these selfsame large property-liability companies, despite their larger assets, larger premium income, more extensive agent and broker organizations, and customer contacts.³⁷ There [31] is no dispute that from 1962 through the acquisition (and even beyond) F&D has expanded its premium volume, maintained a market share that kept it among the industry leaders, and operated efficiently with a loss ratio well below the industry average (ID f. 26-29).

The only nexus the respondent has suggested between the size of the

³⁷ The respondent dwells on the example of Continental, which assertedly used its considerable resources in other fields to expand its fidelity and surety market share at will (RAB 49; RRB 32-34; Tr. 473-475). The implication is that Continental's abrupt growth came at the expense of bond writers that lack its size and diverse lines. But, as the respondent itself has pointed out, all of the top fidelity and surety bonding companies are also big general property-liability firms. Unless we indulge in the unlikely assumption that Continental's gains were entirely F&D's losses, it is difficult to attribute its direct premium increases to brute strength alone, since it was in large part picking on competitors its own size. Moreover, it is revealing that Continental's expansions in both markets were followed by retrenchment necessitated by what the Continental witness described as unsatisfactory "experience patterns." (Tr. 473, 475). We have already discussed the evident hazards of overhasty expansion, at least in surety bonding. A fair inference is that Continental, like Argonaut, found it easy to write new bonds but only at the price of some costly mistakes.

property-liability companies and their ability to profit at F&D's expense is the advent of various devices to combine bonds with other lines of coverage: package policies, "packaging" of several policies to sell to a single client, and account selling.³⁸ In surety, the respondent argues that account selling poses the primary threat to F&D's market position. (Surety bonds are not sold in package policies.) Full-line companies doubtless possess some advantages over specialized firms such as F&D in marketing surety bonds. The availability of other lines may allow a lower price to be offered (Tr. 702). The multiline company can dangle insurance coverage on an otherwise doubtful risk as an inducement to place the bond with it as well (Tr. 1565). Dealing with one insurance company rather than several may be more convenient.

But there is little evidence in the record of the effects on F&D of the account selling device. F&D's president could name only a single specific account the company had lost to account selling (Tr. 703), although he listed other contractors for whose business he said F&D could not compete (Tr. 706-7). The ALJ found that F&D's direct surety premium volume grew steadily from 1962 through 1972 (with a slight decline in 1973), and between 1962 and 1972 outpaced the industry growth rate in surety (ID p. 11). F&D's ability to do better than hold its own is particularly impressive since there is no dispute that all surety is reported separately, even if it is sold through account selling. Clearly, then, F&D is competing successfully even with multiline companies who attempt to market surety bonds through account selling. The respondent cites declines in [32] F&D's surety market share, measured by direct premiums, that have occurred since 1970 (RAB 56). But all of its market share slippage has taken place after the acquisition, and is entitled to little weight, at best.³⁹

In fidelity, F&D's multiline competition is channelled primarily through package policies, including the previously discussed CMP (commercial multi-peril policies). As in surety, however, F&D has expanded its straight fidelity premiums despite competition from package policies (ID p. 11). Moreover, F&D has developed its own multiperil policy (called "SMP") for financial institutions, which comprise about 60 percent of its fidelity business (ID f. 50, 102; Tr. 1696, 1707). Although most of F&D's fidelity is written outside the package, its president characterized his company as highly competitive in its SMP policy (Tr. 1708, 1705). F&D regarded its vulnerability to multiline competition for financial institution business as much reduced by

³⁸ The distinction between "packaging" of policies and account selling is that the former need not all be obtained from the same insurance company, while account selling involves an insurer trying to place as many of its own policies as possible with a customer (ID p. 28, n. 6, 7A).

³⁹ Account selling, in addition, is aimed primarily at larger accounts—those generating at least \$100,000 in annual total premiums (ID p. 28, n. 7A, as modified in the Appendix).

SMP (RX 146m); although the policy has been slow to show a profit, it was expected to break into the black in 1974 (Tr. 1702-3).

In fidelity bonds other than those sold to financial institutions, F&D has defended its market position to a degree by offering discounts when additional coverages are written by another carrier (ID p. 62). In addition, F&D actively pursued alternative means of offering other commercial insurance coverages itself. Although the price tag was high, F&D considered developing its own CMP policy in 1969 and reinvestigated the option in 1974 (RX 146, 145). F&D also considered either acquiring or forming a holding company with other, complementary insurance companies. It was expected that the new firm could write package policies including fidelity, or offer multiline services to F&D's contractor accounts, or both (RX 98-100, 109; Tr. 730-741).

In addition, F&D's specialization brought with it some compensatory advantages as well as disadvantages (compare Tr. 1355-58 with 1376). F&D's specialized services in such areas as loss prevention enabled it to market its bonds successfully at a price somewhat higher than its competitors' (ID f. 88; Tr. 1700-1702), and F&D's promotional literature for agents stressed its sophistication and skill in its area of concentration (CX 49b).

[33] Respondent places great weight on *General Dynamics*. Competition there was in a market—uncommitted coal reserves—where the acquired firm had nothing left to sell, making current production figures an empty statistic. In contrast, premiums express current bond competition quite well, and it would be fatuous to suggest that F&D is running out of bonds to sell. F&D's competitive problems as a bond specialist do not compare with the acquired coal producer's in *General Dynamics*. While the lower court found that additional strippable reserves were simply unavailable, F&D had taken some steps to remedy its lack of full-line facilities and was pursuing others when its efforts were diverted by the American General acquisition. Finally, as the Supreme Court explicitly noted in *General Dynamics*, brand loyalty and distribution systems support the presumption that past sales imply future competitive strength. F&D possessed a national network of agents and branch offices and a staff of expert underwriters. Unlike coal, presumably fungible or nearly so, F&D's services to its bond customers, to judge from its own statements, are exceptional and help it get and hold business.

F. State Regulation

American General presses state insurance regulation as yet another factor militating against the anticompetitive effect of the F&D acquisition.

Whatever the actual impact of state regulation on insurance practices, however, its overwhelming direction is prohibitory: to prevent company failure, overcharging, discriminatory rates, and unfair contract provisions, as well as to achieve a host of other prophylactic goals. But what state regulation manifestly cannot supply are the *affirmative* benefits that flow only from a competitive market structure, including aggressive competition and innovation. The ALJ found that surety and fidelity bond writers compete in service, availability, and price (ID p. 56), and the fact of state regulation cannot compensate in any measure for the probable lessening of that competition attributable to the American General-F&D acquisition. State insurance commissioners cannot order insurance companies to compete; that is the function of the market.

G. "Sophisticated Buyers"

A final factor the respondent alleges that the initial decision neglected is the sophisticated character of the agents who (both the ALJ and the respondent agree) primarily make the decision about which company writes the bond. We [34] infer from the testimony cited by the respondent (R. Reply B. 25-26) that this sophistication consists largely of the agents' ability to search for the company offering the best combination of terms, conditions, and price for their clients' needs. But we fail to see how the agents' perspicacity in locating alternatives can immunize them from market power. Wise choices among alternatives depend in the first instance on the existence of those alternatives.

H. Conclusion

We have evaluated the various factors, individually and collectively, that the respondent suggests mitigate the basic statistical data in this case. We have found nothing to disturb the conclusion that this acquisition may substantially lessen competition in the fidelity and surety markets, and we believe the ALJ was correct in holding it to violate Section 7.

IV. RELIEF AND RESPONDENT'S MOTION TO REOPEN

The respondent has moved to reopen the record for reception of evidence on the circumstances under which Maryland Casualty assertedly withdrew from the bonding business in mid-1976, after sustaining what are described as heavy losses. The respondent argues that Maryland Casualty's exit undermines the ALJ's conclusions on liability, and even if a Section 7 violation is found, eliminates divestiture as an appropriate remedy. We reopen the record to receive the proffered

affidavit, even though we are aware that complaint counsel have had no opportunity to subject it to cross-examination.

The proffered evidence is, however, immaterial as to liability. The existence of a Section 7 violation depends on competitive conditions at the time the record closes, at the latest. "But the force of Section 7 is still in probabilities, not in what later transpired. That must necessarily be the case, for once the two companies are united no one knows what the fate of the acquired company and its competitors would have been but for the merger." *FTC v. Consolidated Foods Corp.*, 380 U.S. 592, 598 (1965) [7 S.&D. 1189]. The respondent's decision to shut down Maryland Casualty's bonding operations and to allow F&D to skim the cream by trying to pick up the best accounts is just the sort of post-acquisition evidence subject to manipulation that courts and the Commission have regarded with skepticism.⁴⁰ [35] We cannot dismiss the possibility that a respondent under the shadow of a possible divestiture order could impair either its own operations or those of the acquired firm to set up a plausible argument that divestiture is unwarranted.⁴¹

Nor can we agree with the respondent that its decision to terminate Maryland Casualty's bonding business should be controlling on the question of relief. Surely, American General cannot mean that the effect of the illegal acquisition has been neutralized because Maryland Casualty's less favored accounts have been jettisoned. American General has not re-established either of the acquired firms as an independent competitor, which is what happened in *Foremost Dairies Inc.*, 71 F.T.C. 56 (1967), the case on which it relies. It has not even eliminated the area of competitive overlap.

What American General appears to have done is put itself in a position so that the Commission's principal option is to order divestiture and convert American General into a potential competitor (although the disappearance of illegally acquired assets did not prevent the Commission from requiring the reconstitution of the acquired firm in *Ekco Products Co.*, 65 F.T.C. 1163 (1964)). The question is not, however, a new one. In *Diamond Alkali Co.*, 72 F.T.C. 700 (1967), the respondent closed and dismantled all of its cement manufacturing facilities except those it had gained through the challenged acquisition, and it did so after the Commission had issued its complaint. The remaining plant enabled Diamond to keep its own previous market share and the share of the acquired firm. Both these factors parallel the situation into which American General has chosen to place itself. Despite Diamond's vehement declaration that it would never enter the cement business again if required to divest, which the Commission took at face value,

⁴⁰ *United States v. General Dynamics Corp.*, 415 U.S. 486, 504 (1974).

⁴¹ *Litton Industries, Inc.*, 85 F.T.C. 333, 385 (1975).

divestiture was ordered. Although the prospect of actual reentry was not bright, industry members were likely to perceive Diamond as a potential entrant, and the Commission saw its only other alternative as "simply throwing up our hands and surrendering all chance that this Section 7 violation will be remedied." 72 F.T.C. at 751.

[36] Divestiture is equally appropriate here. Although the cement market in *Diamond* was extremely concentrated and entry barriers were high, the lesser but still substantial concentration and barriers in fidelity and surety render American General valuable as a potential competitor. Moreover, as the respondent itself has pointed out, bonding capabilities are a valuable adjunct to other insurance lines, and insurance companies have entered the bonding field to offer clients that additional service (RPF III-34, 35). The same incentive applies to American General as well. Prior experience and interest in the field also suggest that, if divested of F&D, American General would be likely to return. One former bond writer has reentered the market after a period of inactivity (ID f. 148b), and F&D's president testified that he regarded another company that had phased out of surety bonding as a potential entrant (Tr. 858). Finally, Maryland Casualty plans to retain a bonding subsidiary, and a variety of bonding business in miscellaneous categories (McCullough Aff. pp. 8-10). To the extent of the business retained, American General remains an actual competitor. It is evident that if American General chooses to expand its bonding operations, whether through Maryland Casualty or by other means, it still possesses at the very least a share of the market and a reserve of experienced personnel to facilitate reentry. In summary, we regard divestiture as offering the fullest possible measure of relief under the circumstances, despite Maryland Casualty's apparent partial withdrawal.

American General argues that the six months permitted for divestiture of F&D in the ALJ's order is unreasonably short, and urges instead that three years be allowed. The respondent has cited no extraordinary factors complicating this particular divestiture that would justify such an unusually lengthy period of time. In oral argument, complaint counsel suggested that one year would be ample time and would not be inappropriate. We will modify the ALJ's order to require divestiture within one year of the date the order becomes final.

The respondent also suggests that the ALJ's order may be unclear because it mentions divestiture of stock and of assets. We fail to see the unclarity. The ALJ's formulation is common in Commission divestiture orders. *Avnet Inc.*, 82 F.T.C. 391, 486 (1973); *Ash Grove Cement Co.*, 85 F.T.C. 1123, 1150 (1975). We see no reason to modify the order in this respect.

[37] Neither can we agree with the respondent that a ten-year prohibition on acquisitions in these markets without Commission approval is unwarranted. Clearly, the Commission has the authority to order such relief. *Abex Corp. v. FTC*, 420 F.2d 928 (6th Cir.), *cert. denied*, 400 U.S. 866 (1970). American General entered the fidelity and surety market through the acquisition of a leading firm, and followed four years later with the acquisition of a major competitor. It is not unreasonable to suppose that such a path could be followed again. Both markets have experienced a trend toward increased concentration. Even if divestiture relegates American General to the status of a potential competitor, the Commission is under a duty to ensure that its reentry, should it occur, does not have anticompetitive consequences. The ban is not absolute; American General is simply required to obtain Commission approval. Under the circumstances, we deem the ten-year restriction on acquisitions appropriate.

Complaint counsel appeal from the ALJ's failure to enter an order requiring American General to divest a \$20 million special dividend paid to it by F&D in 1973, and regular dividends which have been paid to American General since 1970 rather than retained to supplement F&D's capital and surplus. In view of the state of the record, we decline to overturn the ALJ's refusal to order the "divestiture" of these dividends. Complaint counsel have failed to demonstrate what the ultimate effect of such action would be. They have not established that this action constituted an independent violation of Section 7 of the Clayton Act, nor have they shown that F&D's competitive vitality was impaired. Neither is there an explanation why the forced divestiture of cash would do more than increase the sale price of F&D on a dollar-for-dollar basis.

An appropriate order will issue. [38]

APPENDIX

The Findings of Fact and Conclusions of Law set out in the Initial Decision of the Administrative Law Judge are adopted by the Commission except to the extent they are qualified or supplemented in the Commission's Opinion and in this Appendix.

The following Findings in the Initial Decision are modified as indicated:

I.D. f. 41, 46: Change "Fs. 36-39" in the last line of both findings to read "Fs. 42-45" (Typographical error).

I.D. f. 101: Delete footnote 7A and substitute: "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 accounts generating \$100,000-\$300,000 in total annual premiums (Tr. 212-213, 1746). Account selling gives multiline companies certain advantages over specialized companies, including potentially lower prices and the ability to offer insurance on otherwise doubtful risks in order to write an attractive bond (Tr. 702, 1334-35, 1565-66). There is little evidence of actual harm to F&D from account selling, however. Although F&D's president said his company could not compete for certain

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accounts, he could name only one account actually lost to account selling (Tr. 703, 706-7) (Compare RX 143 with Tr. 1746-7)."

I.D. f. 107: Add after last sentence: "The need for capital and surplus, and state licenses, primarily affects small bond writers."

I.D. f. 114: Delete the last two sentences of the second paragraph, and substitute: "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 as shown on RX 226 (160 and 194, respectively). The figures include companies under common ownership but count them separately (Tr. 1447-48; CX 150). In addition, a Surety Association representative testified that the 1963 figures were consistent with the number of Association affiliates comprising "members" and "subscribers" in 1963 (Tr. 1448); but the Association representative also testified that there were two other classes of affiliates at that [39] time ("manual purchasers" and "statistical filers"), whose presence he did not account for in the 1963 figures (Tr. 1446-47; compare Tr. 1449; see Tr. 2800-1). In short, the figures in RX 226 are too confused to support any valid conclusions with respect to the number of fidelity and surety writers."

I.D. f. 142: In the sixth sentence, change "7.6" to "7.4". (Apparent error in copying from exhibit.)

The Commission makes the following additional finding:

Shortly before its acquisition by American General, F&D was actively seeking to acquire, or form a holding company with, insurance companies that would give F&D multiline capacity but which were not major competitors in fidelity and surety (RX 97, 98, 99, 109). Although F&D's management considered acquisition of a complementary company the better alternative, consideration was also given to internal development of the capacity to offer other insurance lines (RX 146).

FINAL ORDER

[1] This matter having been heard by the Commission upon the appeal of respondent from the Initial Decision, and upon briefs and oral argument in support thereof and opposition thereto, and the Commission for the reasons stated in the accompanying Opinion having determined to sustain the Initial Decision with certain modifications:

It is ordered, That the Initial Decision of the administrative law judge, pages 1-48, be adopted as the Findings of Fact and Conclusions of Law of the Commission, except to the extent indicated in the accompanying Opinion.

Other Findings of Fact and Conclusions of Law of the Commission are contained in the accompanying Opinion.

It is further ordered, That the following Order to cease and desist be, and it hereby is, entered: [2]

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 one year 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, 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. [3]

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 Commis-

sion, 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 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. [4]

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 Commission, the share capital, assets or interest of any corporation engaged in fidelity and/or surety underwriting in the United States.

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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 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, counter-offers, communications and correspondence concerning said divestiture. [5]

XIII

American General shall notify the Commission of any proposed 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.

ADVISORY OPINIONS

Marking of jewelry produced from a 14 karat gold sheet laminated upon sterling (File No. 773 7004).*Opinion Letter*

February 18, 1977

Dear Mr. Goldberg:

This is in response to your request for an advisory opinion concerning the marking of articles of jewelry produced from a 14 karat gold sheet laminated upon sterling, the gold sheet constituting at least 1/20th of the weight of each jewelry item's metal content. The items of jewelry contemplated for manufacture include bracelets, necklaces and earrings. You propose marking such articles "Sterling and 14K" or "Sterling + 14K," on the premise that such markings are permitted by Section 4 of Commercial Standard CS51-35, "Marking Articles Made of Silver in Combination with Gold."¹ In the Commission's opinion, the use of either marking would have the tendency and capacity to mislead consumers and thus be in violation of Section 5 of the Federal Trade Commission Act, 15 U.S.C. 45.

The sample of the laminated metals submitted to the Commission might be described as having an obverse side of yellow gold and a reverse side of silver. The different metals in the sample provided are clearly distinguishable, but casual inspection cannot determine the relative thicknesses of the gold layer and the silver. The 1:20 ratio you have specified, however, does no more than meet the minimum requirements for "gold fill," "gold plate," or "gold overlay." See 16 C.F.R. 23.22(c)(2).

The markings "Sterling and 14K" or "Sterling + 14K," in the Commission's view, could suggest to consumers that the amounts of gold and silver in the articles of jewelry so marked are approximately equal or, at least, would suggest more than five percent 14K gold. Such markings, accordingly, would have the capacity to mislead consumers.

The Commission does not construe Commercial Standard CS 51-35 to justify a different conclusion. In the circumstances presented, a marking must be used which makes clear to consumers the relative

¹ The Standard, a voluntary guide developed by industry members with the cooperation of the National Bureau of Standards, was recently redesignated as PS68-76.

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proportion of yellow gold to silver, either by use of a "gold plate" designation (or related designations set forth in the Trade Practice Rules for the Jewelry Industry, 16 C.F.R. 23.22(c)(2)) or by preceding the gold fineness designation with a fraction consisting of the ratio of the weight of the 14K gold to the weight of the metal in the entire article, a marking clearly not inconsistent with the Commercial Standard.

This opinion is limited to the circumstances presented by your sample, *i.e.*, where silver is combined with yellow gold and both the gold and silver surfaces are equally visible in jewelry made from the laminates.

Assuming that the sterling and 14K yellow gold meet the designated quality standards and that the 14K gold is at least 1/20th the weight of the metal in any finished article of jewelry, the following markings, in the Commission's opinion, would comply with Section 5 of the Federal Trade Commission Act:

Sterling and [or +] 14K Gold Plate*

14K Gold Plate on Sterling

Sterling and [or +] 1/20th [or other fraction] 14K Gold

* "Gold Filled," "Gold Overlay," or "Rolled Gold," or their abbreviations set out in 16 C.F.R. § 23.22(c)(2), may be used if they are appropriate for the laminating process.

By direction of the Commission.

Letter of Request

15 April, 1976

Dear Mr. Tobin:

My company has been in business three years and we manufacture jewelry for the finest retail stores in the United States.

We have developed a new process whereby we laminate, by mechanical means, a sheet of 14 karat gold directly upon sterling silver. We enclose a small sample of our product. Please note, the gold is easily distinguishable from the sterling.

The purpose of this letter is to request a formal advisory opinion under the Federal Trade Commission Act to determine whether or not this item of jewelry made from 14 karat gold and sterling can be stamped 14 karat gold plus sterling in accordance with Commercial Standard CS

51-35, Marking Items Made of Silver in combination with Gold, as recognized in the Federal Trade Commission Trade Practice Rules for the Jewelry Industry, Rule 23 (see footnote No. 4).

The weight of the 14 karat gold to the weight of the entire article will be at least 1/20th of the weight of the entire metal or better.

Commercial Standard CS 51-35, we believed, would apply, since the silver of the 14 karat gold is easily distinguishable, one part from the other part. Paragraph four of this Standard would permit, we believe, this item to be stamped "Sterling and 14K" or "Sterling + 14K".

We are currently not manufacturing this product nor selling the same and request this opinion so that we may correctly designate our jewelry to our retailers for the protection of the consumer.

Since jewelry is a fashion item, and since we would like to produce this product for our Fall market season, we would greatly appreciate your efforts in forwarding this opinion to us no later than June 30, 1976. Your cooperation within this period of time would be, as stated, greatly appreciated.

Sincerely,

/s/ VICTOR GOLDBERG
President

Association's proposed plan to provide gasoline dealer with instant identification intended to assure motorists of the credibility and reliability of such dealer's performance for fill-up customers at full service gasoline pump islands (File No. 773 7003).

Opinion Letter

March 5, 1977

Dear Mr. Houston:

This is in response to your request for an advisory opinion on a certification plan developed by your association for members of the Georgia retail petroleum industry.

Under this plan, as we understand it, participating petroleum retail dealers would provide to "fill-up" customers at designated full service islands, the services of (1) cleaning their windshields and (2) offering to check or checking under their hood. Dealers who certify their provision of the services to customers ordering a fill up of gasoline at one or more designated service islands may participate in the program and receive a seal to post indicating their participation in the program. As we understand the program, retail dealers with multi-island stations could participate on a single island basis.

For the reasons set forth below, the Commission is unable to approve the program.

With respect to the antitrust implications of your proposal, your letter states that "* * * all members of the industry may participate in the proposed plan who perform at least the minimum service for fill-up customers." Your proposed seal, however, bears the words, "Dealer Operated—An Independent Small Businessman." It is therefore unclear whether service stations not owned and operated by dealers may participate in the program. If the program is in fact open to any industry member who supplies the requisite services, regardless of ownership or operation, the Commission finds the plan unobjectionable on antitrust grounds. If a class of stations is excluded on grounds other than their failure to offer and provide those services, however, a question would be raised whether the program could have an illegal anticompetitive effect, and the Commission would be unable without a further factual inquiry, not undertaken in the context of advisory opinions, to approve it. Federal Trade Commission Procedures and Rules of Practice, 16 CFR 1.1(c).

This is not to say that such a program could not result in or facilitate

violation of the antitrust laws. The program could present occasion to fix prices or otherwise to limit competition. For example, if participants agreed explicitly or implicitly to withhold the services provided under the program from "partial fill" customers, or agreed that self-service or other kinds of sales would not be offered to the public, violations of the antitrust laws would result. That retail dealers with multi-island stations may participate on a single-island basis is an extremely important consideration in the Commission's evaluation of the plan.

Fees for participation in the program might best be structured in such a way that association members and nonmembers pay equal shares of program costs. Nonmembers of the association might be charged a higher fee than members if the differential simply insures that nonmembers, who do not pay association dues or assessments, are bearing an equal share of the costs of the program.

Section 5 of the Federal Trade Commission Act prohibits not only antitrust violations in the form of unfair methods of competition, but also unfair or deceptive acts or practices in or affecting commerce. Your proposed program is deficient in certain respects that could lead to illegal unfairness or deception.

You state in your promotional material that the Golden Triangle is "your assurance for receiving the above services when you drive up to a full service gasoline pump island and say—Fill er up." The services specifically designated are cleaning the windshield, checking tires for dangerous conditions, and offering to look under the hood, to check the oil, battery, fan belts, look for faulty or loose wiring and leaking brake or fuel systems. Yet participating dealers only agree to clean windshields and either check or offer to check under the hood. The affidavit should provide that all of the services specified in advertising material will in fact be provided. Of course, both the Association and the individual participants in the program bear the responsibility to ensure not only that the services are promised but also that they are actually provided. The Association should adopt a program of verifying compliance with the program, which should consist at least of spot-checking at appropriate intervals as well as investigating complaints.

In addition, the seal represents that the participant offers "full service at the pump island." In our view this implies that the servicing is available at the designated island to those willing to purchase gasoline. In fact, under the program, dealers commit themselves to provide "full service" only to those who order a fill up. We believe the limitation

regarding a fill up must either be prominently displayed on the seal or otherwise disclosed with prominence equal to that of the seal.

Finally, the Commission sees no problem in principle in franchising the program so that it would be available through trade associations in other states, if the objections raised in this opinion to the present form of the program are removed.

By direction of the Commission.

*Letter of Request**

October 22, 1975

Dear Sirs:

This is to request an advisory opinion on a proposed plan developed by this Association for all members of the industry.

The objective of the proposed plan is to provide the gasoline dealer with instant identification intended to assure motorists of the credibility and reliability of such dealer's performance for fill-up customers at full service gasoline pump islands.

The proposed plan is intended to insure availability of minimum performance which the consumer may expect at a full service pump when the consumer has ordered a fill-up of his tank. Only a general certification (See Exhibit A) that such minimum performance is regularly provided is proposed. Competition and public demand will continue to dictate the quality and extent of performance above the minimum described in this proposal.

This Association, recognizing that professionalism and credibility are valuable to its members, has developed the proposed plan to identify to consumers gasoline dealer locations where minimum performance is certain for fill-up customers. It is proposed that all members of the industry may participate in the proposed plan who perform at least the minimum service for fill-up customers. All participants will voluntarily and without implied or expressed coercion certify in writing to the Association of their willingness to assure such minimum performance is maintained. In return for the certification of such practices by any member of the industry the Association will make available the symbol illustrated in the copy attached (Exhibit B) for posting on his premises.

* The exhibits mentioned in the requesting letter are not reproduced herein but are available for inspection at Public Reference Branch, Room 130, Federal Trade Commission, Washington, D.C.

With reference to the illustration depicting the symbol for performance, it is proposed that the non-member of the Association will be supplied the identical signing with the exception that the word "member" shall be removed and the words "sponsored by the" shall be substituted. To fulfill the credibility intended under the proposed plan for public confidence in performance at locations where such symbol is displayed, it is deemed necessary to use the Association name in said signing. In the alternative, said symbol could be provided without other wordage to avoid any objection to the use of the Association name should the Commission feel this is necessary.

To insure consistency and quality in the use of the symbol and/or signing, it is intended that the Association will retain all rights for reproduction of authorized signing under this plan. Only approved designs as may from time to time be developed by the Association will be permitted in the use of said symbol.

By certification to performance as provided in this proposed plan, it is the intention of the Association to provide the symbol as a distinguishable basis for consumer decisions which might not otherwise be apparent.

In addition to providing the member of the industry who chooses to participate in the proposed plan with adequate signing as described above, it is the intention of the Association to provide from time to time promotional pieces it designs for use of said participating members of the industry. Such proposed promotional pieces as are illustrated by the attached sample (Exhibit C) are intended to develop public confidence in the proposed plan. In addition, such promotional pieces will serve as educational tools to inform consumers of the valuable and essential services performed at the pump island by the full service dealer when the customer says to fill his tank. Participating members of the industry would be encouraged to provide non fill-up customers with the best service performance they can provide to the extent it is economically feasible under their individual circumstances.

The use of the proposed promotional piece is intended for participating member dealers to hand to their fill-up customers. Upon receipt by the Association of complaints against any participating dealer, notice is to be given to the participating dealer complained of as a matter of information. In the event substantial numbers of complaints by consumers are received advising non-compliance with minimum performance certified to for participation in the purposed plan, said participating dealer shall be given an opportunity to appear before the Board

of Directors of the Association. The Board of Directors, acting as a committee which shall have the duty to examine the circumstances, shall hear the participating dealers' views and will make judgment whether the facts merit withdrawal of the right to participate in said program. Among the committee's other duties shall be the responsibility for insuring non-discriminatory access to the program by non members of the Georgia Association of Petroleum Retailers.

To effectively focus public attention upon the symbol and the participating industry members, it is intended that the Association may require all participating industry members to contribute to a co-operative advertising campaign to be conducted through public media. At the option of the Association, it is proposed that either a voluntary contributory plan will be implemented or that an assessment for each participating member of the industry will be implemented to support said intended advertising campaign. A Sample copy of the initial ad (Exhibit D) proposed for use in this connection is attached.

It is intended that non members of the Association will receive all promotional materials and the use of the symbol at a cost no greater than those imposed upon comparable Association members for whom comparable services have been rendered.

The Commission is requested to provide an advisory opinion on the general conditions of the proposed plan as outlined above in addition to the specific questions which follow:

1. Can the proposed plan be implemented as above described without danger of the Association being charged with anticompetitive activity?
2. Could the Association establish an annual charge for the use of the symbol and waive payment by members of the Association?
3. Would the Commission view as anticompetitive activity of this Association if as owner of the symbol and above plan this Association attempted to franchise said plan through other gasoline dealer Associations across the Nation with agreements with other Associations requiring uniformity in operation as described above?
4. If the Commission finds one phase of the above described plan to be improper or anticompetitive the Commission is respectfully asked to comment as to the effect of such finding on the remaining parts of said plan.

Thank you for your attention and for your best effort to expedite this request for an advisory opinion.

Sincerely,

/s/ Jack W. Houston
Executive Director

**Magnuson-Moss Warranty Act—Compliance of Ultrafiche System
with 16 C.F.R. 702, (File No. 773 7005).**

*Opinion Letter**

March 18, 1977

Dear Mr. Raymond:

This is in response to your request for an advisory opinion concerning a proposed method of complying with the Commission's Rule on Pre-Sale Availability of Written Warranty Terms, 16 C.F.R. 702. Your request was made following the Commission's advisory opinion of November 10, 1976, to the National Retail Hardware Association (NRHA) approving use of a microfiche reader system to satisfy Part 702.3(a)(1)(ii) of the Rule. 41 F.R. 53472. The Rule requires a retailer to maintain a binder "or [other] similar system* * *" giving consumers "convenient access to * * * warranties." 16 C.F.R. 702.1(g).

Specifically, you ask whether an ultrafiche viewing system would also satisfy Part 702.3(a)(1)(ii) of the Rule. In addition, you ask whether a retailer wishing to use an ultrafiche system under the Rule must comply with the condition set forth in the advisory opinion to the NRHA that:

The warranties appear on separate microfiche cards which contain all warranties for a given product class, and only that product class (e.g. vacuum cleaners), and which do not contain any other product information* * *.

The system you propose is substantially similar to the NRHA microfiche system. Information is stored on cards in greatly reduced photographic form. The cards can then be inserted into a viewing machine which magnifies the information and displays it in readable form on a screen.

The basic difference between the two systems is that an ultrafiche card contains 2,800 pages of information while a microfiche card typically contains less than 100. You argue that requiring a separate ultrafiche card for the warranties relating to each class of products would defeat the purpose of an ultrafiche system.

The Commission has carefully considered the matters set forth in your letter. It is the Commission's conclusion that the ultrafiche system you propose will satisfy the Commission's Rule if:

* Published in the *Federal Register*, 42 F.R. 15679.

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- (1) Simple, complete instructions for use of the system are posted on each ultrafiche viewer; and
- (2) Personnel in each selling establishment familiar with the operation of the system are available to assist consumers should the need arise; and
- (3) Ultrafiche cards used to display warranties contain only warranty information.

The Commission further concludes that the warranties relating to more than one product class may be stored on a single ultrafiche card provided the conditions listed below are met. Moreover, the Commission has reconsidered the requirement set forth in its opinion to the NRHA that the warranties for each product class be displayed on separate microfiche cards. Therefore, the Commission concludes that the warranties relating to more than one product class may be displayed on either a single ultrafiche or a single microfiche card if:

- (1) All warranties relating to a product class are grouped together on the same ultrafiche or microfiche card; and
- (2) All warranties relating to a particular product class appear on the same row or column of the ultrafiche or microfiche card; and
- (3) Each ultrafiche or microfiche card contains a clear product index.

These conditions are required to ensure that consumers have the "convenient access" to warranties required by the Rule.

By direction of the Commission.

*Letter Revising Conditions on Use of Microfiche System**

March 18, 1977

Dear Mr. London:

This is to advise you of a revision of the Commission's conditions on the use of microfiche viewing systems to satisfy the Commission Rule on the Pre-Sale Availability of Warranty Terms, 16 C.F.R. 702.

In its advisory opinion to the National Retail Hardware Association of November 10, 1976, the Commission required separate microfiche cards. Upon reconsideration, the Commission concludes that warranties from

* Opinion letter published in 88 F.T.C. 1027, and 41 F.R. 53472.

more than one product class may be displayed on the same microfiche card so long as the warranties relating to any particular product class all appear on the same row or column of the card and the card contains a clear index of the warranties it contains. A letter setting out the new conditions is enclosed.

By direction of the Commission.

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"Hiatus" requirement of the Trade Regulation Rule of Games of Chance in the Food Retailing and Gasoline Industries (16 C.F.R. 419.1(f)) (File No. 773 7010).

Letter of Response

March 25, 1977

Dear Mr. Rogal:

This is in response to your March 16, 1977, request for an advisory opinion respecting the so called "hiatus" requirement of the trade regulation rule for Games of Chance in the Food Retailing and Gasoline Industries (16 C.F.R. 419.1(f)).

The Commission has recently directed its staff to initiate a rulemaking proceeding for amendment of said rule, specifically to include consideration of repeal of Paragraph (f), the "hiatus" requirement. As your request seeks, in effect, individual exemptions from the "hiatus" requirement of the rule, it is not deemed appropriate for advisory opinion.

By direction of the Commission.

Letter of Request

March 16, 1977

Honorable Commissioners:

The undersigned was orally informed today by attorney Edwin F. Dosek of the Commission's Bureau of Consumer Protection that the Bureau's staff has determined to advise the undersigned that the proposed courses of action described in the two attached Requests for Staff Advisory Opinion would violate the Commission's trade regulation rule governing games of chance in the food and gasoline retailing industry. He stated that it was the staff's opinion that extensions of the games for additional thirteen week periods would violate section 419.1(f) of the rule which reads as follows:

Promote or use any new game without a break in time between the new game and any game previously employed in the same establishment equivalent to the duration of the game previously employed.

Mr. Dosek further advised me that it is the staff's view that under the circumstances presented, *i.e.*, when some of the independent stores which participated in the first run of the game do not wish to participate in the extension or when stores which did not participate in

the first run will participate in the second run, the second run constitutes a "new game" and falls within the quoted rule provision. According to Mr. Dosek the second run is a "new game" because the geographic area will change and the total number of prizes and game chances distributed will change. The staff was not persuaded by the fact that all other aspects of the game will remain exactly the same including the odds or chances of winning a prize in each separate prize category.

The undersigned is at a loss to understand the staff's negative views on these simple proposals. There is absolutely no chance of consumer confusion or deception. The independent stores are scattered widely over a three state area in one instance and an eleven state area in the other. Newspaper advertising is the only medium employed since the rule bans the use of radio or television advertising. The stores prepare and disseminate their own advertising on a town-by-town or area by area basis.

This request points up the anti-competitive nature of the rule provision quoted above. Here we have independent grocery stores blocked in a competitive fight with large retail food chains. I do not have any current information as to the competition which faces the Malone and Hyde Stores but as the attached Request on behalf of Associated Grocers of Colorado points out, that group is faced with competition from two large chains which together control in excess of 80 percent of the food retail market in that three state area. What possible public interest is served by denying to these independent grocers the right to employ this completely lawful method of competition?

In closing I wish to point out that this request differs from the request submitted by Fox Grocery Company in that we are not requesting the opportunity to engage in an entirely new and different game but merely requesting the opportunity to extend the same promotion with slightly different participants.

Finally, it is urgently requested that the Commission handle this request with all possible speed. A refusal to respond within the next ten days will, in effect, constitute a denial for orders for printing the game materials must be in the hands of the printer by March 25, 1977.

Respectfully submitted,

/s/ Willaim W. Rogal

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First Attachment

March 8, 1977

Dear Mr. Dosek:

This request for a staff advisory letter is submitted on behalf of Glendinning Companies, Inc. Glendinning is a marketer of game of chance promotions utilized by food retailers and others in connection with advertising their goods and services.

On January 12, 1977, approximately 293 retail stores affiliated with Malone and Hyde commenced a thirteen weeks game promotion marketed by Glendinning. The 293 stores are located in the states of Alabama, Arkansas, Indiana, Illinois, Kentucky, Louisiana, Mississippi, Tennessee, Texas, Virginia and West Virginia. The Malone and Hyde stores are grouped into divisions for purposes of organization. The 293 stores now engaged in the game promotions comprise five distinct Malone and Hyde divisions.

Glendinning has recently been notified that some, but not all, of the five divisions wish to renew the game promotion for an additional thirteen weeks when the original promotion terminates in April. Of course, this means that the promotion will be somewhat smaller during the contemplated second run. The odds of winning each separate prize will remain exactly the same but the total number of tickets and the total number of prizes will diminish in proportion to the diminished retail store participants.

It is important to realize that each of the divisions of Malone and Hyde are geographically distinct and separate. The stores in each division prepare and disseminate their own advertising, thus consumers in one division do not see advertising disseminated in another division or divisions. Thus, there is absolutely no chance of consumer confusion by reason of the fact that one or more of the five divisions may decide not to renew the game for an additional thirteen weeks.

In compliance with the Trade Regulation rule, Glendinning and Malone and Hyde have been mixing game chances and making the requisite disclosures over the entire eleven state area encompassed by the Malone and Hyde divisions. They will follow the same procedure during the second run. The new advertising will properly disclose the new diminished area in which the game will be played.

Glendinning requests advice as to whether the procedure outlined above is acceptable. Of course all provisions of the Trade Regulation

rule will be scrupulously followed. Time is of the essence in this request, since advance orders and commitments for the new tickets and game material must be placed within the next few weeks.

Sincerely,

/s/ William W. Rogal

Second Attachment

March 3, 1977

Gentlemen:

This request for a staff advisory letter is submitted on behalf of Glendinning Companies, Inc. and Associated Grocers of Colorado. Glendinning is a marketer of game of chance promotions utilized by food retailers and others in connection with advertising their goods and services. Associated Grocers of Colorado is a cooperative group of independent food retailers operating in Colorado, part of Wyoming and part of New Mexico.

The market area in which Associated Grocers operates is dominated by two large chain retailers, Safeway Stores and King Soopers. Together these two large retailers account for in excess of 80 percent of the food retail market in the relevant area. The combined market shares enjoyed by these two large chains has steadily increased in recent years at the expense of independent grocers such as Associated Grocers of Colorado.

For approximately the last seven weeks 28 Associated stores have employed a Glendinning game of chance promotion known as "Shoppers Sprée Bingo". The game has been successful in the sense that the participating stores have enjoyed increased sales and have regained a small part of the business lost to the larger competitors. Because of this favorable experience most of 28 stores wish to extend or renew the game for an additional 13 weeks. In addition, a substantial number of Associated stores which elected not to participate during the initial run of the game now wish to participate during the 13 week extension. Thus the mix of stores would change during the second run with a few of the original stores dropping out and an undetermined number of new stores entering.

During the extension period the prize structure will remain the same, i.e., the odds or chances of winning in each separate prize category will remain the same. Only the market area, the number of participating

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stores and the number of prizes in each category will increase depending upon the number of stores which elect to participate.

It is important to realize that this is a scattered market area and not a homogeneous, easily defined metropolitan market. The stores are scattered in various small towns and cities. Apparently each separate area or store places its own advertising but the consuming public is free to play the game at any outlet. Glendinning provides all of the stores with assistance in preparing advertising to make certain that all disclosures mandated by the Commission's trade regulation rule are made.

It is not economically possible to provide a unique and separate game for individual stores. The game materials must be mass produced and mixing must be done on a market-wide basis. Moreover, separate games with different prizes and different termination dates would hopelessly confuse consumers.

It seems apparent that an extension of this game in the manner outlined above would not deceive or confuse consumers. It is also apparent that the extension would be in the public interest in that it would enable this group of relatively small food retailers to better compete with their large, chain competitors. And, conversely, a refusal to permit the Associated stores to engage in this method of competition would adversely affect competition in this market area.

Thus, Glendinning and Associated request a staff opinion advising them that an extension of the game in the manner outlined in this letter would not be considered by the Commission as a violation of its trade regulation rule. Unfortunately, time is of the essence in this matter. Plans must be made immediately for the printing and distribution of game materials. Commitments and orders for materials must be placed within two weeks from today in order to permit the extension to commence when the original game terminates.

Sincerely,

/s/ William W. Rogal

89 F.T.C.

Proposed plan to establish a training and certification program for "moving consultants" and a "code of ethics" for certified "moving consultants" and moving company members of an Institute (File No. 773 7001).

Opinion Letter

April 5, 1977

Dear Mr. Brodsky:

This is in response to your request for advice concerning whether the "organization and activities" of the National Institute of Certified Moving Consultants ("Institute") would be lawful under the statutes administered by this Commission.

The Commission has carefully reviewed the Institute's certificate and articles of incorporation, by-laws, and rules of practice, together with the supporting memorandum and supplementary letters. The proposal about which you seek advice is understood to entail (1) establishment of a training and certification system for "moving consultants" employed by household goods moving companies and (2) administration of a code of ethics for certified consultants and moving company members of the Institute. The program covers "moving consultants" and moving companies engaged in both local and interstate moves. The term "moving consultants" is used by the Institute to refer to the estimator-salesmen employed by moving companies to deal with, and provide price estimates to, prospective customers. *See By-Laws*, Art. II, § 3(A), *as amended*. The Institute asserts that the purpose of the program is to "upgrade and professionalize the competency and integrity of estimators and salesmen employed in the household goods moving and storage industry." *Application* at 14.

The Commission has concluded that it cannot approve the Institute's plan. Your application indicates that, in interstate moves, consumer deception could occur when a moving consultant underestimates the price that will in fact be charged under the carrier's tariff. While sympathetic to this problem, the Commission is nevertheless of the opinion that the proposed estimator training and certification procedures necessarily entail a severe risk that unlawful restraints on price competition will be introduced into areas of commerce not subject to the regulatory jurisdiction of the Interstate Commerce Commission.

Article II, Section 4 of the *By-Laws* states that the Institute will develop and administer programs to train moving estimators with

respect to “moving costs,” “industry services at origin and destination,” and “best methods of moving and storage.” See also *Rules of Procedure*, § 9 and *Application* at 1-3. The emphasis on moving costs is heavy in both the *By-Laws* and the *Application*, and, in context, it is plain that the repeated references to “costs” mean costs to customers (*i.e.*, price), rather than costs to carriers.

Section 3 of the Code of Ethics, as amended, prohibits any Institute member from granting “any rebate either directly, indirectly, or in any form whatsoever, to customers or shippers for services rendered.” This section would operate to prohibit the use of rebates in any form to grant price reductions to customers.

The proposal contemplates that failure to comply with the Institute’s regulatory requirements could result in the denial of initial certification to estimators, and in the revocation of certification and Institute membership from estimators already certified. Membership could also be stripped from moving companies found to be participating in disfavored conduct.

In light of these elements, the Commission has concluded that approval of the Institute’s program is foreclosed because of manifest conflicts with the antitrust laws. The plan will operate, in part, to establish and enforce a common method for calculating price estimates. This can only result in narrowing of the range over which prices for any given job will be quoted. Joint activity among competitors to implement a uniform system for determining price estimates approaches price fixing far too closely to sanction. Further, it is difficult to imagine a more fertile field for outright price collusion than a training program for price estimators run jointly by competing companies. A concerted elimination of price rebates would, of course, also violate the antitrust laws.

The Commission is aware that the Motor Carrier Act of 1935 prohibits household goods movers both from allowing rebates and from deliberately underestimating moving charges. 49 U.S.C. 317(b). The Commission is also aware that, under the Reed-Bullwinkle Act, competing motor carriers may establish uniform rates and obtain ICC approval immunizing those rates from the operation of the antitrust laws. 49 U.S.C. 5b(9). However, both the statutory injunction in Section 317(b) and the statutory exemption in Section 5b(9) apply only to the extent that the Interstate Commerce Commission has jurisdiction over the commerce involved. 49 U.S.C. 302(a), 303(a)(10), 5b(1)(A). In addition, the Institute’s program will plainly affect commerce *not* within the

ICC's regulatory ambit as well as commerce within the ICC's jurisdiction. The commerce subject to ICC regulation is not as broad as that susceptible to Federal Trade Commission jurisdiction. *Compare* 15 U.S.C. 45(a)(1), *as amended, with* 49 U.S.C. 302(b)(1), 303(b)(8).

Moreover, with respect to the Reed-Bullwinkle Act, Section 5b(6) of that statute limits immunity to *voluntary* price-fixing agreements. In the Commission's view, the Institute's proposal presents ample opportunity for coercive activity designed to force uncooperative competitors into compliance with a uniform rate schedule.

The Commission also notes in passing that the proposal appears to involve other potentially anticompetitive elements undesirable in industry codes of ethics, such as vague standards for refusing and revoking certification, failure to adopt less restrictive alternative methods, and inadequate attempts to minimize opportunities for abuse of the disciplinary processes.

Finally, Section 10 of the Code of Ethics requires that participating estimators hold themselves out to the public as "certified moving consultants." When employees who essentially operate as salesmen (such as do moving estimators) are designated as "consultants," deception may result. Cf. Guide 7(b) for *Private Vocational and Home Study Schools*, 16 C.F.R. 254.7(b).

With respect to the problem of consumer deception caused by underestimation of moving charges, the Commission notes that on August 6, 1976, the Interstate Commerce Commission directed the opening of a proceeding to consider problems associated with moving cost estimation. The ICC's report states that, in light of extreme consumer dissatisfaction with the present cost estimating system, "an exhaustive analysis of existing practice coupled with an intensive review of existing Commission regulations should now be undertaken." Ex Parte No. MC-19 (Sub-No. 23): *Practices of Motor Common Carriers of Household Goods* (Experiment for Improving Accuracy of Estimates—Reentitled—Investigation of Estimating Practices), 125 M.C.C. 307, 316 (1976). Among the question specifically proposed for resolution are the following:

- (e) Should estimators be required to register with this Commission and/or be certified? Should standards be developed to which estimators would be required to conform? Should the methods of training and compensation for estimators be regulated? If so, what methods should be prescribed? What would be the pitfalls of such requirements? *Id.* at 317.

Accordingly, it appears that the ICC will have before it for considera-

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tion, *inter alia*, issues respecting consumer deception and possible solutions in the form of certification, performance standards, and training programs for moving estimators.

The Federal Trade Commission, of course, considers in this opinion only so much of your request as may fall within its own jurisdiction.

By direction of the Commission.

Letter of Request

June 17, 1975

Gentlemen:

Enclosed please find original application and five copies for informal advisory opinion upon the validity, under the Federal Trade Commission Act, 15 U.S.C., Sec. 1 *et seq.*, of the organization and activities of the National Institute of Certified Moving Consultants, organized under the General Not for Profit Corporation Act of the State of Illinois.* This application is submitted in accordance with FTC, Procedures and Rules of Practice, Section 1.1.

I would appreciate acknowledgment of the receipt of said application.

Very truly yours,
BRODSKY, LINETT and ALT-
MAN
/s/ David Brodsky

* The material submitted is not reproduced herein but is available for inspection at Public Reference Branch, Room 130, Federal Trade Commission, Washington, D.C.

89 F.T.C.

Compliance advisory opinions as to whether truck driver training schools have properly determined which of their former students are eligible for partial tuition refunds under a consent order (88 F.T.C. 55, Dkt. 9026).

Opinion Letter

April 8, 1977

Gentlemen:

This is to advise you that the Commission has given consideration to your submission, under cover of your letter of January 26, 1977, of questionnaires which you have sent out pursuant to the order in the above-referenced matter and the determinations you have made with respect thereto regarding eligibility for tuition refund as prescribed by said order. In accordance with said order, you have submitted said questionnaires for review by the Commission and an advisory opinion as prescribed in Section 3.61(d) of the Commission's Rules of Practice.

Except as noted below, the Commission has determined that your submission represents compliance with the applicable order provisions regarding eligibility of former New England Tractor Trailer students for partial tuition refunds.

As a preliminary observation, the Commission has noted that a number of the questionnaires are payable because, under item 6, the former students did not attain employment as tractor trailer drivers after leaving your school, and such students met the other criteria for eligibility contained in the Commission's order.

Several questionnaires, however, were determined by you to be payable even though item 6 was answered in the affirmative, indicating that the former student successfully attained a job as a tractor trailer driver after leaving your school. The Commission's order defines "eligible class member" to comprise those students who *did not* attain the stated employment. Accordingly, the Commission is of the opinion that those questionnaires which contain an affirmative answer to the question in item 6 — Have you ever attained a job as a tractor trailer driver after you left the school? — are not payable.

The Commission has also noted that a second category of questionnaires were determined by you to be payable even though the former students provided information under item 2 showing that they enrolled in your courses either before January 1, 1973 or subsequent to December 31, 1973. The Commission's order defines "eligible class member" as those

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students who enrolled during the period of time from January 1 to December 31, 1973 in your tractor trailer courses. Accordingly, the Commission is of the opinion that under the terms of its order, students who do not meet this requirement are not eligible for partial refunds of tuition. Also, the Commission is of the opinion that your determination of date of enrollment should not be based exclusively on a student's response to item 2 of the questionnaire but should take into account documentation submitted with the questionnaire, or otherwise in your possession, reflecting the actual date of enrollment.

It is the opinion of the Commission, based upon the information furnished that with the two exceptions noted hereinabove, your eligibility determinations under Part III, paragraph 5 of the Commission's order represent compliance with that provision to the extent that your obligations under other order provisions have been fulfilled. This opinion is not intended to apply to any other duties or obligations imposed upon you by the order other than your responsibility under Part III to make initial determinations as to who constitutes eligible class members for purposes of the required tuition refunds.

Chairman Collier continues to object to the rules which govern eligibility for refunds in this case and which are the subject of this request for advice.

The student questionnaires are being returned to you under separate cover.

By direction of the Commission.

Letter of Request

January 26, 1977

Dear Mr. LaDue:

We are submitting the enclosed questionnaires* in accordance with docket #9026. These questionnaires are separated as to the Corporations and are also in alphabetical order.

After careful review of the 567 questionnaires, 1 of which is a duplication, it is our opinion that every 1973 enrollee who answered the questionnaire is eligible for refund.

Please return the questionnaires, along with your comments, timely, so

* Not reproduced herein.

that we may issue checks in accordance with rules and regulations of docket #9026.

Sincerely,

New England Tractor Trailer
Training of Connecticut, Inc.

/s/

Arlan Greenberg
President

P.S.

Please note that any address changes were recorded on the bottom of the questionnaire, therefore the questionnaires are needed for mailing out refunds.

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Trade Regulation Rule on Preservation of Consumers' Claims and Defenses, 16 C.F.R. 433, does not create new rights for the consumer against the seller but merely preserves claims and defenses a consumer may assert against a seller so that he may raise them against the holder of the contract when the contract is negotiated or transferred (File No. 773 7007).

Opinion Letter

April 6, 1977

Dear Mr. Ambrose:

This is in response to your letters of January 28, March 17 and May 12, 1976, concerning the Trade Regulation Rule on Preservation of Consumers' Claims and Defenses, 16 C.F.R. 433. Specifically, you request: (1) that the rule be repealed or amended to conform to the Commission's authority; and (2) an advisory opinion as to whether the rule confers any rights on consumers to withhold payment either from the original holder of a consumer credit contract or from a subsequent holder of the contract.

In considering the rule the Commission provided a substantial opportunity for interested parties to file written data, views and arguments. In addition ample opportunity was provided for interested parties to testify at public hearings. A history of the rulemaking proceeding appears at 40 F.R. 53506 (1975). The rule was promulgated pursuant to and in accordance with Section 6(g) of the Federal Trade Commission Act, Sec. 202(c) of the Federal Trade Commission Improvement Act (Pub. Law 93-637) and all other applicable law. A legally sufficient Statement of Basis and Purpose for the rule was published with the rule. *See* 40 F.R. 53506 - 53529 (1975). Your requests for repeal or amendment of the rule are accordingly denied.

The Trade Regulation Rule, in pertinent part, provides that it is an unfair or deceptive practice for a seller, directly or indirectly, to take or receive a consumer credit contract which fails to provide a notice, as specified, that holders of the contract are subject to all claims and defenses which the debtor (consumer) could assert against the seller.

The rule does not create new rights for the consumer against the seller. Claims and defenses of a consumer, assertable against a seller under state law, remain unchanged under the rule. When a consumer contract is negotiated or transferred, the rule, through the required contract notice, merely preserves the claims and defenses a consumer may assert

against a seller so that he may raise them against the holder of the contract. Accordingly, if the consumer, under applicable law, is entitled to withhold payment from the seller, he may, pursuant to the notice, withhold payment from the holder.

By direction of the Commission.

Third Letter of Request

May 12, 1976

Dear Mr. Tobin:

Thank you for your telephone call on May 10, 1976 to notify me of the decision to deny the ICCA's petition for repeal of its trade regulation rule on preservation of consumers' claims and defenses. We appreciate that thoughtful effort.

Today I received your lengthy letter of the same date, which misidentified the International Consumer Credit Association as the International Consumer Finance Association. Presuming that this error arose from pressure of time in preparation of the letter rather than actual confusion between our organization and the National Consumer Finance Association, I and the ICCA's legal counsel are concerned because your letter states that the Commission considered only one letter from the ICCA and only one petition among several under Section 553(e) of the Administrative Procedure Act.

Although your letter of May 10 explains reasons for denial of those petitions filed by other associations it names, it does not seem to address itself to any of our petitions. Since we do not regard it as complying with the requirements of Section 555(e) of the Administrative Procedure Act, we hope that you will agree that we have a legitimate concern regarding whether our petitions have received due process of law and that you will therefore act promptly to relieve that concern.

My letter of January 28, 1976 to Acting Chairman Dixon requested a Commission interpretation of its trade regulation rule on preservation of consumers' claims and defenses. Failure of the Commission to respond to that petition led to a second petition on March 3, 1974, addressed to Mr. Christofer W. Keller, urging repeal of or amendment of the trade regulation rule on grounds of denial of due process of law for this and other stated reasons.

As a result of receipt of Ms. Dewey's letter of March 3, 1976, I wrote

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again to Acting Chairman Dixon on March 17, 1976. That letter again protested denial of due process of law, and it certainly should have been considered by the Commission in connection with both of the earlier petitions, not only because of bearing on the earlier petitions, but because that letter closed with a request for postponement of the effective date by the Commission until it had acted on our other petitions, which we regarded at that time and now as essential in affording us due process of law. Consequently, our request for postponement is quite different from those petitions for postponement filed by other trade associations.

We believe that your letter of May 10, 1976 did not provide reasons for denial of our petition for repeal or postponement and did not address itself at all to our petitions for interpretation and amendment of the rule.

Section 555(e) of the Administrative Procedure Act states: "prompt notice shall be given of the denial in whole or in part of a written application, petition, or other request of an interested person made in connection with any agency proceeding. Except in affirming a prior denial or when the denial is self-explanatory, the notice shall be accompanied by a brief statement of the grounds for denial.

This letter is not intended as an appeal with regard to any denial of our petitions, but rather to seek clarification of the status of the following petitions and a brief statement of the grounds for denial of any that have been denied by the Commission with identification of the date of Commission action:

- 1) Our petition for interpretation by the Commission of whether this trade regulation rule is intended to confer any right on the consumer to withhold payment either from an original creditor or any subsequent holder in due course. We have been informed that the Commission's general counsel is preparing an advisory opinion in response to this petition. We are compelled to comment that delay in the issuance of an interpretation of a rule promulgated so many months ago should not be occurring if the Commission and its staff understand their own rule, the purposes for which it was issued, and its probable legal effects.
- 2) Our petition for repeal of the trade regulation rule on grounds of lack of statutory authority to issue it, especially since it is intended to abrogate and/or pre-empt the laws of most if not all states.
- 3) Our petition for amendment of the rule to conform to the Commission's authority to prevent unfair and deceptive acts or

practices, to conform to the requirement of the Magnuson/Moss Act relating to specificity of prohibited acts or practices and to conform to a requirement that the rule include a statement of findings and purpose as required by law. This petition alleged that the Commission has no authority to preserve consumer claims and defenses, per se, nor to issue a trade regulation rule for such a purpose.

4) Our petition for postponement of the effective date of the trade regulation rule was conditioned only on the need of the Commission itself for time to adequately consider and respond to the above three petitions.

This and other correspondence which I have transmitted to the Commission and its staff was written to meet the responsibilities of the Board of Directors of the International Consumer Credit Association to nearly 45,000 American members. May I have an early reply so that I can provide an accurate report of the Commission's actions on our petitions as soon as possible. Thanks for your cooperation.

Sincerely yours,

/s/ JAMES A. AMBROSE
Secretary-Treasurer

Second Letter of Request

March 17, 1976

Dear Mr. Dixon:

On January 28, 1976, I wrote to you on behalf of the International Consumer Credit Association to formally request interpretation by the Commission of its trade regulation rule on preservation of consumers' claims and defenses. The purpose of that letter was to raise and hopefully settle at least one question of constitutionality as part of the official record of the proceedings.

Failing to receive anything but a form letter acknowledgment of this request by March 3, 1976 from Mr. Christofer W. Keller, presiding officer for the proceedings on this rule, I wrote on that date to Mr. Keller to petition the Commission under Section 553(e) of the Administrative Procedure Act, a part of the Commission's statutory authority for promulgation of its rule on consumers' claims and defenses. In response, as of this date, we have received another fill-in form letter from Mr. Keller identical to the acknowledgment of my letter of January 28.

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Attached is a copy of a letter dated March 3, 1976, which I received on March 8, 1976 from Anne E. Dewey, Division of Special Projects, apparently as a result of improper referral to her for a reply.* We asked for an interpretation from the Commission itself, which would be binding thereafter not only on the Commission but on the federal courts as well. We did not ask for an informal staff opinion, which has no legal standing of any kind.

Under due process of law, our request required either its denial by the Commission itself or issuance of an interpretation by the Commission itself. We recognize that the Commission had an option, but also a duty either to deny our request or to respond to it affirmatively through issuance of an interpretation. Unless the referral of my letter to Ms. Dewey was inadvertent, that referral was denial of due process of law, because the Commission did not have the option of a staff opinion letter.

Despite that fact, I am compelled to comment in respect to several statements in Ms. Dewey's letter. A copy of that letter is attached for your convenience.*

Any present or even past authority which the Commission has in promulgating trade regulation rules is limited to prevention or prohibition of specific unfair and deceptive acts or practices in or affecting commerce. Any act or practice covered by a trade regulation rule must in fact be unfair and deceptive in all instances. Rules promulgated under P.L. 93-637 may include requirements, but only as corollaries to stated provisions of such rules which prohibit specific acts or practices. The Commission has no authority to legislate generally, nor to pre-empt or repeal or annul either statutory or common (decisional) laws of the states. If the Commission does not agree with that view of its authority, I will appreciate information on its interpretation of P.L. 93-637 and/or the Federal Trade Commission Act.

The second paragraph of Ms. Dewey's letter specifically states that it is the intention of the trade regulation rule on consumers' claims and defenses to repeal the holder-in-due-course doctrine. She specifically used the legal term "abrogate," which means to annul by an authoritative act, to abolish or to repeal, revoke or cancel. The Commission has no such authority.

Ms. Dewey states that it is the intention of this rule to abrogate the

* Not reproduced herein.

doctrine which permits the separation of the duty to pay from the duty to perform in the context of consumer credit transactions. Neither this rule nor any other promulgated by the Commission has declared that failure in performance by a seller is an unfair or deceptive act or practice. Further, the promulgated rule would make a holder in due course liable for any claim or defense which a consumer could assert against a seller, even when the seller has not been involved in any unfair or deceptive act or practice, fraud or any other form of misconduct. Consequently, the rule sets a requirement which is not a corollary of any prohibition, other than the taking or receiving of a contract which does not meet that requirement.

Ms. Dewey's letter, in its third paragraph states, quite incorrectly, that the rule permits a consumer to withhold payment from a subsequent holder of his contract if state law grants him the right to withhold payment in that situation from his immediate seller. It is clearly the intention of the Commission through promulgation of this rule to abrogate, as Ms. Dewey stated, the holder-in-due-course doctrine, which gives a third party holder immunity from all claims and defenses which a consumer may have against a seller. The rule even abrogates or pre-empts the laws of those states which have either abridged or outlawed the holder-in-due-course doctrine as codified in the Uniform Commercial Code.

If it is the intention of the Commission to merely preserve consumers' claims and defenses, then it can do so by amending its rule to prohibit the inclusion in credit contracts or agreements of any provisions which would grant immunity to any holder in due course from any claim or defense which the buyer may assert, either affirmatively or defensively, against a seller under state laws. But even if the Commission would amend its rule in this fashion, it would still lack statutory authority of any kind to promulgate the rule because it would not serve to prohibit any specific unfair or deceptive act or practice. The consumer problems which the Commission intends to resolve or alleviate through this rule are problems which cannot be properly handled through rulemaking, but which the Commission can appropriately handle on a case by case basis where its acts against a seller for unfair or deceptive acts or practices, such as in the case of Main Street Furniture, Inc., FTC Docket No. 2772, announced on January 28, 1976.

Ms. Dewey's letter asserts that the Commission has both a duty and authority to enforce state statutes and decisional law through promulgation of a rule which is intended to preserve consumer rights and remedies established under such laws. We disagree, and our position is

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supported by that of the National Association of Attorneys General, as expressed in two resolutions it adopted at its recent Mid-Term Meeting in Scottsdale, Arizona, and transmitted to Congress.

However, the Federal Trade Commission does have a duty to taxpayers to use the funds appropriated by Congress in proper exercise of its duties and responsibilities under federal laws, one of which is to uphold and defend the Constitution of the United States as the supreme law of the land and therefore involves supreme duties and responsibilities. It was in recognition of this that the International Consumer Credit Association has asked the Commission for a formal interpretation of its trade regulation rule, and why the Association has subsequently petitioned the Commission for amendment or repeal of its rule.

Consequently, we will appreciate early formal action by the Commission on both our request for an interpretation and our petition for amendment or repeal. If the Commission cannot take quick action in either instance, then we also request a postponement in the effective date of its trade regulation rule beyond May 14, 1976, until such time as the Commission will have acted.

Sincerely yours,

/s/ JAMES A. AMBROSE
Secretary-Treasurer

First Letter of Request

January 28, 1976

Dear Mr. Dixon:

On January 26, 1971, the Federal Trade Commission proposed a trade regulation rule on preservation of consumers' claims and defenses, which it promulgated on November 14, 1975 to become effective on May 14, 1976. Because of a recent press release sent out by Rep. Frank Annunzio (D-Ill.), chairman of the House Subcommittee on Consumer Affairs, the International Consumer Credit Association requests interpretation of this trade regulation rule before its effective date to clarify whether or not it confers any right on consumers to withhold payment from either any original creditor or subsequent holder in due course.

When the Commission announced this proposed trade regulation rule, the ICCA filed a strong protest with both the Commission and Congress on grounds that such a trade regulation rule would be unlawful and

unconstitutional exercise of legislative powers, particularly because it would pre-empt both the Uniform Commercial Code and other statutes carefully considered by the legislatures of the various states. It was and continues to be our view that, if federal intervention is necessary in the law of contracts, only Congress (and not the FTC) has authority to legislate. It is our view that promulgation of this trade regulation rule by the Commission is a violation of the Civil Rights Act of 1964 *per se*.

Our Association has not taken a position with regard to any proposal at the state level of government to either outlaw or abridge the so-called holder-in-due-course doctrine. These proposals have been constitutional exercise of the police powers and duties of the states, and not efforts to reallocate losses arising from misconduct by sellers to ultimate creditors and thus to consumers in general. If any such laws confer on a consumer the legal right to withhold payment either to the original holder of a credit contract, agreement or note or to a holder in due course, we do not interpret them in such a manner.

However, in his press release on January 8, Congressman Annunzio indicated that the Commission's trade regulation rule will confer such a right. If that is a correct interpretation of the rule, a new question of constitutionality with regard to this rule emerges—one where there are related court decisions.

In recent years, many courts and the U.S. Supreme Court have given a great deal of cognizance to the need for hearings and due process of law in connection with replevins, garnishments and other activities of creditors conducted "under color of law." Replevins and garnishments have been declared unconstitutional for lack of hearings and due process of law. The Commission should be aware of such decisions and the basis for them. But it should be also aware that, unless the Supreme Court ultimately decides otherwise, so-called "self-help" repossession has been regarded by a number of state and federal courts as constitutional because the property was not taken by the creditor under color of law. We do not believe that the courts will deny creditors the same rights as consumers.

When a consumer buys goods or service from a retailer who remains the creditor, he does not exercise any right under color of law if he refuses to pay this creditor in the event of dissatisfaction arising from the purchase. Consumers frequently do this in disputes with retailer creditors where there is no element of deceit, dishonesty, fraud or misconduct on the part of the retailer. They do it in connection with simple disputes. But when they do it, they do so at their own risk. It

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gives them an unfair leverage in having a dispute resolved in their favor. The retailer will often give them their way even when his cause is just, because the cost will be less than the nuisance and cost of resolving the dispute in court.

We disagree with the Commission's view that the common law holder-in-due-course doctrine arose solely in commercial credit and has no application in consumer credit transactions. To have immunity from buyers' claims and defenses, a holder in due course under the doctrine had to be dealing "at arm's length." It did not include the commercial situations leading to the abuses which the Commission is attempting to correct until the doctrine was codified and corrupted through the Uniform Commercial Code, which grants immunity if the third party financing source is merely "dealing in good faith." We made that point unsuccessfully with the National Conference of Commissioners on Uniform State Laws through correspondence before the Commission proposed its rule.

Section 5 of the FTC Act authorizes the Commission to prevent unfair and deceptive acts and practices in commerce. The Commission proposed its trade regulation rule on preservation of consumers' claims and defenses under that authority. If the Commission's proposal or even the much simpler and briefer one it finally adopted were limited to situations involving fraud, deceit, deception or any other clear form of misconduct by sellers, its authority and the constitutionality of the rule would hardly be in question. But the final rule more frequently will apply to simple, uncomplicated disputes between buyers and sellers involving a third party financing source, who sometimes will be as powerless as either of the other two parties to equitably resolve the dispute. Further, the rule will apply to many situations in which the seller is a totally innocent party and there is misconduct on the part of the buyer.

The brief rule published on page 53506 of the issue of the *Federal Register* for November 18, 1975 places a clear duty on sellers. It is limited to giving a prescribed notice. But the rule is totally moot on the rights of buyers arising "under color" of this law. And the effect of the rule on creditors, as that term is defined in the rule, is indefinite. The term "creditor" includes both retailer creditors and third party financing sources, such as banks and time sales finance companies. The required notice states "any holder," so it would seem to apply to any retail credit contract, not just those that will be sold to third parties. So the question of how "creditors" may violate this rule and thus become

subject to FTC action is open to a great deal of both uncertainty and speculation.

In his press release, Congressman Annunzio said that this rule will hurt only disreputable businesses. That does not appear to be the case.

When a consumer buys goods or services from a retailer on credit and the retailer remains the creditor, the consumer may withhold payment to exercise his rights and remedies. His situation is analogous to that of a creditor who engages in self-help repossession, except for one factor. The consumer exercises his rights and remedies at his own risk, and he may not be aware of the extent of that risk.

The Commission's rule will apply to retail sellers who remain as creditors and to those who transfer their contracts to third parties. It will also apply to those third parties and to consumers. The required notice states: "Any holder of this consumer credit contract is subject to all claims and defenses which the debtor could assert against the seller of goods or services obtained pursuant hereto or with the proceeds hereof. Recovery hereunder shall not exceed amounts paid by the debtor hereunder."

Any holder, including a retailer seller, is prohibited under the rule from taking or receiving, etc., any contract which does not bear this notice. The exception is retail sellers who remain creditors as credit card issuers.

The rule purports to preserve consumers' claims and defenses, but whether or not the seller continues to be a holder, the rule appears to cut off or limit claims of any type, such as damages, because the notice also says: "Recovery hereunder by the debtor shall not exceed amounts paid by the debtor hereunder." Thus, the rule could result in graver injury to consumers than the abuses it seeks to correct.

If the rule confers a right on the consumer to withhold payment to a creditor and that right is exercised, the exercise is "under color of law." The creditor is deprived of money or other property without a hearing and due process of law. The creditor would be denied constitutional rights in a situation which is analogous to *Fuentes v. Shevin*, in which the U.S. Supreme Court outlawed replevin statutes of many states. This denial would result solely from the Commission's rule, in conflict with the Civil Rights Act of 1964.

Consequently, we urge the Commission to interpret its own trade regulation rule before it becomes effective to determine whether or not

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it is intended to confer a right to withhold payment and, if so, under what circumstances.

Through the Fair Credit Billing Act, Congress has exerted its authority to regulate holder in due course matters relating to credit cards. In this, it exercised authority to pre-empt state laws. That authority has not been challenged to date. Perhaps the Commission should reconsider its position regarding issuance of a trade regulation rule on preservation of consumers' claims and defenses by referring the matter to Congress for appropriate legislation. None of the Commission's efforts would be wasted if Congress would accept such a recommendation.

Sincerely yours,

/s/ JAMES A. AMBROSE
Secretary-Treasurer

Obtaining only the signature of the insured party on personal insurance form when personal insurance is selected or the signature of either co-maker if personal insurance is declined constitutes compliance with the requirements of the order to cease and desist (82 F.T.C. 1841, Dkt. C-2420).

Opinion Letter

May 6, 1977

Dear Sirs:

The Commission is in receipt of the communications from your counsel, James H. Rowe, Esquire, dated December 23, 1976, and January 21, 1977, with attached exhibits, which you have filed as a supplemental report showing the manner and form of your compliance with the order to cease and desist issued on June 26, 1973, in the above case.

The Commission has reviewed the supplemental report of compliance and has concluded, on the assumption that the information submitted is accurate and complete, that no compliance action by the Commission is indicated at this time. The Commission will not be precluded, however, from instituting appropriate action should it subsequently appear that such information is inaccurate or incomplete. In addition, the Commission may at any time reconsider, revoke, or rescind such determination should it subsequently appear that such information is inaccurate or incomplete, or if action had been taken in violation of the terms of the order.

In his letter of January 21, 1977, Mr. Rowe contends that the notification he made in that letter of Commercial Credit Company's acquisition of Great Western Loan & Trust Company and its subsidiary, Great Western Finance Company, does not appear to be required by the Commission's order since these companies require the purchase of credit insurance and, as required by law, therefore include the credit insurance premiums in the amount of the finance charge in consumer loans. The Commission wants to make it clear that the notification was required by the order. First, the provisions of the order are not limited to requirements concerning the inclusion or non-inclusion of credit insurance premiums in the amount of the finance charge. Paragraphs 3 through 6 of the order impose additional requirements in connection with the granting of consumer loans. Secondly, a policy of an acquired subsidiary to require credit insurance does not remove the acquisition from the notification requirement of the order since the acquisition of a corporation engaged in the making of consumer loans and the sale of

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credit insurance may affect compliance obligations under any provision of the order.

By direction of the Commission.

Supplemental Letter Relative to Request

January 21, 1977

Dear Mr. Howerton:

Please note the penultimate paragraph of the Consent Order in the above-entitled proceeding which reads in full:

IT IS FURTHER ORDERED that respondent notify the Commission within thirty (30) days of any change in the corporate respondent which may affect compliance obligations with regard to the extension of consumer loans arising out of this order, such as dissolution, assignment or sale resulting in the emergence of a successor corporation, the creation or dissolution of subsidiaries or any other change in the corporation with regard to the extension of consumer loans which may affect compliance obligations arising out of this order.

As of January 1, 1977, Commercial Credit Company acquired a new subsidiary, Great Western Loan & Trust Company, 1000 North Alamo, San Antonio, Texas. The new subsidiary, and one of its subsidiaries, Great Western Finance Company, at the same address, engage in the making of consumer loans and the sale of credit insurance.

However, as permitted by Texas law, credit insurance is *compulsory* for the consumer loans made, and all credit insurance charges *are included* in the finance charge. Hence, notification to the Commission of the foregoing acquisition does not appear to be required. Notification is required of only such corporate changes "which may affect compliance obligations with regard to the extension of consumer loans *arising out of this order.*" (Emphasis supplied). The Consent Order itself, and accompanying complaint are concerned with the *non-inclusion* in finance charges of credit insurance on consumer loans.

Nevertheless, the Commission is welcome to this advice of the new acquisition.

Sincerely,

/s/ James H. Rowe, Jr.

Counsel for Commercial Credit
Company

Letter of Request

December 23, 1976

Dear Sirs:

Enclosed, as requested, are two tables showing penetration rates on credit life and credit accident and health for October 1976, the latest month for which such rates are available.* In Arkansas which is listed on both tables as "0," the Company does no business. Eleven states are left blank on the table for credit accident and health because the Company does not offer credit accident and health in those states.

As I understand it from our conference, you will now submit to the Commission the question of whether, under the Consent Order, the Personal Insurance Authorization form must be presented for the signatures of both husband and wife where both are to be obligated for a consumer loan but only one of them is to be insured, and you will recommend that only presentation to, and the signature of the spouse to be insured is required.

Your courtesy and consideration are much appreciated.

Greetings of the Season to you.

Sincerely,

/s/ James H. Rowe, Jr.

* Not reproduced herein.

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When needed pharmaceuticals are unavailable or difficult to obtain, non-profit hospital may resell the needed pharmaceuticals to the general public as humanitarian gesture during emergency caused by medicaid strike (File No. 773 7009).

Opinion Letter

May 27, 1977

Dear Mr. Iseman:

This is in response to your letter of December 20, 1976, requesting advice concerning the exemption to the Robinson-Patman Act found in the Non-Profit Institutions Act, 52 Stat. 446, 15 U.S.C. 13c.

The Commission understands that your client, St. Peter's Hospital of the City of Albany, is a not-for-profit corporation currently receiving preferential price treatment in its purchases of pharmaceuticals as permitted by the above-cited exemption of the Robinson-Patman Act; that your client would like to resell pharmaceuticals, at cost, to a neighboring, not-for-profit nursing home which currently purchases its drug needs at retail from local druggists; and that your client would like to resell pharmaceuticals to the general public during the medicaid strike, should pharmaceuticals become otherwise difficult or impossible to obtain. You seek advice on whether such resales are permissible under the Robinson-Patman Act.

The Non-Profit Institutions Act exempts from the Robinson-Patman Act "purchases of their supplies for their own use by * * * hospitals, and charitable institutions not operated for profit." The Supreme Court in *Abbott Laboratories v. Portland Retail Druggists Ass'n. Inc.*, 426 U.S. 1 (1976), held that the phrase "for their own use" limited the classes of individuals to whom the supplies could be resold. However, the Commission does not believe these limitations were intended to apply to resales of supplies, at cost, by one charitable institution to another that are limited, in turn, to the latter charitable institution's own use. A resale of this nature would constitute a not-for-profit transfer of supplies from one institution, eligible under the exemption, to another such institution, also eligible under the exemption. In the Commission's view, the exemption was intended to insulate from Robinson-Patman application all purchases of supplies (for their own use) by the designated classes of institutions not operated for profit. The transactions, as above described, would not appear in conflict with such a purpose. The Commission, accordingly, would regard the resale, at cost, of pharmaceuticals by your client to the nursing home as not altering

its exempt status under the Non-Profit Institutions Act. Such pharmaceuticals must be acquired for the nursing home's "own use" as that language was interpreted in *Abbott Laboratories, supra*, for the exemption to apply.

The question of whether a non-profit hospital such as your client may open its pharmacy to the general public in an emergency situation was addressed specifically by the Supreme Court in the *Abbott Laboratories* case. We direct your attention to that portion of the decision which states that:

[W]hen the hospital pharmacy is the only one available in the community to meet a particular emergency situation [,] * * * [s]o long as the hospital pharmacy holds [that] situation within bounds, and entertains it only as a humanitarian gesture, we shall not condemn the hospital and its suppliers to a Robinson-Patman violation * * *. [*Id.* at 18.]

Accordingly, the Commission is of the opinion that if needed pharmaceuticals are not available or difficult to obtain, your client may resell the needed pharmaceuticals to the general public as a humanitarian gesture during the emergency caused by the medicaid strike.

By direction of the Commission.

Letter of Request

December 20, 1976

Dear Sir:

I represent St. Peter's Hospital of the City of Albany, (hereinafter the Hospital), a not-for-profit corporation organized and existing under the Not-for-Profit Corporation Law of the State of New York. Pursuant to 16 C.F.R. §1.1 *et seq.*, I am hereby requesting an advisory opinion from the Commissioner with regard to the following proposed sales of pharmaceuticals by the Hospital. I certify that the proposed courses of action herein described have not been and are not now being followed by the Hospital and upon information and belief, they are not the subject of a pending investigation or other proceeding by the Commission or any other governmental agency.

The Hospital operates its own pharmacy, and as a not-for-profit entity it enjoys the preferred price treatment permitted to such organizations by virtue of the non-profit institution exception to the Robinson-Patman Act. 15 USC §13c.

Geographically adjacent to the Hospital is the Villa Mary Immaculate

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Nursing Home (hereinafter the Nursing Home) which is also a not-for-profit corporation. The Hospital and the Nursing Home are completely separate corporate entities, but both are sponsored and controlled by different Orders of Religious Women under the canonical jurisdiction of the Bishop of the Roman Catholic Diocese of Albany. In this regard, the Hospital is sponsored by the Religious Sisters of Mercy, Albany, and the Nursing Home is sponsored by the Sisters of Allegheny.

The Hospital would like to sell its pharmaceuticals to the Nursing Home for the same reduced cost that the Hospital receives from its supplier. The Nursing Home does not have its own pharmacy and it is currently being supplied by local retail druggists. Is this a permissible sale under the not-for-profit exemption contained in the Robinson-Patman Act? If it is not a sale deemed to be for the Hospital's "own use," can it be justified on the grounds that the Nursing Home would itself be entitled to the preferential price treatment if it elected to operate its own pharmacy?

The second question concerning which I am seeking guidance relates to the impact of a medicaid strike being conducted by certain retail pharmacies in New York State. If needed pharmaceuticals are not available or difficult to obtain because of such a strike, is it permissible for the Hospital to sell these items to the general public?

Very truly yours,
DeGRAFF, FOY, CONWAY and
HOLT-HARRIS

/s/ Robert H. Iseman

89 F.T.C.

General audience film featuring, in the period-setting of contemporaneous news events, selections from the first 25 years of television commercials (File No. 773 7012).

Opinion Letter

May 27, 1977

Dear Mr. Sweda:

This is in response to your request for advice concerning production by your company of a general audience film to feature, in the period-setting of contemporaneous news events, selections from the first 25 years of television commercials.

The selections, as your request appears to presuppose, might include television ads involving advertising methods or representations against which, in the course of corrective enforcement actions, the Commission has issued inhibiting orders (*e.g.*, order proscriptions involving the use of deceptive mock-ups, misleading demonstrations, camera tricks that magnify, minimize or distort, cigarette advertising not appropriately disclosing the prescribed health warning, or the like).

Your request, in substance, seeks pre-clearance from the Commission for use of any such television commercials in the context of the proposed film. You have reported that no sponsoring relationship exists between the film and any product or service supplier whose past television commercials may be subject to selection for the film.

The Commission desires to assure you that, as to matters within its jurisdiction, it has no objection to the proposed feature film project. Please be advised, however, that this Commission assumes no position respecting possible applicability of any laws or regulations not within its enforcement authority.

Because the Commission may have taken enforcement action against and prohibited some of the advertisements which will be included in your feature film, the Commission hopes that you will consider including in the film a short, general disclosure to that effect.

By direction of the Commission.

Supplemental Letter Relative to Request

April 4, 1977

Dear Mr. Garvey:

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This letter is to confirm our telephone conversation of 31 March, 1977 regarding our request for the use of old television commercials in a feature film project.

1. The feature film project described in our request of 3 March, 1977 is for national and international distribution to movie theatres.
2. As producer of the film project, I alone am the final judge of what films and commercials will be used.
3. The investor, whether private or corporate, will have no creative control of the film, except to the extent of judging what film should *not* be used in the project on the basis of objectionability to the financial success of the film.
4. The primary and singular aim of the project is as a film of entertainment and documentation of the world of the T.V. commercial. In no way is the project to be used as an advertising vehicle for an investor.
5. There will be no intentional use of misleading ads in the film project. I am considering a section from the 90-minute length to show the glaring deception practiced by some unscrupulous advertisers.

May I again stress the urgency for an early ruling as I want to release the film sometime in December of this year. As we cannot begin to work even on the selection of 100-200 commercials from the more than 200,000 commercials in existence, I think you can understand my need for expediency.

Sincerely,

/s/ F. Wendell Sweda
President

Letter of Request

March 3, 1977

Dear Mr. Secretary;

Subject: Request for an advisory opinion ruling.

Petitioner: SSE Communications

89 F.T.C.

Re: Feature film project, tentatively titled, "And Now A Word From Our Sponsor* * *."

We at SSE Communications are working on a feature film project for national theatre distribution. We are putting together the best of the first 25 years of the American television commercial. Cooperating with us in this project are the Museum of Modern Art and the Screen Actors' Guild.

Television commercials represent a cross-section of the entire lifestyle of our generation. They epitomize the tastes, jobs, personal identities, conveniences, entertainment, leisure, desires and fantasies which reflect this television age.

The film is best described as a compilation of some of the best television commercials put together as an entertainment vehicle. It will be a General Audience feature production.

From nearly 200,000 commercials to choose, approximately 100 of the best will be included. Many are regarded as classics for their techniques, approach, interpretation, and reflection of our times. They are classics in entertaining the viewer.

We plan to use noteworthy filmed news events, i.e., the first space shot, Krushchev using his shoe at the U.N., etc., to re-orient the viewer to the various time periods within the 25-year history.

Because the Film Department of the Museum of Modern Art classifies the television commercial as an art form unto itself with genuine artistic and historic merit, we are donating a percentage of the gross to the Museum's Film Archives Department for the further preservation of films. We are also donating an equal percentage of the film's gross to the Screen Actors' Guild for a special fund for old actors' homes in New Jersey and California.

Therefore, SSE Communications respectfully requests an affirmative ruling to the use of old television commercials (including those, because of their age, that no longer conform to current F.T.C. regulations) for this specific project.

Sincerely,

/s/ F. Wendell Sweda
President

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**Proposed advertising and sale of information concerning the
Taxpayers' Service of the Internal Revenue Service (File No. 773
7011).**

Opinion Letter

June 9, 1977

Dear Mr. Chasnoff:

This letter is in response to your request for an advisory opinion on behalf of your client, Information Foundation, Inc., concerning the proposed use of submitted advertising copy. For a fee, your client anticipates sending to persons responding to the proposed advertisement information about the Internal Revenue's Taxpayers' Service, including services available under that governmental program, and advice about how to use that program effectively.

Because, in the Commission's view, the advertisement has the capacity to mislead the public into believing that your client itself is offering to provide, for the \$5 fee listed, both tax advice and tax preparation services, the Commission cannot approve the advertisement in its present form. With appropriate changes, however, the Commission believes your marketing proposal would comply with laws it administers. Please be advised that the Commission has not reviewed, and therefore does not endorse, the accuracy of any of the technical information and advice your client proposes to send to consumers.

By direction of the Commission.

Letter of Request

February 8, 1977

Gentlemen:

This office represents Information Foundation, Inc. which has requested that I obtain from you an advisory opinion respecting the advertisement they will be placing in various printed media, including newspapers, magazines, journals, and printed flyers. Also enclosed, in addition to the advertisement, is the printed material they will be forwarding to persons responding to the advertisements.*

It would be appreciated if you would submit an advisory opinion to me respecting the legality of the advertisement in accordance with Federal

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89 F.T.C.

Trade Commission rules and regulations. I shall be happy to be of any assistance to you should you desire additional information.

Sincerely,

/s/ Joel Chasnoff

PROPOSED ADVERTISEMENT

GET TAX ADVICE AND YOUR FEDERAL RETURN PREPARED FREE BY EXPERTS.
FOR DETAILS ABOUT THIS LITTLE-KNOWN U.S. GOVERNMENT PROGRAM, SEND
\$5.00 TO INFORMATION FOUNDATION, INC., P.O. BOX 246, BURTONSVILLE,
MARYLAND 20904.

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Compliance advisory opinion that proposed use of a "Confidential Dealer Cost List" would not violate Commission order (88 F.T.C. 24, Dkt. C-2828).

Opinion Letter

June 17, 1977

Dear Mr. Schwab:

The Commission has considered the request for advice as to whether United Audio Products, Inc. (United) may engage in a proposed course of action, whereby United would issue a "Confidential Dealer Cost List," without violating the order issued by the Commission on July 12, 1976, in the captioned matter.

The proposed "Confidential Dealer Cost List" would have a cover sheet notifying the retail dealer that United does not maintain any fair trade programs, prices are for informational purposes only, the approximate nationally advertised values are for informational purposes only, all retail dealers are free to set their own resale prices, no employee or representative has authority to advise or suggest to a retail dealer any resale price, no favorable or unfavorable treatment will be given to a dealer based on his selection of a resale price, and United does not intend to sanction any deceptive practices.

The proposed cost list is a multi-column list containing a column for item description, item cost to the retail dealer, gross margin price columns ranging from 15 percent to 45 percent which reflect the price a retail dealer would charge to obtain a specific gross margin on the sale of United's products, an "Approximate Nationally Advertised Value" column, and a blank "Your Price" column.

On the basis of the facts submitted, you are advised that the Commission is of the opinion that the proposed use of the "Confidential Dealer Cost List" would not violate Commission order No. C-2828.

By direction of the Commission.

Second Supplemental Letter Relative to Request

May 9, 1977

Gentlemen:

Responding to your letter of May 3, 1977, we would advise as follows:

United Audio Products, Inc. is about to introduce a completely new product line of record players which will be launched in June and will be nationally advertised in the manner as shown on the enclosed advertisement.*

It is therefore essential that we have prepared a dealer price list such as we submitted to you which is in every respect similar in form to dealer price lists used by competitors with your knowledge and approval.

The approximate nationally advertised value is predicated upon the comparative values of similar products in the market place consistent with the cost thereof to the dealer. The dealer has the unrestricted right to fix his own margin of profit and selling price.

We do trust to receive a response as soon as possible since we must have our dealer price list ready for distribution by June 1, 1977.

Very respectfully yours,
UNITED AUDIO PRODUCTS,
INC.

/s/ By

Rudolph Taplitz

First Supplemental Letter Relative to Request

April 25, 1977

Gentlemen:

United Audio Products, Inc., the marketer of Dual Audio Products, which is operating under the Federal Trade Commission Consent Order of July 12th, 1976, finds itself under a distinct competitive disadvantage in refraining from communicating to its dealers the nationally advertised values of its products, a practice indulged in by all its competitors, including those operating under an identical F.T.C. Order.

The practice is not intended to suggest or dictate to the dealer the resale prices of the products as is indicated in the cost sheet of the enclosed proposed notice to dealers, but is intended to show the comparative value of Dual products in the marketplace.

* Not reproduced herein.

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The enclosed form of cost list* is identical with that authorized by the F.T.C. in the case of competitive products operating under similar F.T.C. consent orders and it is submitted that we, in fairness, should have the same privilege.

Under the circumstances, pursuant to the provisions of Paragraph 3.61 D of the Rules of The Commission; we respectfully request advise from the Commission as to whether the proposed course of action as indicated in the form annexed hereto, will constitute compliance with the order of July 12th, 1976. We wish to add that:

1. The course of action indicated is not being followed by us and is proposed for the future.
2. The course of action indicated is not under investigation and is not nor has it been the subject of a current proceeding, order, or decree initiated or obtained by the Commission or any other government agency.

We trust to receive an early response.

Respectfully,
UNITED AUDIO PRODUCTS,
INC.
/s/ By

Rudolph Taplitz

Letter of Request

April 14, 1977

Dear Mr. Cohen:

United Audio Products, Inc., the marketer of Dual Audio Products, which is operating under the Federal Trade Commission Consent Order of July 12th, 1976, finds itself under a distinct competitive disadvantage in refraining from communicating to its dealers the nationally advertised prices of its products, a practice indulged in by all its competitors, including those operating under an identical F.T.C. Commission Order.

The practice is not intended to suggest or dictate to the dealer the

* Not reproduced herein.

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resale prices of the products as is indicated in the preamble to the enclosed proposed notice to dealers,* but is intended to show the comparative value of our products in the market place.

We enclose herewith a copy of a Pioneer Confidential Cost List,* which includes an approximate nationally advertised value. As we have indicated above, Pioneer and Dual are subject to identical F.T.C. orders.

We also enclose a Dual confidential cost list* containing a reference to the nationally advertised approximate values which is proposed to be used.

While we believe that such use is not in violation of the F.T.C. Order, we would like to discuss the matter with you at your office, at your earliest convenience.

We would appreciate your advice as to when we may have an appointment.

Very truly yours,
TAPLITZ & TAPLITZ
/s/ Rudolph Taplitz

* Not reproduced herein.

FEDERAL TRADE COMMISSION DECISIONS

Idea promotions	31
Insecticides	536
Insurance, property-liability	557
Jewelry	415
Land sales	255
Leases, shopping centers	240
Loans	345, 531
Margarine	46
Men's and boys' shirts	169
Newspapers	338
Nocturnal enuresis treatment	99
"Phantom Roach Powder"	536
Razor blades	139
Ready-to-eat snack foods	552
Shoes	451
Shopping service memberships (Buying service)	492
Ski bindings	24
Ski equipment	24
Specialty clothing	451
Sugar	15
Televisions	157, 209
Termite control	192
Vitamin supplements, children's	82
Waterproofing services	110
Wearing apparel	451
Wool blend fabrics	126
Wool products	548