



NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

## MEMORANDUM

### EXECUTIVE HEADQUARTERS

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Date: February 1, 2007

To: Members of the NAIC

From: Gail M. Sciacchetano, Deputy General Counsel  
Kara Binderup, Staff Attorney

Re: Arthur J. Gallagher Settlement – Antitrust Class Action

### GOVERNMENT RELATIONS

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### Executive Summary

This is a class action lawsuit alleging collusion among insurers and brokers (including the Gallagher defendants) to rig bids and set up improper, undisclosed contingent commission engagements creating the potential for conflicts of interest. Specifically, plaintiffs allege that the contingent commission arrangements violate federal and state antitrust laws, various states' deceptive and unfair trade practices statutes, and RICO.<sup>1</sup>

The case consists of 15 actions consolidated as *In Re Insurance Brokerage Antitrust Litigation*, MDL No. 1663. The Judicial Panel on Multidistrict Litigation ordered the consolidation on Feb. 17, 2005 and transferred the action to the United States District Court for the District of New Jersey.<sup>2</sup>

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The proposed settlement requires certain defendants related to Arthur J. Gallagher & Co. to pay \$28 million to current and former clients as well as an additional \$8.85 million in attorney fees. The defendants also agreed to take non-monetary action including prohibiting contingent compensation, "pay-to-play" arrangements, "bid-rigging" arrangements and reinsurance "leveraging." In addition, this settlement is intended to follow the business reform provisions of both Illinois Regulatory Settlements, as described below.

The date for the Fairness Hearing has not yet been set.

### WORLD WIDE WEB

[www.naic.org](http://www.naic.org)

### Contact Information

<sup>1</sup> Thomas W. Brunner, Anne McBride Walker and John C. Yang, *Private Contingent Commission Litigation: How Will it Affect the Insurance Industry*, NEWSLETTER (Wiley Rein & Fielding LLP), June 16, 2005, [http://www.wrf.com/docs/newsletter\\_issues/364.pdf](http://www.wrf.com/docs/newsletter_issues/364.pdf) (last visited Jan. 30, 2007).

<sup>2</sup> Master Docket Listing, Judicial Panel on Multidistrict Litigation (Nov. 9, 2006), [http://www.jpml.uscourts.gov/Pending\\_MDLS/MasterDocketSummary.pdf](http://www.jpml.uscourts.gov/Pending_MDLS/MasterDocketSummary.pdf) (last visited Jan. 30, 2007).

Settlement information can be obtained by contacting Marsha J. Akin, Investor Relations, of Arthur J. Gallagher & Co., at 630-773-3800.

### **History of the Case**

This MDL was consolidated Feb. 17, 2005. On May 18, 2005, Gallagher entered into an Assurance of Voluntary Compliance with the Illinois Attorney General and the Director of the Illinois Division of Insurance. Gallagher also entered into a Stipulation and Consent order with the Director of Insurance on the same date. These agreements are known as the “Illinois Regulatory Settlements” and are nearly identical, both finding that Gallagher operated under a potential conflict of interest by:

- Establishing the goal of placing business with selected insurers to increase revenue
- Encouraging managers to do likewise
- Rewarding managers with bonuses
- Entering into expense subsidies with certain insurers
- Committing a certain volume of business in return
- Proposing to increase retail business in return for commitments to use Gallagher’s reinsurance<sup>3</sup>

The Illinois Regulatory Settlements required the establishment of a \$26.9 million settlement fund for eligible policyholders nationwide and various business reforms to remedy Gallagher’s practices. At the time of the settlements and thereafter, the Gallagher defendants have been in voluntary compliance.

On October 3, 2006, the U.S. District Court for the District of New Jersey ruled on the MDL defendants’ motion to dismiss. The court declined to dismiss the case, ruling that the McCarran Ferguson antitrust exemption did not apply in the action. The court directed plaintiffs to file more particular statements as to the antitrust and RICO claims.<sup>4</sup>

The MDL settlement agreement as to the Gallagher defendants was filed with the court on Dec. 29, 2006. At least one other group of MDL defendants, those related to Zurich American Insurance Co., has also filed a proposed settlement for the court’s approval. At this time, none of the proposed settlements have completed the steps required to receive final approval of a proposed settlement.

### **Terms of the Settlement Proposed in Stipulation dated December 29, 2006**

The proposed settlement contains monetary relief as well as non-monetary benefits.

- **Monetary Relief:**

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<sup>3</sup> Stipulation and Consent Order in the matter of Arthur J. Gallagher & Co., State of Illinois Department of Financial and Professional Regulation, Division of Insurance, May 18, 2005.

<sup>4</sup> Reinsurance Focus, Brokers and Underwriters (Oct. 17, 2006), <http://www.reinsurancefocus.com/index.php?/categories/12-Brokersunderwriters> (last visited Jan. 30, 2007).

- Defendants shall distribute \$28 million to current and former clients remaining in the class, and others that used a broker to purchase retail insurance from 1994 to 2005. Arthur J. Gallagher & Co. will also pay \$8.85 million in attorney’s fees.<sup>5</sup> Defendants shall pay the settlement amount within thirty (30) days. Interest shall be calculated at the interest rate for the period starting the day after final judgment and ending on the date the settlement amount is wired into an escrow account. The escrow account shall be established and administered pursuant to the escrow agreement.
  - Members of the class who released all claims in exchange for restitution under the Illinois Regulatory Settlements are not eligible for distributions under the proposed MDL settlement. The Illinois Regulatory Settlements required eligible policyholders to elect to tender a release by December 31, 2005.
- **Non-Monetary Benefits:**
    - **Permissible Forms of Compensation:** Defendants shall accept only (a) a specific fee to be paid by the client, (b) a specific fee and/or percentage commission or premium to be paid by the insurer; or (c) a combination of both. The defendants may retain interest earned on premiums. Defendants shall not directly or indirectly accept or request anything with a material value of \$500 or more from an insurance company.
    - **Prohibition on Contingent Compensation:** Defendants shall not directly or indirectly accept or request any contingent compensation. Defendants shall also not accept contingent compensation on behalf of clients in the wholesale insurance market.
    - **Prohibition of “Pay-to-Play” Arrangements:** Defendants shall not directly or indirectly accept or request any compensation in connection with the selection of insurance companies from which to solicit bids for its clients.
    - **Prohibition of “Bid-Rigging” Arrangements:** Defendants shall not directly or indirectly solicit or knowingly accept any false, fictitious, inflated, artificial, “B” or throw away” quote or indication.
    - **Prohibition of Reinsurance “Leveraging”:** Defendants shall not directly or indirectly accept from or request any promise or commitment to use any Gallagher agency or service.
    - **Prohibition of Inappropriate Use of Wholesaler Insurance Brokers:** Defendants shall not place, renew, consult on or service its clients’ business in the wholesale insurance markets through a wholesale insurance broker without disclosing: (a) the compensation received or to be received by defendants; (b) any ownership interest in or contractual agreement with the Wholesale Insurance Broker; and (c) any alternatives to using a Wholesale Insurance Broker.
    - **Mandated Disclosures to Clients:** Defendants shall: prior to binding in all written proposals, disclose the line of business, insurer, premium,

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<sup>5</sup> Press Release, Arthur J. Gallagher & Co., Arthur J. Gallagher & Co. Reaches Settlement in Federal Class Action Related to Contingent Commissions (Dec. 29, 2006), <http://www.ajg.com/portal/gateway.asp?GID=912&CID=304&URL=http%3A%2F%2F> (last visited Jan. 16, 2007).

effective date, limits and deductibles relevant to all bindable quotes. Alternately, defendants may provide copies of all bindable quotes and all compensation, excluding treaty reinsurance fees or commissions, to be received for each quote.

- **Standards of Conduct and Training:** Defendants have implemented company-wide written standards of conduct and appropriate training, including, business ethics, professional obligations, conflicts of interest, anti-trust and trade practices compliance and record keeping pursuant to the Illinois Regulatory Settlements. Defendants shall not place their own financial interest ahead of their clients'. Defendants will recommend moving a book of business from one insured to another only when it is in the best interest of the client.
- **Additional Terms:**
  - **Limitation of Extraterritorial Effect:** These provisions shall apply only to entities that: (a) service clients domiciled in the United States; (b) place, renew, consult on or provide services for policies covering risks in the U.S.; or (c) are domiciled in the U.S.
  - **Illinois Regulatory Settlements:** In the event that any business reform provision in either of the Illinois Regulatory Settlements is changed, the parties shall change the corresponding provision in this settlement within fifteen (15) days of written notice.
  - The obligations of this settlement shall cease on December 31, 2009. Defendants will not be in violation of this settlement if within three (3) years of the date it acquires any business subsequent to May 18, 2005 it brings that business into compliance with these terms. If Gallagher acquires any business that is a broker defendant, that defendant shall remain subject to this action. In addition, if Gallagher acquires any business that is a broker defendant who has reached an agreement with either its state regulator or the settlement class which is more restrictive than these terms, these terms shall be inapplicable as to the acquisition of that defendant.

### **Final Notes**

This MDL settlement agreement is dependant upon the provisions of the Illinois Regulatory Settlements. If business reforms change in the Illinois Regulatory Settlements, the changes must be reflected in the MDL settlement agreement through Dec. 31, 2009, when obligations of the MDL settlement cease.

Although related to the efforts of the NAIC Broker Activities (EX) Task Force, the Illinois Regulatory Settlements have not generated a companion multi-state regulatory settlement for the consideration of chief insurance regulators. This is in contrast to the Zurich multi-state regulatory settlement made available by the task force in March 2006 for regulatory consideration and adoption.

With respect to the proposed MDL settlement of the Zurich defendants, a representative of the task force appeared before the court to signify its support of the proposed settlement in that the proposed settlement recognizes and incorporates the disclosure requirements of the Zurich multi-state regulatory settlement. Presumably

because there is no underlying multi-state regulatory settlement at issue in the case of the Gallagher defendants, the task force has not been asked to, and has not to date taken a position on Gallagher's proposed MDL settlement.

Should you need further information, please do not hesitate to contact Gail Sciacchetano at 816-783-8019, or Kara Binderup at 816-783-8023.