

Contingent Commissions, Steering, and Bid-Rigging:
The New York State Attorney General, the Insurance Commissioner,
and the (Non)regulation of Insurance

Angela Moore
Multi-State Litigation and the State AG
Professor Tierney

Introduction

As he announced the suit against Marsh & McLennan Companies, New York State Attorney General Eliot Spitzer provided this caution:

“The insurance industry needs to take a long, hard look at itself. If the practices identified in our suit are as widespread as they appear to be, then the industry’s fundamental business model needs major corrective action and reform.”¹

His warning has resonated with insurance industry insiders. Faced with plummeting stock prices, a widening investigation, mounting litigation costs, and in some cases, individual criminal charges, insurers and insurance brokers are reexamining old practices and considering reforms they dismissed less than six months ago. Sweeping changes in the way the insurance industry does business seem inevitable.

The practice at the root of the bid-rigging and steering charged in Spitzer’s complaint, charging insurers contingent commissions, had been widely accepted within the insurance industry prior to this lawsuit. Several prominent insurance executives, upon hearing of Spitzer’s investigation six months before, had predicted that the contingent fee structure was too common and too well-established to be uprooted.² In October, however, industry giants Marsh and American International Group (AIG) announced that they would halt participation in contingent commission agreements.³

The New York State Insurance Superintendent, charged with regulating the insurance industry, has come under sharp criticism for his failure to detect and address the serious conflict of interest problem presented by contingent commissions. This paper

¹ Press Release, Office of New York State Attorney General (Oct. 14, 2004).

² See, e.g., Gretchen Morgenson, “Hat Trick: A 3rd Unit of Marsh under Fire,” New York Times (May 2, 2004) (Jeffrey Greenberg, chairman and CEO of Marsh, had sent a memo to his staff referring to contingent commissions as “long-standing, common industry practice”).

³ Joseph B. Treater, “Under Fire, Marsh Stops Taking Fees from Insurers,” New York Times C1 (Oct. 16, 2004).

examines the events leading up to the suit against Marsh & McLennan, considering whether contingency fees should have been addressed by the insurance commissioner as well as how the matter came to the attention of the Attorney General. In addition, this paper questions whether the Attorney General should have a role in shaping new regulations requiring disclosure of contingent commission agreements or prohibiting their use.

Challenging Contingent Commissions

A. The Attorney General's Investigation

On October 14, 2004, Eliot Spitzer filed a complaint against Marsh & McLennan Companies, Inc. and Marsh Inc., alleging that the insurance broker had engaged in steering and bid-rigging.⁴ The Attorney General's investigation, which had started as an inquiry into contingent commissions, had revealed a system in which Marsh directed business to insurance companies on the basis of commissions while soliciting fake bids intended to create the appearance of real competition. A Marsh executive had put the scheme into plain relief in an email that read, "We need to place our business in 2004 with those [insurance companies] that have superior financials, broad coverage and pay us the most."⁵

The investigation, launched early in 2004, was prompted by tips in the form of an anonymous letter and phone call from two separate individuals.⁶ The Washington Legal

⁴ Press Release, Office of New York State Attorney General (Oct. 14, 2004).

⁵ Id.

⁶ Joseph B. Treaster, "Broker Accused of Rigging Bids for Insurance," New York Times A1 (Oct. 15, 2004).

Foundation, a conservative public policy think tank, had also expressed concerns about possible conflicts of interest created by contingent commissions.⁷ As an initial matter, Spitzer began examining the practices of Marsh, Aon, and Willis Group Holdings, as well as smaller insurance brokers.⁸

At the start of the investigation, insurance brokers and insurers seemed unconcerned, noting that contingency fees were a “longstanding, common, and well-known” practice.⁹ The apparent acceptance of the practice heightened the industry’s surprise when charges were filed against Marsh. Marsh had been given no opportunity to negotiate, a decision which Spitzer explained in saying, “The leadership of that company is not a leadership I will talk with. It is not a leadership I will negotiate with.”¹⁰

The Attorney General’s complaint charged Marsh with establishing a system, based upon “placement service agreements” (PSAs) or “market services agreements” (MSAs), in which insurance companies agreed to pay Marsh commissions for placing business with them.¹¹ These commissions came in two forms: front-end commissions, which were based on the volume of business referred, and back-end commissions, which were based on the profits generated by the business.¹² The payments generally ranged from 5% to 7.5% of the value of the insurance underwritten.¹³ In 2003, these commissions accounted for nearly \$800 million, or more than half of Marsh’s net

⁷ Thor Valdmanis, Adam Shell, and Elliot Blair Smith, “Marsh & McLennan accused of price fixing, collusion,” USA Today 1B (Oct. 15, 2004).

⁸ Joseph B. Treaster, “Broker Accused of Rigging Bids for Insurance,” New York Times A1 (Oct. 15, 2004).

⁹ “Spitzer moves on insurance firms; Steering ‘payoffs’ alleged; Marsh sued,” Chicago Tribune C3 (Oct. 15, 2004).

¹⁰ Joseph B. Treaster, “Broker Accused of Rigging Bids for Insurance,” New York Times A1 (Oct. 15, 2004).

¹¹ Complaint, *People v. Marsh & McLennan Companies, Inc.* (Oct. 14, 2004) (“Complaint”), ¶ 7.

¹² Gretchen Morgenson, “Hat Trick: A 3rd Unit of Marsh under Fire,” New York Times (May 2, 2004).

¹³ *Id.*

income.¹⁴ The Attorney General’s complaint alleged that the MSAs, although not illegal in themselves,¹⁵ created a serious conflict of interest and placed Marsh in a position to choose to maximize its own profit at the expense of its clients’ interests.¹⁶

At the outset of the Attorney General’s investigation, insurance executives had acknowledged that they accepted contingent commissions in the form of MSAs, but claimed that they disclosed the existence of these agreements to their clients. In addition, insurance brokers claimed that the individuals making recommendations had no knowledge of the commissions their recommendations might trigger.¹⁷ Attorney General Spitzer’s investigation revealed both of these statements to be false.¹⁸

Contradicting Marsh’s claim of information walls, an email from one Marsh executive stated that the MSAs directly determined “who [we] are steering business to and who we are steering from.”¹⁹ Marsh had developed a system to rate insurance companies on the basis of how much they paid in contingent commissions and directed managers to ensure that placements occurred so as to maximize Marsh’s revenue.²⁰ Moreover, no public disclosure of Marsh’s contingency commission system had taken place: Marsh publicly acknowledged the existence of agreements with insurance companies, but claimed that MSA payments were based on performance of particular

¹⁴ Thor Valdmanis, Adam Shell, and Elliot Blair Smith, “Marsh & McLennan accused of price fixing, collusion,” USA Today 1B (Oct. 15, 2004).

¹⁵ Hearing of the Financial Management, the Budget, and International Security Subcommittee of the Senate Governmental Affairs Committee, Subject: Insurance Brokerage Practices, Including Potential Conflicts of Interest and the Adequacy of the Current Regulatory Framework (Nov. 16, 2004), Federal News Service (“Insurance Brokerage Practices Hearing”) at 4.

¹⁶ Complaint ¶ 8.

¹⁷ Insurance Brokerage Practices Hearing at 4.

¹⁸ Complaint ¶ 25 (arguing that “the information barrier that Marsh describes simply does not exist”).

¹⁹ Complaint ¶ 8.

²⁰ Complaint ¶¶33, 34.

services (in spite of the fact that Marsh performed no additional services to earn the fees).²¹

To conceal these practices, and to give its clients the impression that true competition had taken place, Marsh sought to obtain non-competitive quotes from other client insurance companies.²² In soliciting these misleading quotes, called B quotes, Marsh made it clear that the companies providing them would not win the client's business.²³ Marsh claimed that the quotes were "backup" or "protective" quotes to be used only in the event that the insurance company chosen by Marsh to win the client's business should prove unable to perform on the contract.²⁴ Insurance companies refusing to provide B quotes jeopardized their relationship with Marsh and risked losing future business.²⁵

On the basis of this conduct, the Attorney General charged Marsh with fraud and antitrust violations.²⁶ The complaint cited six causes of action, including various types of fraud, unjust enrichment, and violation of New York's antitrust statute, the Donnelly Act.²⁷ In addition, the Attorney General accepted guilty pleas on criminal charges from Marsh executives and from insurance executives who participated in Marsh's scheme by furnishing B quotes. Former Marsh employees who have pleaded guilty include senior vice-president Robert Stearns,²⁸ managing director Joshua Bewlay,²⁹ and managing

²¹ Complaint ¶¶ 26, 27.

²² Complaint ¶9.

²³ Complaint ¶46.

²⁴ Complaint ¶46.

²⁵ Thor Valdmanis, Adam Shell, and Elliot Blair Smith, "Marsh & McLennan accused of price fixing, collusion," USA Today 1B (Oct. 15, 2004).

²⁶ Press Release, Office of the New York State Attorney General (Oct. 14, 2004).

²⁷ Complaint ¶79-86.

²⁸ Samuel Mall (AP), "Marsh Broker Pleads Guilty in Fraud: Senior VP Agrees to Cooperate with Spitzer's Investigation," The Washington Post E3 (Jan. 7, 2005).

director Kathryn Winter.³⁰ Executives from AIG, Ace, Ltd., and Zurich American Insurance Co. have also offered guilty pleas and are cooperating in Spitzer's continuing investigation.³¹

B. The Reaction of the Insurance Industry

As stated above, insurance brokers were not immediately concerned about the possible effects of the Attorney General's investigation. An article in the New York Times, published five months before the Marsh complaint was filed, noted that "few in the industry expect the kinds of significant changes that came as a result of past investigations by Mr. Spitzer into Wall Street analysts and the trading of mutual funds."³² Jeffrey Greenberg, Marsh's chairman and CEO, sent a memo to his staff defending the collection of contingent commissions as a "long-standing, common industry practice."³³

Other groups responded much more positively to Spitzer's efforts. Following the launch of the investigation, concerns among risk managers sparked online debate over whether insurance brokers wielded too much power, and whether their practices violated notions of fair play.³⁴ An Advisen survey, conducted in May 2004, revealed that 69% of 330 risk managers who had been anonymously polled believed that contingent

²⁹ Joseph B. Treaster, "A Senior Marsh Executive Admits Role in Bid-Rigging," NY Times C2 (Feb. 16, 2005).

³⁰ "Ex-Director at Marsh Pleads Guilty in Bid-Rigging," NY Times C12 (AP) (Feb. 25, 2005).

³¹ Samuel Mall (AP), "Marsh Broker Pleads Guilty in Fraud: Senior VP Agrees to Cooperate with Spitzer's Investigation," The Washington Post E3 (Jan. 7, 2005).

³² Joseph B. Treaster, "Inquiry Widens: Insurance Brokers May Face Change," New York Times C1 (May 18, 2004).

³³ Gretchen Morgenson, "Hat Trick: A 3rd Unit of Marsh under Fire," New York Times (May 18, 2004).

³⁴ Joseph B. Treaster, "Inquiry Widens: Insurance Brokers May Face Change," New York Times (May 18, 2004).

commissions created a conflict of interest for insurance brokers.³⁵ Moreover, 82% of risk managers felt that disclosure of contingent fees was inadequate and 56% claimed that their brokers failed to disclose at all.³⁶ Such statements would seem to undercut Marsh CFO Sandra Wijnberg's claim that, as the investigation proceeded and Marsh began disclosing more information about its fee arrangements, it found that "bigger clients already were pretty knowledgeable, and they haven't been particularly agitated about this."³⁷

On October 15, Aon indicated confidence in the propriety of its contingency fee arrangements, arguing that "[c]ompensation agreements between insurance companies and brokers are longstanding, common, and well-known practices in the insurance industry" and insisting that Aon had disclosed its fee arrangements in agreements, invoices, and statements posted on its website.³⁸ Other insurance players were less certain. Marsh halted its collection of contingency fees³⁹ and AIG, through chairman Hank Greenberg, announced that it would begin paying straight fees, which would be fully disclosed, rather than contingent commissions.⁴⁰

Less than two weeks after the complaint was filed, Marsh's board of directors accepted chief executive Jeffrey Greenberg's resignation.⁴¹ In response, the Attorney General's office issued a press release announcing its decision drop criminal charges against Marsh, explaining that "[t]he actions announced today by the Board of Directors

³⁵ Thor Valdmanis, Adam Shell, and Elliot Blair Smith, "Marsh & McLennan accused of price fixing, collusion," USA Today 1B (Oct. 15, 2004).

³⁶ *Id.*

³⁷ *Id.*

³⁸ "Spitzer Moves on Insurance Firms: Steering 'payoffs' alleged, Marsh sued," Chicago Tribune C3 (Oct. 15, 2004).

³⁹ "Marsh & McLennan drops fees from insurers: In wake of Spitzer probe, company to suspend controversial commissions; shares plunge further," Newsday A18 (Oct. 16, 2004).

⁴⁰ Floyd Norris, "When Spitzer Speaks, Insurers Take Note," New York Times C1 (Oct. 16, 2004).

⁴¹ "Greenberg Resigns from Top Job at Marsh & McLennan," Datamonitor (Oct. 26, 2004).

of Marsh & McLennan Companies permits Marsh and this office to move forward toward a civil resolution of our lawsuit.”⁴² On January 31, 2005, Marsh’s new chief executive, Michael G. Cherkasky, reached an agreement with the Attorney General’s office regarding the civil case against Marsh.⁴³ Cherkasky, who had been Spitzer’s supervisor when both were working in the Manhattan district attorney’s office, agreed to pay \$850 million (or roughly half of the \$1.7 billion Marsh had received in contingency fees between 2001 and 2004) in restitution.⁴⁴ Cherkasky also issued a statement calling the behavior of “a few people” at Marsh both “shameful” and “unlawful.”⁴⁵ Finally, Marsh agreed not to accept payments from insurance companies in connection with its referral services.⁴⁶

C. State Insurance Commissioners: “Asleep at the switch”?

Given the magnitude of Marsh’s deceptive practices and the fact that collection of “contingent commissions” seems to have been commonplace within the insurance brokerage industry, many have questioned how such behavior could have gone unchecked for so long. J. Robert Hunter, the Consumer Federation of America’s director of insurance, went so far as to say that “[m]ost of the state insurance commissioners who are charged with overseeing the insurance industry were asleep at the switch while these abuses were occurring.”⁴⁷ Gregory Serio, the New York state Superintendent of Insurance, takes issue with this characterization. He argues that a lack of cooperation

⁴² Press Release, Office of New York State Attorney General (Oct. 25, 2004).

⁴³ Joseph B. Treaster, “Insurance Broker Settles Spitzer Suit for \$850 Million,” NY Times A1 (Feb. 1, 2005).

⁴⁴ Id.

⁴⁵ Id.

⁴⁶ Id.

⁴⁷ Meg Fletcher, “Regulators ‘asleep at the switch’: Consumer advocates; NAIC proposes plan to fight fraud, require disclosure,” Business Insurance 43 (Nov. 1, 2004).

from industry insiders, in combination with the limited powers available to the Insurance Department, prevented discovery of the deceptions practiced by Marsh.⁴⁸ Serio suggested that the Attorney General’s office was the appropriate lead agency, “given his broader legal powers, his greater investigative resources and frankly his tireless pursuit of cases of this nature.”⁴⁹

1. Regulating in the public interest

Regulation of insurance occurs at the state level, with each state making an individual determination of the nature and scope of its insurance commissioner’s responsibilities. The National Association of Insurance Commissioners (NAIC), created to address the problem posed by multi-state insurers, provides a forum for coordinated action.⁵⁰ The NAIC lists these as its goals:

- Protect the public interest;
- Promote competitive markets;
- Facilitate the fair and equitable treatment of insurance consumers;
- Promote the reliability, solvency, and financial solidity of insurance institutions;
- and support and improve state regulation of insurance.⁵¹

Ascendant among these goals, however, is the regulator’s obligation to protect the interests of insurance consumers.⁵²

Promoting the solvency and financial stability of insurance providers could be viewed as the best tool available to insurance commissioners for protecting the interests of consumers. If this is the case, the goals stated above collapse into the single objective

⁴⁸ Gavin Souter, “Serio Faults Buyers for Lack of Response,” *Business Insurance* (Nov. 8, 2004), p.4 (Serio pointed to the lack of complaints from risk managers as a cause of his office’s inability to detect bid-rigging and self-dealing by brokers).

⁴⁹ Insurance Brokerage Practices Hearing at 7.

⁵⁰ NAIC History and Background, *available at* <http://www.naic.org/about/background.htm>.

⁵¹ NAIC Mission Statement, *available at* <http://www.naic.org/about/mission.htm>.

⁵² NAIC History and Background, *available at* <http://www.naic.org/about/background.htm>.

of safeguarding the vitality of the insurance community. Policing the insurance community, according to this line of argument, is a task better left to prosecuting authorities. Even in this narrow view of the responsibilities of the insurance commissioner, however, an anti-competitive environment of the sort created by contingency commissions would have to be thought to sacrifice the health of the industry in favor of the financial interests of a few industry giants.

A different view of the role of the insurance commissioner might focus on the tension between protecting insurance consumers and safeguarding the solvency of insurance institutions. By requiring regulators to safeguard the interests of two separate constituencies, the objectives of insurance commissioners may create a fundamental conflict. Once again, however, the argument fails to persuade in the face of outright deception and fraud. Misrepresentations on the scale practiced by Marsh harm competing insurance brokers as well as insurance consumers, and would seem to tip the balance decisively in favor of closer regulation.

2. The New York Insurance Department

Section 201 of New York State's insurance law grants the superintendent of insurance, as the head of the insurance department, "the rights, powers, and duties, in connection with the business of insurance in this state, expressed or reasonably implied by this chapter or any other applicable law of this state."⁵³ The superintendent's mission statement somewhat clarifies this general grant of authority, setting out as the objectives of his office the following:

Ensure the continued sound and prudent conduct of insurers' financial operations;

⁵³ NY CLS Ins. §201 (2004).

Provide fair, timely and equitable fulfillment of insurer obligations;
Protect policyholders from financially impaired or insolvent insurers;
Eliminate fraud, other criminal abuse and unethical conduct in the industry; and
Foster growth of the insurance industry in the state.⁵⁴

Although similar to the NAIC's stated goals, the New York insurance department's apparent focus is insurers rather than insurance consumers. Nonetheless, the office's interest in elimination of fraud and other deceptive conduct within the insurance industry should have allowed it to effectively safeguard the interests of consumers in the context of contingent commissions.

In fact, the New York Department of Insurance had called attention to the possible problem posed by insurance brokers' fee system years before the present investigation began. In 1998, after receiving information from corporate risk managers, the insurance department issued a statement recommending the disclosure of all compensation arrangements, concerned that contingent commissions would "create the perception that brokers are conflicted in their loyalties."⁵⁵ The statement also suggested that such commissions might constitute a violation of New York state insurance law.⁵⁶ Although the insurance department continued to investigate contingency commissions, Serio argues that its efforts were thwarted by the unwillingness of risk managers to provide specific details or actively participate in an investigation.⁵⁷

While it may be true that the insurance department could not conduct an investigation on the scale of that orchestrated by the Attorney General's office, closer regulation of contingent commissions might have effectively eradicated illegal practices.

⁵⁴ Available at <http://www.ins.state.ny.us/hp97wel.htm>.

⁵⁵ Joseph B. Treaster, "States vs. U.S.: Who Will Police Insurance Firms?" New York Times C1 (Dec. 31, 2004).

⁵⁶ Joseph B. Treaster, "Insurance Investigations Under Way Over Fees," New York Times C1 (April 24, 2004).

⁵⁷ Gavin Souter, "Serio Faults Buyers for Lack of Response," Business Insurance 4 (Nov. 8, 2004).

Contingent commissions had been collected by insurance brokers for decades, and the practice became a matter of public concern at least as early as 1998.⁵⁸ In addressing the problem in a vague and uncertain manner, however, the superintendent left the industry with more questions and answers. Maurice “Hank” Greenberg, the chairman and CEO of AIG, reported having sought guidance from the New York state insurance department on the legality of MSAs as early as 2002.⁵⁹ He renewed his inquiries again a year later, but received no advice from the superintendent.⁶⁰

Given that the issue had been raised six years before and had continued to be viewed as a potential problem, the superintendent of insurance should have acted more decisively. Although Serio might have been unaware of any specific instances of steering or bid-rigging, the potential conflict of interest posed by the MSAs should have been evident. Moreover, even a limited investigation should have revealed that insurance brokers were not disclosing the nature and scope of the commissions they collected from insurance providers.

When the Attorney General’s office announced in March of 2004 that it intended to begin an investigation of contingent commissions, the Department of Insurance surrendered all of the information that it had been able to gather on the subject.⁶¹ Serio identifies this as the point at which control of the matter transferred from his agency to the Attorney General’s office; the focus in the case had shifted from regulation to

⁵⁸ Joseph B. Treaster, “Broker Accused of Rigging Bids for Insurance,” *New York Times* A1 (Oct. 15, 2004).

⁵⁹ Joseph B. Treaster, “Under Fire, Marsh Stops Taking Fees from Insurers,” *New York Times* C1 (Oct. 16, 2004).

⁶⁰ *Id.*

⁶¹ Joseph B. Treaster, “States vs. U.S.: Who Will Police Insurance Firms?” *New York Times* C1 (Dec. 31, 2004).

enforcement.⁶² A month later, when the investigation was well underway, Serio declined to make any comment on the matter to the press.⁶³

As the scope of the investigation widened, Serio's office seemed to become more involved. A press release from October 14 claimed that the insurance department had participated in investigating insurance brokers and would continue to collaborate in the prosecution of the cases brought by the Attorney General.⁶⁴ Serio's office also appeared to fully support the Attorney General's handling of the case, asserting with newfound conviction the necessity of full disclosure of all fee structures:

The New York State Insurance Department's position on this matter is clear—a broker's undisclosed receipt of additional compensation constitutes a dishonest and untrustworthy practice. Today, we remind all in the broker community that this standard applies to them and that New York State will not tolerate any criminal or improper behavior in its insurance markets.⁶⁵

Subsequently, the insurance department issued citations to fifteen Marsh divisions, charging the them with violations of sections 2110(a)(4) and 2402(c) of the New York state Insurance Law, as well as section 340 of the New York state General Business Law.⁶⁶ In addition, Serio flagged all Marsh licenses.⁶⁷

It is noteworthy that Serio's statement, although occurring at the same time as Spitzer's announcement of charges, is not premised on the idea that contingent commissions give rise to other deceptive and fraudulent practices. His argument does not rely on any of the evidence discovered in the Attorney General's investigation. The superintendent's emphasis on complete disclosure, however, is considerably more

⁶² Id.

⁶³ Joseph B. Treaster, "Insurance Investigations Under Way Over Fees," New York Times C1 (April 24, 2004).

⁶⁴ New York State Insurance Department Press Release (October 14, 2004).

⁶⁵ Id.

⁶⁶ Amended Citation in the matter of Marsh & McLennan Companies, Inc. (Oct. 25, 2004).

⁶⁷ Insurance Brokerage Practices Hearing at 7.

forceful than his earlier recommendation. Had he taken this position with respect to disclosure in response to earlier industry inquiries, he might have prevented many of the abuses uncovered in the Marsh investigation.

3. Garamendi: A Model of an Active Insurance Commissioner

Also undercutting Serio's explanation of his inaction is the fact that the insurance commissioner of California, John Garamendi, has taken the lead in California's investigation of insurance commission practices. Garamendi has been working to detect and prosecute wrongdoing, on the one hand, while also seeking a prospective regulatory solution. His efforts demonstrate the degree to which insurance commissioners can be effective in utilizing both enforcement and regulatory tools.

Garamendi was involved in the early investigation of the insurance industry, and has continued to provide leadership throughout the development of the legal case.⁶⁸ In November, Garamendi brought a complaint against Universal Life Resources (ULR), a health insurance broker, as well as four insurance companies: MetLife, Cigna, Prudential Financial, Inc., and UnumProvident.⁶⁹ Garamendi reached a settlement with ULR two days later.⁷⁰ The settlement consists of a consent decree and permanent injunction which prohibit ULR from engaging in the collection of undisclosed fees, steering, or bid-rigging.⁷¹

⁶⁸ Gretchen Morgenson, "Hat Trick: A 3rd Unit of Marsh under Fire," New York Times (May 2, 2004).

⁶⁹ News release, California Department of Insurance (November 18, 2004).

⁷⁰ The settlement agreement can be found on CDI's website, at http://www.insurance.ca.gov/PRS/PRS2004/Consent_Decree_Signed.pdf.

⁷¹ Id.

In the settlement, Garamendi agreed not to seek to suspend or revoke ULR's license, or to seek civil or criminal penalties.⁷² This approach, while much less aggressive than that favored by Spitzer, demonstrates one way in which an insurance commissioner can regulate effectively while seeking to preserve the integrity of insurance markets. Although ULR may not be prosecuted to the full extent possible, by calling attention to the organization's conduct, Garamendi has disclosed dishonest practices and triggered enhanced scrutiny that will, along with the settlement agreement, ensure that such practices are discontinued.

C. The Future of the Insurance Industry

Despite the appearance of agreement between the New York Attorney General and the Superintendent of Insurance, Serio's office initially favored, and continues to advocate, a less much less aggressive form of regulation. In contrast to Spitzer's regulation-by-prosecution, Serio favors an industry-driven, moderate solution. In a hearing held by the Financial Management, Budget, and International Security Subcommittee of the Senate Governmental Affairs Committee, Serio presented the NAIC's proposal for reform and advocated self-regulation by the insurance industry.⁷³ On other occasions, he emphasized the need for insurance industry participation in the regulation process⁷⁴ and questioned whether insurers, as sophisticated consumers, wanted regulators to intervene on their behalf.⁷⁵

⁷² Id.

⁷³ Id. At 7-8.

⁷⁴ "Industry Scandals Spotlight Regulatory Issues," BestWire (Nov. 19, 2004).

⁷⁵ Greg Souter, "Serio Faults Buyers for Lack of Response," Business Insurance 4 (Nov. 8, 2004).

The NAIC's proposed solution to the problem posed by contingent commissions focuses on disclosure. As described by Serio at the Senate hearing, the NAIC's solution has three components: disclosure of all compensation structures, written consent for any contingent commissions, and a tip system that would allow insurance industry insiders to anonymously report illegal activity.⁷⁶ On December 29, 2004, the NAIC adopted model legislation that provides a concrete representation of the organization's disclosure solution.⁷⁷

Although Spitzer has not formally advocated the abolition of all contingent commission systems, it is difficult to imagine that he, like the NAIC, would be satisfied with a simple disclosure system.⁷⁸ Given the extent of the corruption he discovered during his investigation, it seems certain that he will seek a more comprehensive means of addressing improper incentives. Testifying before the Senate subcommittee, the Attorney General condemned what he termed a "failure of the regulatory entities that are supposed to oversee this sector."⁷⁹ He faulted state insurance commissioners for "fail[ing] to ask even obvious questions that would have revealed deep seated problems."⁸⁰ In concluding, Spitzer asked for congressional inquiry into a variety of topics related to the illegal behavior of actors in the insurance industry.⁸¹

Going forward, it seems likely that conflict will arise between the solutions to insurance industry abuses proposed by Serio with the NAIC and those advocated by

⁷⁶ Insurance Brokerage Practices Hearing at 7.

⁷⁷ Compensation Disclosure Amendment, *available at* http://www.naic.org/committee_activities/executive/docs/BrokerActAdoptedclean.doc.

⁷⁸ As noted above, Spitzer has actually stated that contingency fees are not inherently illegal. *See* Insurance Brokerage Practices Hearing at 4. On the basis of the extensive fraud he discovered, however, one might expect Spitzer to argue that commissions inevitably create conflicts of interest, and should therefore be prohibited.

⁷⁹ Insurance Brokerage Practices Hearing at 4.

⁸⁰ *Id.*

⁸¹ *Id.* at 5.

Attorney General Spitzer. Serio has commented that regulators should streamline requirements for the insurance industry and “get out of the way” when possible.⁸² Like his earlier comments about self-policing mechanisms, this perspective reveals a fundamental hesitancy to intervene that is squarely at odds with the more aggressive enforcement tactics favored by the Attorney General. Although Serio will not be spearheading the effort in New York,⁸³ should the new insurance commissioner’s views control prospective regulation? Or is it proper for the Attorney General to use his office to create and implement more stringent regulations?

The Maine Supreme Court addressed the possibility of conflict between the state Attorney General and the insurance commissioner in *Superintendent of Insurance v. Attorney General*.⁸⁴ In that case, the court found that the fact that members of the Attorney General’s staff had assisted the insurance commissioner at the administrative stage of the proceedings did not prevent the Attorney General from subsequently challenging the rate order issued by the Superintendent of Insurance.⁸⁵ Although the Attorney General usually provides assistance and representation to the Superintendent of Insurance, the court in this case approved a broad scope of discretion for the Attorney General, even on an issue, such as a rate order, properly within the scope of the insurance commissioner’s duties.⁸⁶ While the Maine court was specifically focused on the issue of whether the Attorney General’s involvement at the administrative stage foreclosed the

⁸² “Industry Scandals Spotlight Regulatory Issues,” BestWire (Nov. 17, 2004).

⁸³ Pataki announced that Serio would be leaving the Insurance Department in January. Joseph B. Treaster, “States vs. U.S.: Who Will Police Insurance Firms?” New York Times C1 (Dec. 31, 2004).

⁸⁴ 558 A.2d 1197 (Maine 1989).

⁸⁵ *Superintendent of Insurance v. Attorney General*, 558 A.2d at 1204.

⁸⁶ *See Superintendent of Insurance v. Attorney General*, 558 A.2d at 1200 (finding that Maine law “directed the Attorney General to control state litigation and consolidated control in his office without mandating representation in all cases”). Note that *Hawaii v. Klattenhoff*, 801 P.2d 548 (1990) came to the same conclusion in an analogous case.

possibility of a subsequent challenge under conflict of interest rules, this case ultimately represents a broad grant of discretion to the Attorney General to challenge decisions made by state officials.

The lower court had come to the opposite conclusion, relying upon *Deukmejian v. Brown*, a California case taking a narrower view of the scope of the authority of the state Attorney General.⁸⁷ In *Deukmejian*, the California Supreme Court found that it was impermissible for the Attorney General to write a letter to the Governor encouraging him to sign legislation, then later file suit against the Governor on the grounds that the statute was unconstitutional.⁸⁸ The California court restricted the scope of its holding, however, arguing that “the Attorney General cannot be compelled to represent state officers or agencies if he believes them to be acting contrary to law, and he may withdraw from his statutorily imposed duty to act as their counsel, but he may not take a position adverse to those same clients.”⁸⁹

Both *Superintendent of Insurance* and *Deukmejian* support the idea that the Attorney General can oppose the actions of a state officer if he believes that those actions violate state law.⁹⁰ The question becomes a closer one, however, where the actions in question are not strictly illegal. Spitzer has noted that contingent commissions are not illegal as a matter of law.⁹¹ Given the scale of corruption revealed by his investigation, however, he might reasonably conclude that these commissions create an inevitable and insurmountable conflict of interest for insurance brokers. The question then becomes

⁸⁷ *Deukmejian v. Brown*, 624 P.2d 1206 (1981).

⁸⁸ *Deukmejian v. Brown*, 624 P.2d at 1208. Note that in this case, a different individual held the office of Attorney General when the advice was given than at the time that the suit was initiated. The California Supreme Court, in effect, held the Attorney General bound by the acts of his predecessor.

⁸⁹ *Deukmejian v. Brown*, 624 P.2d at 1209.

⁹⁰ *Deukmejian* limited this principle only in situations in which the Attorney General would be taking a position adverse to his client or clients. *Deukmejian v. Brown*, 624 P.2d at 1209.

⁹¹ Insurance Brokerage Practices Hearing at 4.

whether the Attorney General can seek to prohibit contingent commissions, in spite of the decision of the insurance commissioner to limit regulation to full disclosure of fee agreements.

It is important to note that while the insurance commissioner has the responsibility of regulating the insurance industry, the Attorney General is entrusted with protecting consumers and investors from fraudulent business practices. The Martin Act, which provided two of the causes of action in Spitzer's complaint against Marsh & McLennan, confers broad powers of investigation, regulation, and enforcement on the Attorney General.⁹² If the Attorney General believes that the use of contingent commissions, while legal, is inextricably intertwined with deceptive practices, he could make a compelling case for the use of his regulatory authority under the Martin Act to prohibit the collection of fees of this kind.

Such a regulatory action will not likely be necessary, however, in light of the impact that Spitzer's complaint against Marsh & McLennan has already had. With AIG and Marsh abandoning contingent commissions in the face of prosecution, it seems probable that other industry players will soon follow suit. The Attorney General's complaint against Marsh, in combination with the resulting flurry of negative publicity and falling stock prices, already seems to be having the effect of purging many of the practices regulation would target from the insurance industry.

⁹² NY CLS Gen. Bus. §§ 352, 353. *See* *People v. Ferone*, 641 N.Y.S.2d 815, 816 (1996) (finding that the Attorney General has broad powers to regulate, investigate, and enforce under the Martin Act); *see also* *Dunham v. Ottinger*, 243 N.Y. 423, 438 (1926) (describing the Attorney General's authority under the Martin Act as "great and far-reaching").

Conclusion

In the wake of Spitzer's announcement of the case against Marsh & McLennan, many people within the business community have questioned his decision to go after a practice as well-entrenched and commonplace as contingent commissions. Even his own office second-guessed Spitzer's refusal to negotiate with Marsh leadership.⁹³ Regardless of one's view of the Attorney General's choices, however, his authority to investigate and prosecute insurers engaging in corrupt practices is unquestionable. Although the insurance commissioner may favor a different mode of regulation, the Martin Act confers broad authority on the Attorney General to protect the public from fraudulent business practices. This authority allows a range of action going forward, including regulation as well as further prosecutions, and the new Superintendent of Insurance may play a role in determining which of these options the Attorney General chooses.

⁹³ Steve Fishman, "Inside Eliot's Army," New York Metro.com (last viewed Jan. 3, 2005).