CPI COMPETITION POLICY INTERNATIONAL

The CPI Antitrust Journal
July 2010 (1)

Collusion Among Health Insurers in Chile: Good, Bad, and Ugly Reasons in a Split Decision

Claudio A. Agostini, Eduardo Saavedra, & Manuel Willington

ILADES-Alberto Hurtado University

Collusion Among Health Insurers in Chile: Good, Bad, and Ugly Reasons in a Split Decision

Claudio A. Agostini, Eduardo Saavedra, & Manuel Willington[1]

I. INTRODUCTION

In 2002 five of the largest Chilean private health insurance providers ("Isapres") reduced the coverage they offered to their members without reducing the price of their plans. In other words, their members were given worse health plans than they previously had, but at the same price. Consequently, in 2005 the National Antitrust Prosecutor (Fiscalía Nacional Económica "FNE") accused the five Isapres—Banmédica, Colmena, Consalud, ING, and Vida Tres—of collusion before the Chilean Competition Court (Tribunal de Defensa de la Libre Competencia, "TDLC"). More than two years thereafter, the TDLC ruled, in a "split decision" (3 votes in favor and 2 against) that there was no sufficient evidence that the Isapres colluded to reduce the coverage of their plans, and acquitted them. The case was appealed before the Supreme Court of Justice, which, in January 2008, also issued a split decision, based on similar arguments and confirmed the previous decision.

The FNE did not provide any "smoking gun" about the alleged collusive agreement. Before 2009 the FNE had no legal power to conduct dawn raids, carry out unannounced inspections, or intercept communications, which significantly limited the possibility of finding hard evidence of collusion.[2] The accusation against the health insurance providers was mainly based on economic and econometric evidence detailed in Agostini et al. (2008), which does not reject the collusion hypothesis, but rejects the cost-increase hypothesis used by the five Isapres to explain their parallel behavior in terms of reducing coverage.[3]

A brief recount of the case and an analysis of the TDLC´s ruling are presented in the following pages. This analysis considers the fact that the system to be followed by the TDLC to assess the proof is the rule of reason, which requires the judges to assess the evidence based on their experience, formal rules of logic, and economic theory. Likewise, TDLC judges are obliged to explain and justify their judgments with not only their appreciation of the proof, but also an account of all the evidence submitted.

It is our opinion that the TDLC judgment is precise and correct in some disputed points and sets important precedents for the future of the health insurance industry. However, the

[1] Claudio Agostini, PhD in Economics from the University of Michigan, Professor of the School of Economics and Business of the Alberto Hurtado University. Eduardo Saavedra, PhD in Economics from Cornell University, Professor of the School of Economics and Business of the Alberto Hurtado University. Manuel Willington, PhD in Economics from the University of Pennsylvania, Professor of the Faculty of Economics and Business of the Alberto Hurtado University. At the request of the National Antitrust Authority (FNE), in December 2005 the authors prepared an economic report to be submitted to the TDLC. This document is partially based on that report.

[2] On April 15, 2009, the Senate approved a new competition law that provided the FNE with two new tools to detect collusive agreements: dawn raids and a leniency program.

[3] *See* CLAUDIO AGOSTINI, EDUARDO SAAVEDRA AND MANUEL WILLINGTON, COLLUSION IN THE PRIVATE HEALTH INSURANCE MARKET: EMPIRICAL EVIDENCE FOR CHILE, WP I-206 ILADES-Georgetown University, (2008).

majority decision has essential errors that ultimately led to the acquittal of the accused Isapres. Such failures, according to our analysis, are related to the fact that part of the submitted evidence (a substantial part in our opinion) and part of the rationale followed by the judges are contrary to economic theory and furthermore—as implicitly admitted by the minority decision—are contrary to logic.

Regarding the final Supreme Court verdict, most of the judges based their decision on the lack of explicit collusion evidence, dismissing the use of indirect collusion evidence. The minority judges, however, stated that the evidence of implicit collusion was sufficient to condemn the Isapres.

Below is a detailed analysis of the TDLC judgment. This court specializes in free competition and is composed of a combination of economists and lawyers, so economic arguments have greater relevance on their decisions than in the cases heard by the Supreme Court.

Undisputed Facts:

- During the second quarter of 2002, the summoned Isapres started a process of replacing their "100/80" coverage plans by others with "90/70" coverage.[4]
- The plan substitution process undertaken by the Isapres—except for Consalud, which was much slower in substituting plans during the first six months—took place in a noticeably "parallel" way.
- Such reduction of coverage was not accompanied by a reduction in prices or increases in the caps that determined effective coverage.
- A prominent characteristic of the health insurance market is the existence of moral hazard: as long as an insured does not face significant co-payments, the insured is encouraged to overuse the insurance. A problem that may be aggravated by the supplier-induced demand phenomenon, whereby the doctor may urge the patient to undergo more tests or consultations than those economically reasonable because neither the doctor nor the patient pays for the cost of the additional tests.

II. THE INITIAL ACCUSATION BY THE FNE

According to the accusation of the Antitrust Authority, the gradual and parallel plan-substitution process can only be explained by the existence of a collusive agreement. This is based on the fact that insurance providers, prior to the alleged agreement, obtained about 30 percent profit above their equity; thus the change in offered products was not due to the existence of losses, but merely as an agreement that would permit them to increase profits, which increased by 29 billion pesos (around US$59.7 million) between 2002 and 2004 for the group of open Isapres, an increase of approximately 200 percent. Naturally, the agreement would have been detrimental for consumers, who saw a reduced quality in the insurance they acquired without the corresponding reduction in the premiums paid.

Additionally, at the same time as the plans' coverage was lowered, the expenditure incurred by the summoned Isapres in advertising and sales force decreased, which shows a lower intensity in the competition among them.

[4] The first value refers to the coverage received by Isapres' members in cases of hospitalization and the second in cases of outpatient care. These values are imperfect indicators of the effective coverage, as typically healthcare services have associated caps that limit the maximum value to be paid by the Isapre.

III. THE DEFENSE

The Isapres defense was based on several complementary—but not consistent—arguments. Answering the arguments submitted by the FNE, the Isapres' defense stated that:

1. Copying plans is typical in the health insurance industry because of both advertising by the actual companies along with fluent communication among the sellers of the different companies;
2. The profits of the companies should not be measured as a percentage of the assets (given the relatively low capital requirements they have) nor should they be based on their accounting assets, as a fundamental portion of the assets is the client portfolio, which is not valued according to the current accounting rules. Hence, the measurement to be used should be related to the operating income, and, measured in this way, the Isapres did not present excessive profits as of 2002;
3. The relevant health insurance market includes Fonasa, the public health insurer, so the summoned Isapres do not have market power, since, in the case of price increases or lower-quality health plans, most members would switch over to Fonasa;
4. Given the low capital requirements,[5] there are no entry barriers to the industry;
5. The "announced nominal coverage" that was reduced from 100/80 plans to 90/70 plans is only one of several factors determining the effective coverage of the plan, as there are coverage caps for the different services;
6. There is no abuse of market power, as the new 90/70 plans are more convenient for consumers considering they limit the moral hazard problem, thus permitting the Isapres to offer these plans at a lower cost than the 100/80 plans; and
7. During the 2002-2004 period, there was an important rotation of members between the open Isapres and Fonasa and among the Isapres themselves.

IV. ANALYSIS OF THE TDLC'S JUDGMENT

It is important to bear in mind that regarding free competition, the appreciation or assessment of the evidence must take place according to the rule of reason (as opposed to the system of legal proof or appraised proof that is still prevailing in the Chilean legal system). "The rules of reason are those prescribed by logic and derived from experience, the former having permanent character and the second being variable over time and space."[6]

This approach to evidence assessment clearly delivers greater discretionary powers to judges, as it differs from the more traditional approach of legal proof, where the law determines the relative importance assigned to each piece of evidence. However, such discretionary powers do not reach the level permitted by the intimate conviction system. According to E. Couture, "Within this method (intimate conviction) the judge becomes convinced of the truth through the evidence under consideration, beyond the evidence under consideration and even against said evidence."

[5] It is interesting to note the contradiction between this argument and stating that the client portfolio forms a fundamental portion of the assets.

[6] HUGO ALSINA, TRATADO TEÓRICO PRÁCTICO DE DERECHO PROCESAL CIVIL Y COMERCIAL, (Theoretical-Practical Treaty on Civil and Commercial Procedural Law) (1956).

The rule of reason is increasingly being used in the Chilean legal system.[7] According to Joel González Castillo, four elements identify and make up the principles of rule of reason under the Chilean law: the need to adjust to the principles of logic, the experience acquired by the judges, established scientific knowledge and, finally, the need to justify the judgment by presenting the rationale and evidence that led to the conclusions.[8]

A second factor that should be considered when analyzing the judgment is that even though both a tacit and an explicit agreement clearly damage consumers and there is still a debate among economists as to whether both types of agreement should be punished or only those that are explicit (see, for example, in Motta 2004, arguments in favor of this last position), the Chilean law is clear that both types of behaviors are to be punished. Thus, Article 3 of Decree 211, when listing the practices that are contrary to free competition includes "…the express or tacit agreements between economic agents or the concerted practice among them, intended to set sale or purchase prices, limit production or assign market zones or quotas, abusing the power granted thereto by said agreements or practices."

A. The Good Reasons

1. The Relevant Market

The first controversial point between the FNE's presentation and the Isapres' defense was related to the relevant market: FNE argued that the market should be defined as formed only by the Isapres, whereas the summoned Isapres claimed that the public insurer (Fonasa) should be included. If the court had accepted the Isapres position, the summoned Isapres' market share would have been around 30 percent, which could hardly be considered a dominant market position. The court decided that the relevant market was that of the Isapres, and in this case the summoned Isapres' market share was close to 80 percent.

For this decision, the TDLC considered the statistical information available that illustrated the segmentation by income and age of Isapre and Fonasa members. Such segmentation is explained by the different nature of both insurances: Fonasa is forced by law to use a logic based on solidarity, providing a coverage that is independent from the age, sex, and number of the contributor's dependants. Also, its coverage depends inversely on the contribution made by the member, as members with higher incomes have higher co-payments. On the contrary, the Isapre system has a merely individualistic logic where people with higher income, lower risk, and less dependants can have access to a more comprehensive insurance.

The court decision also valued the report of these authors submitted by the FNE showing econometric evidence of how the probability of being affiliated to one open Isapre is lower when the insured is a woman, when he or she reports a "bad" health condition, when the household autonomous income is lower, and when the number of people in the household increases. This probability is also lower for young and elderly people.[9]

---

[7] *See* JOEL GONZALEZ CASTILLO, LA FUNDAMENTACIÓN DE LAS SENTENCIAS Y LA SANA CRÍTICA, (Judgment Rationale and Sound Criticism"), 33(1) REVISTA CHILENA DE DERECHO, pp.93-107, (Apr. 2006).

[8] According to this author, it is generally agreed that judges do not comply with this requirement of justifying the judgment: …" usually in judgments, after a simple account of the submitted evidence –that is rather a summary with the form of an analysis - followed by the generic statement 'and that having thoroughly considered the evidence', the cases are decided without further ado. This is all the reasoning that is often expressed in the text of judgments." It should be mentioned that this comment does not particularly refer to TDLC's judgments.

[9] *See* AGOSTINI, ET AL. op. cit.

Once accepted that the relevant market consists of the private health insurances, the five summoned Isapres jointly represent about 80 percent of the insured people. Consequently, as long as that there are barriers to the entry to and/or exit from the industry, the investigated Isapres would have a huge market power.

The fact that the market of open Isapres has been established as the relevant market is very important for the future. If it had been concluded that the Isapres and Fonasa belong to the same market, a door would have been opened to any type of antitrust behavior by the former, as they would not, in any way, have market power.

2. Entry Barriers

To serve as a competitive pressure dissuading potential collusive agreements, entry of a potential competitor must be sufficiently probable, timely, and sufficient in magnitude. The TDLC understands that these three conditions will not be present in the case of private health insurances. According to the court's analysis, the ability of a new agent to create attractive networks of healthcare providers for consumers could be limited by the different vertical integration degrees existing among the Isapres in the market and some relevant providers.

Additionally, building a client portfolio may be very difficult for a new agent because of two binding restrictions. First there are existing restrictions on the transfer of members, as those who have chronic illnesses are virtually incapable of switching insurers because of either a practice of excluding applicants with pre-existing conditions or just rejection; second, the transfer restriction existing for all members, who can modify their contracts only once in the year (at the annual plan renewal).[10]

The TLDC valued the simulation included in the FNE's report prepared by these authors which stated that, in the best scenario, a new Isapre would reach 7 percent of the market only after 2 years and this percentage would be between 8 and 9 percent of the market at the end of 4 years. Clearly, a new entrant could not be either timely enough or sufficiently big to dissipate market power of existing Isapres.

3. Other Market Characteristics

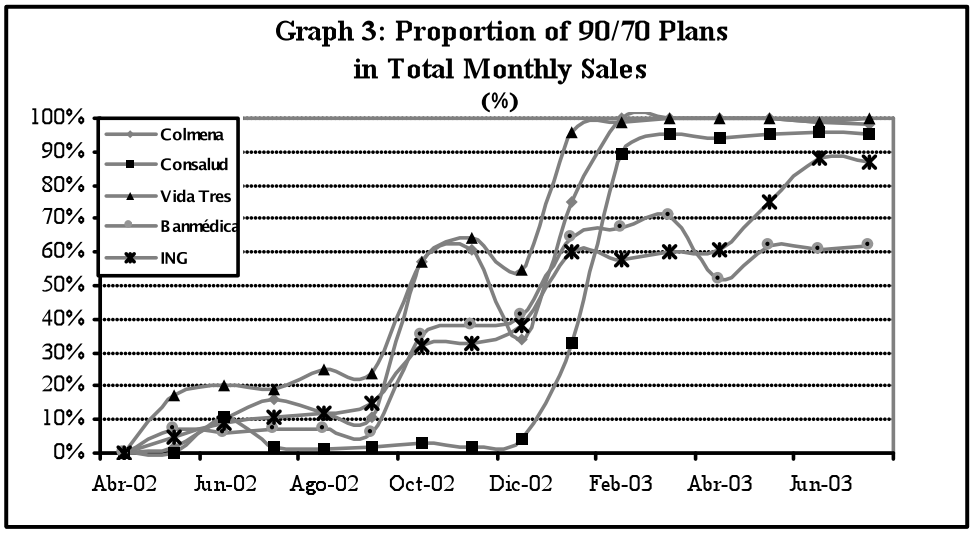
In cases of tacit collusion, it is standard to analyze the market conditions that, theoretically, would favor or impede agents from reaching collusive agreements. The TDLC recognizes three insurance market characteristics that, a priori, would facilitate collusion (in addition to the existence of entry barriers): reduced number of competitors, transparent information about available plans and prices, and frequent interaction of companies in organizations such as the Association of Isapres, e.g. meetings of managers, etc. As a matter of fact, the Isapres themselves admit copying plans and fluent communication among their sales agents.

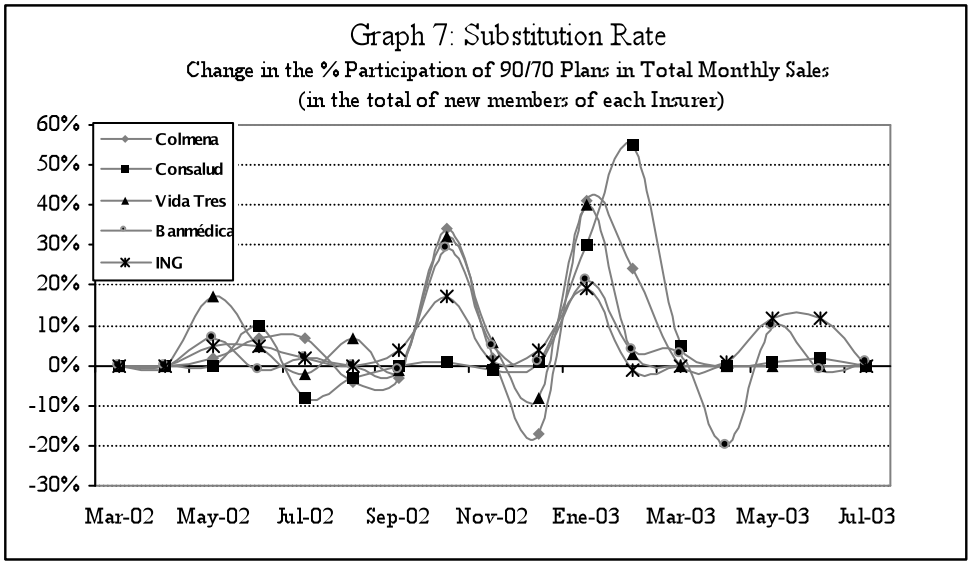
Regarding the factors that would hinder an agreement, the TDLC highlighted the asymmetries existing among the players, particularly in terms of the income segments served by the different insurers.

4. Parallel Actions

[10] In Chile, the Isapres have the right to deny the sale of health insurance to consumers. As a result they usually deny people with chronic illnesses, disabilities, and previous history of surgeries or acute diseases.

Based on the statistical information provided by the summoned Isapres, the TDLC concluded that there was actually a parallel behavior in the substitution of 100/80 plans for 90/70 plans. Such parallelism is stronger in four of the Isapres, with the substitution process followed by Consalud taking place soon after the other summoned entities. Graphs 3 and 7 of the court decision illustrate this substitution process:





Graph 7 of the judgment shows the evolution of the "substitution efforts," measured as the change from one month to the other in the sales percentage of 90/70 plans in respect of all sales. The evident coincidence during the months of October 2002 and January 2003 is, in the court's opinion, the most important sign that could lead to inferring a collusive agreement among four of the summoned Isapres.

B. The Bad and Ugly Reasons

Once verified that the Isapres behavior was "parallel" (and that they could have obtained financial benefits to the detriment of consumers based on a collusive agreement), it then must be determined whether this parallel behavior corresponds to a collusive agreement or to a

competitive non-concerted (neither explicitly nor tacitly) reaction of the Isapres. In order to distinguish between both hypotheses, additional arguments or "plus factors" that are consistent with one hypothesis but not with the other should be analyzed.

According to the TDLC, the defense submitted three arguments that would have naturally (and not concertedly) encouraged the plan substitution decision: a) The general economic crisis and the difficult situation of insurers due to an increasing loss ratio; b) the context of regulatory uncertainty; and c) everything that would have led to the need for encouraging a cultural change towards cost containment.

Generally, the TDLC judgment valued most of these arguments as follows:

1. That, although it was true there had been an economic crisis since 1997 that negatively impacted the employment rate, in the beginning of 2002 there was already some partial sign of financial recovery. On the other hand, the amount of members of the summoned Isapres who had monthly incomes over Ch$400,000 (almost US$800, which was the average of income distribution in Chile around those years) had been increasing from 1999 (this increase did not occur with members having incomes below $400,000).
2. That the "loss ratio," measured as the ratio between operating costs and operating income, showed growth in the period 1996-2002, whereas the operating results showed a decrease. In this scenario, a reduced coverage would be a rational answer in order to reduce moral hazard problems (both related to patients and doctors), and so reduce losses. According to the court, since 2002 the growth of the loss ratio in the summoned Isapres would have dropped with an important variance among Isapres.

Based on this information, it concluded that the evidence of the loss ratio does not rule out the possibility that the substitution of plans has been caused by an intention to mitigate the above-described moral hazard problems. The minority decision was in disagreement with this point and emphasized that the "loss ratio" defined by the summoned Isapres (and used in the majority decision) had no basis within the economic theory and, what is more important, its increasing trend may have been due to different reasons. A drop in the operating incomes due, for example, to the economic cycle, would lead to a higher "loss ratio" and the moral hazard problem would not have been affected in any way. Consequently, it would not be reasonable that all the summoned Isapres (the defendants) reacted by attempting to control the moral hazard problem by redesigning their plans.[11]

A more precise indicator of the changes in the relevance of the moral hazard problem is the change in the average annual number of payments by beneficiary. According to the information available in the Health Superintendency (based on non-audited information provided by the Isapres themselves), the total payments per beneficiary between 1996 and 2000 was 9.9; 10.2; 10.9; 12.3, and 13.1, respectively.

The information regarding rates of use which the court used in its judgment begins only in 2001 (there is an inconsistency between the data before and after 2001), and this makes it difficult to conclude that there was a tendency before 2002 and another one after 2002.

[11] It is interesting to highlight that the economic theory acknowledges the existence of the moral risk problem and the consequences thereof in some insurance markets for more than thirty years, thus it would be naïve to think that the Isapres "discovered" it in 2002 and adjusted their plans accordingly.

> It should be noted, however, that anything related to the loss ratio after the substitution of plans is not really relevant, as—without prejudice to the practical results (that could be affected by a number of other factors)—the reduction of coverage is an adequate answer firmly supported by the economic theory, if the intention is to reduce the rate of use of the services.

3. Regarding the argument of regulatory uncertainty, the TDLC considers that there was actually a significant uncertainty when the plans started to be substituted due to a health insurance reform proposal that, at that time, seemed to affect Isapres from several perspectives. However, in the court's opinion, it is unlikely that all of the summoned Isapres would have answered in the same way to so much uncertainty.

In favor of the main argument of the defendants stating that the plan substitution and their time coincidence was the result of their competition, the judgment used vague concepts when referring thereto as follows:

> In fact, the greater synchrony in the changes observed during the period between May 2002 and January 2003, could be explained, for example, as the result of a 'substantial adjustment process' in one of the important competition aspects of this industry, that is, the announced nominal coverage for predominant plans in the marketing strategy of each Isapre. From the data analyzed in this judgment, it is clear that the health plan substitution process strongly implemented from May 2002 to January/February 2003 was an important adjustment period in the open Isapres industry, as evidenced in the statement of the Superintendent of Health on pages 2024, 2040 bis 10 and 2040 bis 11. The adjustments implemented by the summoned Isapres in this period probably involved, in the opinion of this court, expectations of relevant financial effects. Given this scenario, a possible and even reasonable competition strategy could have consisted of (a) gradual and sequential efforts in the sale of new 90/70 plans, as a precautionary and also exploratory testing of the responses observed, a posteriori, in the market, together with (b) the exercise of a close and intensive monitoring process (which could be implemented, for example, through the delivery of contractual incentives to the staff retained as sales teams) of the substitution and sale rates (intensities) of the new 90/70 plans; and all this, by accepting the possibility that the removal of the 100/80 plans could have mean, foe each summoned Isapre, a competition strategy and not necessarily collusion, given the change and adjustment processes effective at that time on the side of the supply (costs) and demand (the latter related to the economic cycle phases and the improvements gradually introduced in the plans offered by Fonasa);

Several issues need to be highlighted regarding the change processes on the demand side, as admitted by the court. At the beginning of 2002, there were already signs of economic recovery, so it is not obvious that this was the time to introduce lower-quality and lower-price plans (than that which, according to the Isapres, should have been the price in the case of 100/80 plans if they were honest about their costs). Less evident is that, given the quality improvements of the plans offered by an alleged competitor (Fonasa), the response would be that of making their own plans worse! This reflects a contradiction between some of the arguments posed by the Isapres and it is surprising that the majority vote of the TDLC accepted this contradiction. Regarding the "gradual efforts in a way of a precautionary and exploratory testing of the responses observed by the market together with the exercise of a close and intensive monitoring process of the substitution plan rates," it is not clear whether the judgment refers to the responses on the demand side or on the supply side, i.e., the remaining competitors.

An essential element of the analysis should be whether or not the actions of the companies were the best feasible responses, regardless of the reaction of their competitors.

In other words, if the coverage reduction by one company was optimal only to the extent that competitors followed behind, the basis of the competition hypothesis becomes automatically an argument in favor of collusion. The judgment is not clear in this regard:

> … both in the collusion hypothesis and in the oligopolistic interdependence, and irrespective of the reasons the Isapres might have had to do so, this court may establish that the substitution of the announced nominal 100/80 coverage plans for those of 90/70 coverage was mutually convenient for the Isapres.

However, the rationale of these statements is not clear. The fact that the actions were consistent with the collusion hypothesis is evident: If a relevant group of companies reduces the quality of the product they offer without lowering the price (and there are entry barriers and the demand for the product is relatively inelastic), their profits should increase. This is precisely the reason why the firms have incentives to collude.

The reason why this could not be true if the firms compete is related to the loss of market share by the firm that started the quality reduction in the health insurances offered. However, this point was not analyzed by the court.

At this stage of the justification, the judgment is simply incorrect. The court considers that if a firm decides, in an uncoordinated way, to reduce its health plan coverage in the hope that the other companies will "follow" behind, but knowing that if it is not imitated by the "competitors" it may revert its action without facing excess costs, this would not be collusion. Citing the verdict once again:

> Thus this Court deems it plausible to think that all Isapres may have reached the same conclusion [that the substitution of 100/80 plans would be convenient] and that, under the circumstances, one Isapre, without the need for coordination, could have started to reduce the announced nominal coverage being assured that the other Isapres would follow behind, as it would be convenient for them to do so, and this is exactly what has happened;
>
> That the possibility that this has happened is reinforced by the fact that, considering that the replacement of plans with nominal 100/80 coverage was a process that lasted over a relatively long time, the company that had started such replacement, would have had the opportunity to analyze the competitors' reaction and, if the remaining Isapres would have reacted by maintaining their 100/80 plans, the cost assumed and accrued up to then to restart marketing those plans would not have been really relevant, and this is precisely the result of the gradual and precautionary character of the strategy followed to substitute the supply of 100/80 plans for new enrollments. Indeed, the gradual replacement of the 100/80 plans by 90/70 plans could have been explained by the fact that the company that started such change wanted to know the competitors' reaction before speeding up the process;"

The decision thereafter continued:

> That it can be inferred from the foregoing that the substitution of the 100/80 plans could take place if the company that started this replacement became convinced that its competitors in this segment would follow behind or that, otherwise, it could go back to offer 100/80 plans to the new enrollments, without suffering in the meantime very substantial losses. Such assurance could have

> arisen from a collusive agreement opposed to free competition or from an analysis of the strategy that it thought the competitors would follow, although in this case there would be a higher risk involved. Therefore, the mere parallelism does not permit to verify the collusion subject matter of the injunction;

It then concluded that the proceedings did not show evidence that the occurrence was the consequence of a collusive agreement or of oligopolistic interdependence. The problem is that this hypothesis of oligopolistic interdependence is tacit collusion. The behavior described by the court is that of a company sending a signal for its competitors to coordinate in a market equilibrium more convenient for them. The economic theory, based on the development of game theory, systematically shows how such behavior permits to sustain market equilibria with prices above the competitive ones. Again, it is surprising that the Court implicitly ignores the basic economic theory without solid arguments to the contrary.

In Agostini et al. (2008) three "plus factors" are presented that, in our opinion, are consistent with the collusion hypothesis and not with that of competition:

1. During the period of plan substitution, the colluded companies reduced their expenditures in advertising and sales force, which would respond to a strategy of not "stealing" clients from competitors in the period when the traditional plans were replaced by other plans with lower coverage. However, if, as the Isapres have stated, the plans were innovative and definitively benefited insurers and the Isapres were competing with this new product, one would expect an increase (or at least not a reduction) both in marketing and in sales force expenses;
2. In the period after the alleged collusive agreement, both the summoned Isapres and those that were not involved in alleged collusive agreement had an increase in their profitability, measured as the operating margin rate. This is typical of collusive agreements (those who do not sign the agreement are the most benefited) and is inconsistent with the competition hypothesis (the companies that innovate should obtain better results than the others); and
3. During the plan substitution period a reduction was observed in the rates of member rotation within the summoned Isapres as compared to the same rate of the non-summoned Isapres. Beyond the diversity of variables where Isapres may compete, if they effectively do so, this should be reflected in the amount of members that are "stolen" from one another. This indicator, for the group of summoned Isapres, began to decline in the period of plan substitution.

Regarding the first of these elements, the majority decision considered that indeed these expenses should theoretically have not decreased, but the behavior in terms of advertising expenses within the group of summoned companies is heterogeneous and, as the FNE's study shows, it had been dropping since before 2002.[12] It should be noted, however, that the TDLC's analysis omits the fact presented by the FNE's study that, more important than the reduction evidenced since 1999, there was a downward structural change during the second quarter in 2002; a change in the level of these expenses in the summoned companies that did not occur in

[12] According to the minority decision, the fact that Consalud and ING (contrary to the other summoned Isapres) had increased their advertising is explained by the fact that Consalud would have not taken part in the collusive agreement (the court agrees with this point) and ING could have transitorily broken the agreement (accepting that there is no evidence in this respect).

those companies that are not summoned. Regarding the expenditure in sales force, the tribunal considers that it shows a homogeneous behavior that declined in 2002, but not in 2003.

Thus, the judgment came to the conclusion that:

> The preceding data could, in principle, be consistent with the hypothesis of a concerted action or collusive agreement amongst the summoned companies, especially during 2002, not only in terms of announced nominal coverage but also regarding their respective expenditures in advertising and sales force. Nevertheless, and as it has been previously argued, it is also possible to think of a group of other relevant factors that could additionally condition the optimum levels of these expenses, over which no information whatsoever is stated in the proceedings. Consequently, it is the opinion of this Court that, based on the data analyzed so far, it cannot be categorically concluded that the similarities in the observed behaviors of the summoned Isapres in terms of expenditures in advertising and sales force, especially during 2002, are necessarily a consequence of the alleged collusive agreement amongst the Isapres.

This argument is vague and incorrect; the judgment rationale ignores the nature of the econometric evidence submitted. The econometric analysis presented in the FNE's report compared the group of summoned and non-summoned Isapres and its control was based on specific variables of each Isapre that did not change during the period of analysis. In other words, in order to invalidate the FNE's analysis, "the group of other relevant factors that could additionally condition the optimum levels of these expenses, and on which there is no information whatsoever in the proceedings" should be factors that affect only the summoned Isapres and not the others, and factors that coincidently appeared during the second quarter of 2002. It seems reasonable to suppose that, if such specific and exonerating information were available, it should have been provided by the summoned companies.

Furthermore, according to the rule of reason, the majority decision should argue which group of relevant additional factors would condition the optimum values of these variables; otherwise, it is impossible to compare them against the remaining evidence and submit the argument supported by the judgment to the rules of logic.

The strength of the results showed by the report that we prepared for FNE regarding expenses in advertising and sales force is criticized in a Consalud's report supported by the court. According to the judgment, this report shows similar results to those obtained by FNE if the structural change date is proposed in any quarter between the last quarter of 2001 and the first quarter of 2003 and, also, if the groups of colluded and non-colluded Isapres are "reorganized." Thus, it comes to the conclusion that the results of the FNE's report do not permit indentifying the companies that took part in the alleged agreement.

This is correct, but this is not and cannot be the purpose of the exercise. The identification of the summoned Isapres and of the structural change date is derived from the observed plan substitutions and it is to be expected that if the breakpoint period is changed, and if the composition of the groups is slightly altered (by exchanging one company in each group), results are similar.

The cited robustness exercise is based on 15 alternative setups of the groups of 5 Isapres (those summoned) and 3 not summoned. Of course, one should wonder (although the tribunal did not) about the robustness exercise: exercises were submitted for only 15 alternative setups of the possible 55… Why did both the Consalud's report and the court's analysis omit 40 of the 55

setups? And the evidence regarding the operating margin rate? And the evidence regarding the transfers of members?

The FNE's report shows that the operating margin rate of the summoned and non-summoned Isapres increased after the plan substitution had been implemented.

The TDLC does not pronounce on this additional factor. It does examine the "loss ratio" defined above, which is clearly related to the operating margin rate that we analyzed in the study,[13] but the court's analysis considers the evolution of the "loss ratio" before 2002 as a possible justification of the change of plans introduced, and the subsequent evolution as indicative of the possible success of controlling the moral hazard problem. The analysis we made in the study compared the evolution of the operating margin rate of the summoned and non-summoned Isapres. What we found is that both increased after this alleged agreement, which is consistent with the collusion hypothesis and inconsistent with the competition hypothesis.

Regarding the rate of transfer of members, the collusion hypothesis states that the transfer of members within the summoned companies should have declined, as this is a variable of results that reflects the intensity applied to competition by the Isapres, even though it is not known at which point they compete. On the contrary, if the competition would have been equally intense during the period of the alleged collusion, then the transfer rate should not have changed.

The results submitted show a reduction that is consistent with the collusion hypothesis. The exercise controls the situation based on each company's characteristics, seasonality, trends, and shocks that could have impacted the entire industry. It does not control, however, any generic or asymmetric factors that, in a context of uncertainty, could have affected the summoned Isapres and not the other Isapres just around the second quarter of 2002, although it is difficult to imagine which such a factor could be.

The majority decision, violating the duty imposed by the rule of reason, did not pronounce on the evidence submitted about the reduction in the transfers of members within the group of summoned Isapres. Neither did the dissident judges.

V. THE VERDICT OF THE SUPREME COURT

On January 28, 2008, the Third Room of the Supreme Court rejected the FNE's appeal against the TDLC judgment, by three votes against two.

The majority vote not only accepted the thesis of absence of solid collusion evidence, but also punished the TDLC judges due to "…an inappropriate lack of certainty in the rationale that should support the resolutions adopted by the judges of the Republic." (Article 11 of the verdict). Thus, the Supreme Court opted to follow the Chilean code of criminal procedures as the way of requiring concrete evidence, and did not leave any room for using the principle of rule of reason to appreciate the evidence. According to the majority vote, "…in order that the evidence involved may produce full probationary value, it is necessary that it meets the requirement of being direct, and as this is not the case, it is mandatory to conclude that it is not capable of demonstrating the aforesaid concerted action." (Article 15 of the verdict).

Although the Supreme Court's judges' view of how a free competition case should be judged is worrying, both judges that issued the minority vote, however, adopted the rule of

[13] This is equal to the result of the difference between operating income and operating costs and operating income.

reason to appreciate several evidences based on their merits, without disregarding such evidences that could indirectly prove a collusive agreement. In fact, the minority vote stated: "…the requirement of agreement or concerted practices among economic agents may be verified by a direct or indirect evidence as established in article 22 second paragraph of Decree Law N°211, all of which is related to the assessment of evidence according to the rule of reason system established in the final subparagraph of the aforementioned article."(Article 8 of the verdict).

In harmony with that appreciation, the minority vote stated:

> That it is deemed proved that Isapre ING S.A.; Isapre Vida Tres S.A.; Isapre Colmena Golden Cross S.A. and Isapre Banmédica S.A. simultaneously started the substitution of plans, with an evident parallelism in the rate of replacement of said plans, added to a remarkable reduction in the intensity of competition by the players, reflected in a decline of the expenses in advertising and sales force; considered as a group, these facts may only be explained by the existence of an agreement among the four summoned Isapres mentioned above. (Article 4 of the Supreme Court verdict).

In summary, three of five judges opted for the requirement of direct evidence, whereas the minority considered that the appreciation of direct and indirect evidence is adequate and pursuant to Law. If the minority had decided, at least four of the five summoned companies would have been found guilty of collusion regarding the health insurance plans offered.

VI. CONCLUSION

In Chile, much progress has been made in the last years to improve the institutional character and capacities of the entities in charge of ensuring free competition. Among this progress, the creation of the Free Competition Court, which replaced the Central Preventive and Resolving Commissions, should be highlighted. Contrary to the old commissions, the new Court has expert judges (attorneys and economists), elected by public contest based on their merits, who also devote part-time to their task as judges and are remunerated, (as opposed to the old members of the Preventive and Central Commissions who were appointed by the Government or elected by drawing lots, worked without remuneration, and devoted only a few hours in the week to this task).

However this verdict shows that there is still needed improvement, particularly regarding punishing collusive practices. Because agreements between companies to set higher prices or lower qualities (than those that are perfectly competitive) are difficult to detect , collusion poses a greater challenge for the antitrust policy.

Lessons can be inferred in two fields. First, it is necessary to have a National Antitrust Prosecutor with the capacity and attributions to pursue cartels and deliver hard evidence about collusive agreements whenever they exist (recording of conversations, e-mails, faxes, hard-disk files of companies' officers, etc.). Second, the decisions of the Free Competition Court should effectively apply the rule of reason to all the evidence and arguments used in the case, use state-of-the-art economic analysis (and not contradicting the most basic theories thereof), and justify their rulings in ways consistent with the logic.

In this regard, the minority decision itself criticizes the judgment when it states that the majority decision does not show a single explanation, alternative to that of collusion, which justifies the verified facts when looked in a competitive environment. Instead, the majority

justified their decisions by different hypotheses and, in the opinion of the minority judges, such hypotheses were not only very implausible but were also inconsistent with each other.

Regarding the first lesson, in 2009 a legal reform of the Competition Law finally allowed the FNE to conduct dawn raids, carry out unannounced inspections, seize computers and documents, and intercept communications. Additionally, a leniency program was created to reduce penalties for the first firm that reports and provides evidence of a cartel. None of these new tools have been used yet and, therefore, it is impossible to evaluate their success in detecting collusive agreements.

Finally, it is important to mention that the Senate is currently discussing whether or not penalties for collusive agreements should include imprisonment. Currently, penalties are only monetary, so the addition of imprisonment might significantly reduce the incentives to form a cartel. The main concern, however, is that the Court would rise the standard of proof required to condemn collusive agreements.