Compulsory Insurance of Loss to Property caused by Natural Disasters: Competition or Solidarity?

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There are three types of public intervention to make sure that property damage caused by natural disasters is compensated: ad hoc solutions, payments through compensation funds, and a compulsory catastrophe extension of property insurance contracts. The best known example of the latter approach is the French law, which imposes a mandatory catastrophe insurance on all owners of property (tying clause), fixes the premiums and arranges re-insurance by the State. This French scheme creates distortions that competition law is willing to prevent and it is also at odds with the principles of the group exemption for the insurance industry. However, both efficiency reasons and grounds of national solidarity may provide powerful arguments to justify a compulsory catastrophe extension of voluntarily subscribed property insurance contracts. The concerns about competitive distortions are legitimate but should be discussed in a broader social welfare context. Since pure forms of public intervention (ad hoc solutions and compensation funds) provide insufficient incentives for risk prevention and mitigation of losses, forms of public-private cooperation that avoid the latter efficiencies may generate benefits outweighing the costs of anti-competitive distortions.

I. INTRODUCTION

Natural disasters, such as floods and earthquakes, may cause very substantial physical injury and property damage. The harm caused will only partly be covered by social security and tort claims. This article focuses on property damage, which is not compensated by social security schemes and for which no tort claims can be filed, since no liable wrongdoer can be identified. In European countries, specific disaster laws provide different schemes, according to which victims can claim compensation for property damage caused by natural disasters. Three types of public intervention exist: compensation by the State after the occurrence of a specific disaster (ad hoc solutions), payments through compensation funds and a compulsory catastrophe extension of voluntarily subscribed property insurance contracts. Whereas the first two schemes are exclusively based on public intervention, the third scheme leaves an important role to private market players and stipulates the conditions of public-private cooperation for compensation of catastrophic loss.1 When market forces are introduced in traditional government activities, the question emerges whether the rules of competition law will be applicable.

The applicability of the competition rules to public-private compensation schemes has become an important issue on the political agenda, since the existing public law

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1 Below, only a short characterisation of the different schemes is provided. A detailed description of the various legal systems can be found in M. Faure and T. Hartlief, (Eds), Financial compensation for victims of catastrophes: a comparative legal approach, Vienna, Springer, 2005, forthcoming.
instruments have been criticised for their counterproductive effects on the prevention of catastrophic loss. This criticism applies to both compensation funds and ad hoc solutions. Both mechanisms distort incentives of victims to take preventive measures and impede the development of market solutions. By contrast, insurance solutions have been favoured because they keep incentives for prevention intact and allow for an adequate risk differentiation. However, private insurers may be unwilling to offer insurance coverage if the risk cannot be spread in a satisfactory fashion. Two problems may arise. First, if insurers can identify high risks, they may be unwilling to offer insurance coverage if the group of insured is too small to be able to profit from the law of large numbers. Second, if insurers cannot perfectly distinguish between low risks and high risks, adverse selection will occur if only the less desirable risks and the highest expected losses seek disaster coverage, whereas the low risks do not subscribe to such insurance contracts. If the problem of adverse selection cannot be overcome, private insurers may decide to reduce the extent of the insurance cover or withdraw from the insurance market altogether. These problems are overcome by the French law, which has introduced a compulsory catastrophe extension of voluntarily subscribed property insurance contracts.2 Unfortunately, the French scheme generates anti-competitive effects that competition law is trying to prevent. Tying clauses impede competition on the market for disaster insurance, limit consumer choices and may also negatively affect the competition on the market for property insurance. Also, an analysis of the current EC group exemption for agreements in the insurance industry3 makes clear that the main features of the French compulsory insurance scheme for catastrophic loss are at odds with the goal to achieve competitive insurance markets. For these reasons, the Italian Competition Authority has voiced a negative opinion on the proposal to introduce a compulsory catastrophe extension of fire insurance policies in Italy.4

Obviously, the rules of competition law concern only the conduct of undertakings and not legislation adopted by Member States. Insurance companies may therefore invoke the State compulsion defence, according to which there is no infringement of the competition rules if a certain anti-competitive action is required by mandatory law. However, in such a case the liability may shift to the State since, according to settled case-law of the Court of Justice, Member States may not introduce legislative measures, which may render ineffective the competition rules applicable to undertakings. State legislation which requires a compulsory extension of voluntarily subscribed first-party insurance reduces competition in insurance markets and causes distortions similar to the anti-competitive effects that the competition rules are trying to prevent. In the area of public-private cooperation, it may be difficult to draw the borderline between

sovereign State action that blocks the applicability of the competition rules and State action that is guided by industry considerations and infringes the competition provisions of the EC Treaty. Even though the State does not explicitly legalise a prohibited cartel agreement, the public regulator may be inspired by cartel-like considerations of the insurance industry that favour anti-competitive measures. Hence, difficult questions arise with respect to the liability of the State for potential infringements of the rules of EC competition law.

In spite of its anti-competitive effects, a duty to buy insurance coverage for catastrophic loss imposed on low-risk groups (or even on individuals who are not exposed to the risk) may nevertheless be justified. Without such a duty to insure, only high risks may decide to buy insurance coverage for natural disasters and the risk may become uninsurable. A compulsory catastrophe extension involves a cross-subsidisation of high risks by low risks: it avoids adverse selection and may be justified also on grounds of national solidarity. In European law, solidarity has been constructed and categorised as a qualified derogation to the full applicability of the competition rules. In the case-law of the European Court of Justice, the applicability of the rules of competition law has been put aside in order to achieve a high level of social protection in the field of health services and pension schemes. This exploratory article broadens the debate on the scope of the solidarity exception by including another ambition of the modern welfare state. Citizens may expect State assistance whenever they are in serious difficulties. This includes not only medical treatment in case of illness and the payment of an adequate pension, but also financial assistance in case of harm caused by catastrophes. In each of these cases, the goal to achieve competitive markets may collide with the goal of the welfare state to provide assistance to citizens in serious difficulties. Since the State increasingly relies on private actors to realize its ambitions in several areas, including health and public safety, pure forms of public intervention will gradually be replaced by regulatory interventions in private markets, which create a framework for public-private cooperation. The increasing popularity of the French scheme in European countries reflects this tendency. The concerns about anti-competitive effects that such a scheme creates may be legitimate, but should be discussed in a broader social welfare context.

This article is structured as follows. In Section II, the different schemes for compensation of property damage caused by natural disasters are described. The traditional forms of public intervention, which provide compensation to victims of natural disasters, are analysed and compared with the alternative approach of a compulsory catastrophe extension of first-party property insurance contracts. Particular attention is given to the French scheme of compulsory disaster coverage. In Section III, arguments are advanced to support the superiority of insurance solutions over governmental relief: whereas the former provide incentives to take efficient preventive measures and allow for an adequate risk differentiation, the latter approaches may have negative effects on the total accident costs caused by natural disasters. However, insurance solutions may no longer be the preferred option if there is insufficient
competition in private insurance markets. In Section IV, it is argued that the French insurance solution causes anti-competitive effects. These consequences are at odds with the goal to achieve competitive insurance markets. The French law generates anti-competitive effects that competition law is willing to prevent: for example, tying clauses are outlawed by Article 81 of the EC Treaty and not covered by the group exemption for the insurance industry. It is also investigated under which conditions French insurance companies may escape from antitrust liability by profiting from the State compulsion defence. The last question addressed in Section IV relates to the potential liability of the French State for having introduced a law that makes the competition provisions of the EC Treaty ineffective. Section V of the article re-assesses the anti-competitive consequences of a compulsory catastrophe extension of first-party property insurance. It is examined whether these restrictions (in as far as they are based on underlying agreements between insurance companies) could be exempted from the ban of Article 81 of the EC Treaty by way of an efficiency defence and, if this is not the case, whether they should profit from a broadly interpreted solidarity exception. In the absence of existing case law on these issues (with the exception of the opinion of the Italian Antitrust Authority), this last section of the article should be seen as a thought experiment. Its goal is to broaden the debate on the compensation of property damage caused by natural disasters by balancing the anti-competitive effects, the efficiency advantages and the solidarity features of a compulsory catastrophe extension of property insurance contracts. Finally, some conclusions are presented.

II. THREE DIFFERENT SCHEMES FOR COMPENSATION OF PROPERTY DAMAGE CAUSED BY NATURAL DISASTERS

Three different types of disaster coverage exist in Europe. The first scheme awards compensation to victims on an *ad hoc* basis. Under this approach, after the occurrence of a disaster the government officially declares that this event is a “catastrophe” and specifies the conditions under which victims can obtain monetary relief. Such *ad hoc* solutions are applied in several countries, including the Netherlands, Germany, Italy and Sweden. In other countries a structural solution has been worked out in the form of a disaster fund. Under this second scheme, public action is taken *ex ante* rather than *ex post*. The legislator does not wait to intervene until after the occurrence of catastrophes, but creates a fund that will compensate victims of a disaster (for a limited amount of the harm suffered) according to a previously determined procedure. An example is the Belgian Disaster Fund Act of 1976. A similar model equally exists in Austria.5 A completely different approach is a regulatory intervention in private insurance markets, which imposes a duty on persons who voluntarily subscribe to a property insurance policy to purchase a catastrophe extension. The best known example is the French

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scheme, which takes the form of mandatory disaster coverage for potential victims who have already subscribed to first-party property insurance. Consequently, damage to houses and cars will also be covered if it is caused by natural disasters, such as floods, earthquakes, heavy snowfalls and storms. The French solution has been introduced in Belgium in 2003, and it has been proposed also in other European countries (including Germany and Italy). More detailed information on these different schemes is provided below.

In a first approach, the government has not designed a structural solution to the benefit of victims of catastrophes and steps in only on an ad hoc basis. After spectacular disasters the public pressure on governments will be high, particularly when the number of victims is large. In those cases politicians may ex post decide to make large amounts of the public budget available for compensation purposes. The amounts of compensation and the procedure to obtain monetary relief from public funds can be quite different in every specific case. An example of the ad hoc approach is the German Flutopferhilfesolidaritätsgesetz of 2002. Large floods of the Elbe river had caused 30 deaths and a total damage of 8.1 billion Euros. The federal government and—to a limited extent—the State of Sachsen intervened to provide compensation up to 7 billion Euros. Ad hoc solutions have also been chosen for man-made disasters, which are not discussed in this article.

In a second approach, the government installs ex ante a compensation fund that has as its primary goal to provide ex post relief to victims of a disaster. The Belgian Act of 12 July 1976 concerning the compensation of damage caused to private property by natural disasters provides a good illustration of such a fund solution. The Act stipulates under which conditions catastrophes can be officially recognised as a disaster by means of a royal decree. After such a recognition, monetary relief (although not full compensation) will be provided for damage caused to private property as a result of the natural disaster. Victims will have to contribute to the loss themselves up to an amount of 250 Euros. Since 1976 the Belgian fund intervened approximately 40 times for a total amount of 250 million Euros. The Belgian compensation fund is completely financed through the public purse. Compared to the compensation paid under ad hoc solutions, such as in Germany after the Elbe flood in 2002, the amounts paid out by the Belgian fund during its 25 years of existence are relatively modest. The recent legislative change (May 2003), which has partially adopted the French solution of a mandatory catastrophe extension of voluntary property insurance polices, is discussed below.

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6 In the Netherlands an Act concerning the compensation for disaster damage of 1998 stipulates that, if the government judges that a specific situation is a disaster, specific financial relief will be provided through the public purse. After some recent large disasters (for example, an explosion in a fireworks factory nearby Enschede and a fire on New Year’s eve in a café in Volendam) substantial amounts were made available by the Dutch government for the relief of the victims and their relatives. Similar solutions are applied in other countries. Swedish victims of disasters usually rely on the social security system and on voluntary private insurances. However, the government may step in to help victims. For instance, after the large fire in a discotheque in Gothenburg in 1998, as a result of which 63 young people died and 200 were injured, specific government relief was provided.
The third approach is best represented by the French scheme of mandatory disaster insurance coverage. This scheme is usually advanced as a point of reference by countries, which consider replacing or complementing forms of public intervention by private market solutions. The main features of the French system are the following. Since 1982 all individuals who have purchased first party property insurance must pay a supplementary premium for a mandatory coverage of natural disasters. Hence, there is no generalised duty to insure catastrophic risks, but a compulsory coverage extension of voluntarily subscribed property insurance contracts. Property damage policies in France are widespread and, consequently, a large group of individuals are forced to pay an additional amount for the coverage of natural disasters. The supplementary coverage for catastrophic loss is financed through an additional premium of 12 percent on all property insurance contracts. The mandatory coverage is applied to all insured individuals, irrespective of whether they are particularly vulnerable to natural disasters and thus exposed to the insured risk. Reinsurance is provided through the Caisse centrale de réassurance, which is fully controlled by the French State. After the explosion in Toulouse (in the AZF-factory) on 21 September 2001 a legislative change was effectuated in July 2003, as a result of which owners of property insurance now also possess coverage for damage caused by technological risks. Again, additional compulsory disaster coverage is linked with voluntarily subscribed first party property insurance. The latter extension is, however, debated in France. The point is made that it is not clear why in the case of man-made technological disasters, where a liable wrongdoer can be identified, a mandatory coverage for victims had to be introduced. Imposing solvency guarantees on the side of the wrongdoer, such as compulsory liability insurance, has been suggested as a preferable solution.

The French scheme is becoming increasingly popular in Europe: compulsory insurance for catastrophic loss has been introduced in Belgium and other countries (such as Italy) are considering similar changes of their current systems of compensation. In May 2003, Belgium replaced the compensation fund solution by a property insurance scheme. The new Belgian scheme looks like the French one, but there are two major differences. A first difference is that the Belgian Act relates only to the risk of floods. A second difference is that the mandatory supplementary coverage, which is to be included in fire insurance policies, applies only with respect to specifically designated risk areas. The insurance premium is to be differentiated taking into account the characteristics of the different risk regions. The rationale of the Belgian rules is that only those who are exposed to the risk of floods should bear the costs of the additional premium. However, as a result of difficulties in designating the specific risk areas, the new Act has not yet entered into force. In Italy, the discussion regarding the reform of the disaster recovery system began in 1997. The latest Italian proposal, which was a part

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7 See for more information: O. Moréteau, M. Cannarsa and F. Lafay, as note 2 above.
8 Ibid., nr. 51.
9 For more detailed information on the Belgian law, see I. Durant, Belgium, in M. Faure and T. Hartlief (Eds), as note 1 above.
of the draft of the Budgetary Law for 2004,\textsuperscript{10} provided for compulsory coverage of natural catastrophic risks tied to voluntarily subscribed fire insurance policies. At a first stage, the compulsory extension would apply only to new insurance policies entered into by private businesses and individuals after the enactment of the new law, and later on it would be extended to all existing policies. Insurance premiums would be defined on the basis of different indexes reflecting the degree of risk in different areas of Italy. The draft also provided for rules relating to the contract terms, including deductibles and modalities of compensation. In addition, the draft imposed the establishment of a co-reinsurance consortium, which would be responsible for the collection of premiums for natural catastrophic risk coverage. Finally, the draft provided for a yearly maximum indemnification cap, beyond which the Italian State would cover any residual compensation not paid by the consortium.\textsuperscript{11} The Italian Antitrust Authority severely criticised the restrictions of competition contained in the proposal and, ultimately, the draft was not approved by the Italian Parliament.

III. GOVERNMENTAL RELIEF VERSUS PRIVATE INSURANCE

Several authors have criticised the existing forms of governmental relief for victims of natural disasters. A first set of objections has been formulated in the Law and Economics literature: these criticisms relate to the negative effects of governmental relief on the incentives of potential victims to take preventive measures in order to avoid the harm and to mitigate the loss. A second set of objections has been formulated by lawyers: they are mostly concerned about the unequal treatment of victims under ad hoc solutions.

Legal economists emphasise the advantages of private insurance over compensation through the public purse. First-party insurance guarantees that the victims themselves pay, in advance, for the protection they subsequently obtain. Moreover, through an adequate risk differentiation first-party insurance may have preventive effects. In the sphere of flood insurance, one can think of risk differentiation whereby good risks taking adequate preventive measures are rewarded with lower premiums and bad risks (those who choose to build a house near to a river) are punished with higher premiums.\textsuperscript{12} By contrast, governmental relief programmes negatively affect the incentives of the market to develop insurance solutions.\textsuperscript{13} Endres, Ohl and Rundshagen indicate that compensation by the State dilutes any incentives to "self insure" by victims or to take preventive measures in the framework of an effective risk management. Those who can be certain that they will be compensated by the State can

\textsuperscript{10} Article 40 of the proposed budgetary law for 2004 (Lege finanziaria 2004).
\textsuperscript{11} See for more information on the various Italian proposals relating to catastrophic risk coverage: A. Monti and F. Chiaves, Italy, in M. Faure and T. Hartlief (Eds), as note 1 above, nr. 9.
keep the insurance premium in their pocket and hence free-ride on the State.\textsuperscript{14} Harrington argues that there is a relatively low demand for disaster coverage precisely since victims count on \textit{ex post} compensation by the government.\textsuperscript{15} Forms of governmental relief have also been insufficiently able to provide incentives for prevention in the same way as risk differentiation by private insurance companies does.\textsuperscript{16} If the State provides compensation \textit{ex post}, this will dilute the \textit{ex ante} preventive effect that one would normally expect from differentiated insurance premiums.\textsuperscript{17} In sum, compensation of catastrophic loss by governments makes it harder for insurance markets to function and market failure becomes a self-fulfilling prophecy as a result of misguided regulation.

The Law and Economics literature further advances specific criticisms concerning the use of compensation funds.\textsuperscript{18} It is argued that there are not good reasons why, if both private insurance and compensation funds are available, a compensation fund would provide better protection against insolvency than private insurance markets. Insurance, so it is generally held, better enables an adequate risk differentiation and risk spreading.\textsuperscript{19} Moreover, if insurance markets are competitive, insurers can be assumed to be better able to deal with moral hazard and adverse selection than the administrators of a compensation fund.\textsuperscript{20} Therefore, a compensation fund only comes into the picture if insurance markets are not able to provide coverage for certain risks. But as it follows from the above arguments, the preferred solution would be to examine first whether the functioning of insurance markets can be facilitated.

Also the legal literature has advanced criticisms on the current systems of governmental relief. Lawyers stress that the \textit{ad hoc} solutions create legal uncertainty. For one catastrophe an \textit{ad hoc} solution may be introduced, but for another not.\textsuperscript{21} German legal scholars hold that, on the one hand, the German legislator provided very generous compensation for the victims of the Elbe flood in 2002 (up to 7 billion Euros), but that this, on the other hand, created a great inequality \textit{vis-à-vis} other victims of catastrophes.

\textsuperscript{17} Kunreuther, however, points out that there is no empirical evidence that victims refuse insurance coverage because they would count on \textit{ex post} government relief. He advances other reasons for a lacking demand for disaster coverage (H. Kunreuther, \textit{Mitigating disaster losses through insurance}, Journal of Risk and Uncertainty, 1996, p. 177).
(or other accidents), where this *ad hoc* generosity does not apply. Not only is there a possible violation of the equality principle in applying *ad hoc* solutions, but also procedures and amounts of compensation will be different for every *ad hoc* case. Lawyers therefore plead, in the interest of victims, for a uniform and structural arrangement, so that victims know with certainty whether they will be entitled to compensation after a catastrophe. Remarkably, it is precisely this certainty that economists would like to avoid, since it dilutes incentives to develop adequate market solutions. Schwarze and Wagner indicate that, on this point, there is a crucial difference between the economic and the legal approach. Law and Economics scholars suggest denying help to individuals living in risky areas, in order to provide them incentives to develop insurance solutions themselves. However, this strategy would probably be incompatible with the concept of the welfare state as this is interpreted in most Member States of the European Union.

IV. COMPULSORY DISASTER COVERAGE: ANTI-COMPETITIVE EFFECTS AND COMPATIBILITY WITH RULES OF EC COMPETITION LAW

A. RESTRICTIONS OF COMPETITION RESULTING FROM A COMPULSORY CATASTROPHE EXTENSION OF FIRST PARTY PROPERTY INSURANCE

The arguments in favour of insurance solutions discussed in the previous section assume that insurance coverage can be made available through competitive insurance markets. If this condition is not met, insurance schemes are no longer a perfect method for compensating harm caused by natural disasters. Regulation of insurance markets may create distortions reducing the superiority of insurance solutions over governmental relief. The French mandatory disaster insurance scheme generates anti-competitive effects that competition law is willing to prevent.

First, the extension of voluntarily subscribed first-party insurance is achieved by a tying clause. Tying occurs if a supplier who is selling two products makes the sale of one of these products to a particular buyer dependent upon the purchase of the second product by the same buyer. Tying is mentioned explicitly in Article 81(1)(e) of the EC Treaty as an example of prohibited agreements. The cartel prohibition outlaws agreements that "make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts." Tying may also be

25 R. Schwarze and G. Wagner, as note 12 above.
prohibited as an abuse if the firm imposing tie-in contracts enjoys a dominant position. Article 82(d) of the EC Treaty contains a list of examples of abuses of a dominant position and outlaws tying by using the same wording as Article 81(1)(e) of the EC Treaty. The consequence of the legal duty to extend the coverage of property insurance to catastrophic loss is that all insurance companies will have to insert such extension clauses in their policies. Since insurers are not left free to offer property insurance without the extension for catastrophic loss, the effects of the legislative measures are similar to those of prohibited cartel agreements that impose tying clauses.

The overwhelmingly negative attitude towards tying in competition law has its origin in the "leverage theory", which holds that a firm having a dominant position in the market for the tying product uses tying arrangements to extend its dominant position into the market for the tied product. As a consequence, there are two deadweight losses and a dominant firm obtains a monopoly profit twice. In the context of this article, this argument would be relevant when competition on property insurance markets was seriously limited and tying property insurance with disaster insurance could be qualified as an abuse of a dominant position held by a property damage insurer. Even though the leverage argument may not hold in current property insurance markets, anti-competitive effects of tying cannot be excluded. In non-regulated markets, tying may be employed strategically to raise barriers to entry and so worsen the performance of the markets for either the tying or tied good. If capital markets are imperfect, so that the entrant's investments will not be funded, tying may be used for strategic reasons and cause anti-competitive effects. In the regulated French market for disaster insurance, the effect of the compulsory catastrophe extension is equally that competing insurance companies will have to enter two markets at the same time. In sum, the mandatory disaster insurance schemes generate anti-competitive consequences that are similar to those of tying mechanisms used by private firms.

Second, the amount of the premium for the catastrophe extension is laid down in legislation. In France, it is expressed as a percentage of the premium for the original contract. On any first-party property insurance a mandatory additional premium of 12 percent is added for the coverage of catastrophic loss. This legislative measure limits price competition and invites insurers to charge premiums that are not related to the insured risks. Both effects are further discussed below.

In France, insurers may still compete in fixing premiums for the property damage insurance but price competition for the additional disaster coverage is excluded completely. In Belgium price competition remains possible as long as premiums for the different risk areas are not fixed by the legislator. Competition authorities generally regard price agreements as the most serious infringement of Article 81(1) of the EC Treaty. The effect of premium regulation is similar to compulsory membership of a price cartel. Fixed premiums carry the risk that insurance firms will have no incentives

26 The leverage theory was formulated by the American Supreme Court in Northern Pacific Railway Company v. United States, 356 U.S. 1 (1958).
to increase productive efficiency and hurt the interests of individuals and businesses willing to buy insurance coverage. These negative effects may occur both on the market for disaster insurance and the market for property insurance. Because of the tying clause, which requires that property insurance contracts are expanded by a cover for harm caused by disasters, the price regulation may also affect the terms and conditions of the original property insurance contract. Fixed premiums may ultimately worsen the performance of the latter market, for example if the insurers increase the deductible of the property insurance contract (thus raising the amount of the loss the victims have to bear themselves) in order to circumvent the regulation of the premiums for the compulsory cover of catastrophic risk.\(^{27}\)

From an insurance technical point of view, there is no connection between the premium for property insurance and the premium for natural disaster coverage. To calculate actuarially fair premiums, different data and criteria must be taken into consideration. In Belgium, the additional premium to be paid by the holder of a fire insurance policy for the coverage of harm caused by floods is to be determined in function of the characteristics of the different risk areas. According to the Italian proposal, premiums would also have been regulated on the basis of different indicators reflecting the degree of risk in different Italian areas. Under both approaches, the important advantage of an insurance solution over government relief, namely that it allows for an adequate risk differentiation may be kept intact. By contrast, the French law invites insurers to charge premiums that are not related to the insured risks. If the insurers do not take account of the different degrees of risk in setting the premium for the property insurance, the anti-competitive consequences of fixed premiums for the disaster coverage will be exacerbated.

Third, mandatory reinsurance is organised by the State (France) or insurers are forced to participate in a co-reinsurance consortium (Italian proposal). Co-reinsurance can allow insurers to provide insurance for risks for which they might only offer insufficient cover in the absence of such pooling. However, in a free market insurers should be left free to choose whether they will join co-reinsurance groups, depending on their experience of risks and the working rules of the co-reinsurance groups. Compulsory reinsurance limits this freedom and is, therefore, also a violation of the ban on anti-competitive agreements. Gron and Sykes have argued that a role for the government in a structural way, for example as a re-insurer, provides a wrong signal to the market as far as stimulating insurability is concerned. If market participants know that in case of a natural disaster the financial consequences are covered through government intervention, this will provide them little incentives to develop adequate solutions themselves. Gron and Sykes, therefore, favour ad hoc solutions whereby compensation is provided to accident victims on an ex post basis.\(^{28}\)

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\(^{27}\) See also: A. Monti and F. Chiaves, as note 11 above, nr. 137.

B. COMPULSORY CATASTROPHE EXTENSION OF FIRST-PARTY PROPERTY INSURANCE VERSUS THE PRINCIPLES OF THE GROUP EXEMPTION FOR THE INSURANCE INDUSTRY

Also an analysis of Regulation 358/2003 on the application of Article 81(3) of the EC Treaty on agreements, decisions and concerted practices in the insurance sector shows that a compulsory catastrophe extension of first-party insurance is at odds with principles of European competition policy. Fixed premiums, tying clauses and compulsory reinsurance are all in conflict with the goal of creating competitive insurance markets. First, in the French model the premium for the disaster coverage is fixed by State regulation. This has a direct impact on the amount of the commercial premiums, which should remain fully subject to the forces of competition. The group exemption extends to the establishment of common risk premium tariffs, common standard policy conditions, common coverage of certain types of risks and security devices. To illustrate the scope of the group exemption, the following examples are illustrative. Insurance companies may make use of joint calculations, tables and studies to improve their knowledge of risks and facilitate the rating of risks for individual companies. The collaboration between insurance undertakings may include the calculation of the average cost of covering a specified risk in the past or, for life insurance, tables of mortality rates or of the frequency of illness, accident and invalidity. The collaboration may also include joint studies on the probable impact of extraneous circumstances that may influence the frequency or scale of claims. However, the exemption does not cover agreements on commercial premiums. Indeed, commercial premiums may be lower than the amounts indicated by the results of the calculations, tables or studies, since insurers can use the revenues from their investments in order to reduce their premiums. Also, the joint establishment of standard policy conditions is exempted provided that there is no indication of the level of commercial premiums and that their use is not in any way recommended (Articles 5-6 of Regulation 358/2003).

Second, mandatory disaster coverage is an example of tying, which is not covered by the group exemption either. Of particular importance for the analysis of a mandatory catastrophe extension of property insurance is the explicit exclusion from the scope of the group exemption of clauses, which "impose comprehensive cover including risks to which a significant number of policyholders are not simultaneously exposed" (Article 6(1)(c)). Regulation 358/2003 also excludes clauses which require the policyholder to obtain cover from the same insurer for different risks (Article 6(1)(i)). In the Commission's view, bundling of unrelated risks can be a disincentive for insurers to offer a separate and specific insurance cover. The text of the group exemption seems to imply that, from a competition policy perspective, the French scheme is more problematic than the Belgian regulation. The French scheme forces all holders of property damage insurance to buy mandatory coverage for disasters, irrespective of the

29 Regulation 358/2003, p. 9, recital nr. 10.
30 Ibid., p. 10, recital nr. 17.
degree to which they are exposed to natural disasters. By contrast, the Belgian scheme extends only to people living in designated risk areas. The latter approach takes different degrees of risk exposure into account, and this seems preferable to the French solution from a competition policy perspective.

Third, the role of the State as mandatory re-insurer (France) or the compulsory participation in a consortium of insurance undertakings for re-insurance purposes (Italy) is equally conflicting with the principles of Regulation 358/2003. On this point, the group exemption distinguishes between genuinely new risks and risks that are not new. A pooling arrangement for the co-insurance or co-reinsurance exclusively of new risks can be exempted for a period of three years (Article 7(1)). New risks are defined as “risks which did not exist before, and for which insurance cover requires the development of an entirely new insurance product, not involving an extension, improvement or replacement of an existing insurance product” (Article 2(7)). This definition excludes risks which existed but were not insured (for example, floods) or risks whose nature changed significantly (for example, terrorist attacks). Hence, for the disaster insurance schemes, discussed in this article, different rules apply. In the case of risks that are not new, insurance companies must remain free to choose whether they will join the co-insurance or co-reinsurance groups. They should retain the power to withdraw a certain risk, in whole or in part, from the insurance pool. The agreement should also not allocate markets or customers. Finally, in the case of co-reinsurance the market share of the group should not exceed 25 percent of the relevant market (Article 8). Clearly, the legislation on re-insurance of mandatory disaster coverage reaches results that are opposite to the rules of the group exemption for the insurance industry.

C. THE STATE COMPULSION DEFENCE

A particular feature of the French scheme of disaster coverage, which is achieved by way of a compulsory extension of voluntarily subscribed first-party insurance contracts, is that the restrictions of competition (such as tying and fixed premiums) result from State legislation. If anti-competitive behaviour is imposed by State regulation, companies may escape from the ban on prohibited cartels by arguing that the illegal behaviour was imposed by the State, which has left no scope for competition to develop in the relevant market. In particular, the European Commission has made clear that insurance companies do not violate Article 81(1) of the EC Treaty “where there is a legal requirement on insurers to include in policies cover for risks to which a significant number of policyholders are not simultaneously exposed”.31 In this part of the article, the scope for a State compulsion defence will be further investigated. The next part will examine to what extent Member States can be held liable for the enactment of legislation that conflicts with the competition provisions of the EC Treaty.

31 Ibid., p. 10, recital nr. 17
According to the case-law of the European Court of Justice, undertakings are not liable under Article 81 of the EC Treaty where the State by measures of public authority requires them to engage in anti-competitive conduct.\(^{32}\) In such a situation they cannot be held accountable for an infringement of the cartel prohibition. However, the State compulsion defence operates only where the State requires certain behaviour.\(^{33}\) If a law of a Member State merely allows, encourages or makes it easier for undertakings to engage in autonomous anti-competitive conduct, the State compulsion defence cannot prevent the finding of an infringement of Article 81 of the EC Treaty. Even when the State requires the undertakings to engage in anti-competitive conduct, the undertakings can still be held liable if they remain at least partially capable to autonomously restrict competition. The latter hypothesis materialises when the State has left a margin of discretion in the implementation of the anti-competitive national legislation to the undertakings.

The scope for autonomous infringements of Article 81 of the EC Treaty will depend on the more or less detailed contents of the State measures. If insurance companies remain free to decide about some of the contract terms of the disaster insurance policies (for example, deductibles and modalities of payment) they will remain subject to the ban of anti-competitive agreements. Article 81 of the EC Treaty will also be violated if the insurers of catastrophic loss enter into agreements affecting the competition in the non-regulated market for property insurance. Since the State regulation does not extend to the original contract, the cartel prohibition will unrestrictedly apply in the property insurance market.

In the most recent case-law, the limits of the State compulsion defence have been further clarified. In the *Fiammiferi* judgment, the Court of Justice has increased the effectiveness of the cartel prohibition by deciding that national competition authorities must not apply anti-competitive regulations.\(^{34}\) Where undertakings engage in conduct contrary to Article 81 of the EC Treaty and where that conduct is required or facilitated by State legislation, national competition authorities have a duty to give effect to Article 81 of the EC Treaty. The consequence of this judgment is that (associations of) undertakings can no longer escape liability under Article 81 of the EC Treaty by invoking the State compulsion defence when a decision by a national competition authority to not apply the State measures has become definitive. The effect of the *Fiammiferi* judgment is reinforced by recent changes of national competition laws. Whereas the defence is still available in the French competition law,\(^{35}\) the provision that anti-competitive conduct required by legislative measures is exempted from the cartel prohibition has been deleted from the text of the Dutch competition law.

\(^{32}\) *Case C-13/77, GB-Inme-BM*, [1977] ECR 2115.

\(^{33}\) *Case C-198/01, Consorzio Industrie Fiammiferi (CIF)*, [2003] ECR 1—8055. In this judgment it was also decided that national competition authorities must not apply State measures that require or facilitate anti-competitive behaviour.

\(^{34}\) Ibid., at para 51.

\(^{35}\) Ordonnance No. 86-1243 of 1 December 1986 “relative à la liberté des prix et de la concurrence”.


\[^{33}\] 33 Case C-198/01, Consorzio Industrie Fiammiferi (CIF), [2003] ECR 1—8055. In this judgment it was also decided that national competition authorities must not apply State measures that require or facilitate anti-competitive behaviour.

\[^{34}\] Ibid., at para 51.

\[^{35}\] Ordonnance No. 86-1243 of 1 December 1986 “relative à la liberté des prix et de la concurrence”.
When State measures impose or favour rules that limit competition, the Commission and other Member States can start infringement proceedings under Articles 226 and 227 of the EC Treaty. Also persons negatively affected by the State measures can introduce an action for damages against the Member State for breach of EC law. In the past, the European Court of Justice has consistently held that Articles 3(1)(g), 10(2) and 81(1) of the EC Treaty are infringed when a Member State requires or favours the adoption of agreements, decisions or concerted practices, which violate the competition provisions of the Treaty, or reinforces their effects, or where it divests its own rules of the character of legislation by delegating to private economic operators responsibility for taking decisions affecting the economic sphere. In the past, several cartel agreements facilitated by the State were considered as an infringement of those articles. In this way, competition law is able to prevent harmful anti-competitive practices even in cases where these have been approved or facilitated by State law. Where a State adopts measures that are contrary to the provisions of European competition law, national courts and national administrative bodies (including national competition authorities) have a duty to interpret State legislation in the light of those Community provisions and, if necessary, a duty to not apply the rules that are in conflict with the EC Treaty.

In the area of public-private cooperation, it may be difficult to draw the border line between sovereign State action that blocks the applicability of the competition rules (and provides a State compulsion defence to private undertakings) and State action that is guided by industry considerations and infringes the competition provisions of the EC Treaty. Even though the public regulator may be inspired by considerations of the insurance industry that favour anti-competitive measures, it may be difficult to show that the State in fact legalised a prohibited cartel agreement. Hence, in the light of the case-law of the European Court of Justice, discussed above, difficult questions arise with respect to the liability of the French State for potential infringements of the rules of EC competition law. If it can be shown that the State has legalised a prohibited cartel by requiring certain behaviour, the State must bear the ultimate liability for the anti-competitive effects generated by a compulsory catastrophe extension of first-party property insurance.

Clearly, the insurance industry may profit from a compulsory catastrophe extension of property insurance contracts. Insurers may be generally unwilling to cover damage caused by natural disasters. In the 1950s, the Dutch association of insurers issued a binding decision prohibiting its members from insuring the risk of floods and earthquakes in the Netherlands. The Dutch insurers claimed to have too little statistical material to calculate the premiums. It was also feared that only high risks

would have a demand for flood insurance, thus causing serious problems of adverse selection. After an intervention by the European Commission, the Dutch association of insurers decided to bring its policy in line with the rules of European competition law by converting the decision into a non-binding recommendation, leaving each insurer free to cover the risk of floods. Even though it is a less dramatic remedy than totally excluding the coverage of natural disasters, tying also causes anti-competitive effects. The French disaster coverage scheme forces all insurers to include tying clauses in their property insurance policies, thus causing restrictions of competition that would be illegal when they had been the result of binding standard policies adopted by the insurance industry. The French scheme also eliminates the possibility for insurers to compete on prices for the disaster coverage and it excludes competition in re-insurance markets by not allowing companies to freely decide to join insurance pools but forcing them to be reinsured through the State.

In spite of the anti-competitive effects of the compulsory insurance disaster schemes discussed in this article, there do not seem to be sufficient grounds for concluding that States introducing such schemes would violate their duties under the EC Treaty. On the one hand, France (and Belgium) could have chosen less restrictive measures, according to which it would not be mandatory but rather voluntary for citizens to stipulate a disaster insurance coverage when subscribing to a property insurance policy. On the other hand, competition still remains possible as far as the premiums for property insurance are concerned. Moreover, there is no evidence that it is left to French insurance companies to either agree on or jointly propose the fixed premium for disaster insurance. Even if this were the case, according to the judgement of the European Court of Justice in Arduino, the French State would not have violated its obligations provided that it had maintained some role for itself in assessing the appropriateness of the premium before making it obligatory. The conclusion that, from a legal point of view, neither the insurance companies nor the State violate the EC competition rules by implementing insurance schemes that hinder competition may be difficult to accept from a broader policy perspective. For this reason, the remainder of the article will investigate whether the restrictions of competition could be justified by efficiency savings or solidarity arguments.

V. COMPULSORY CATASTROPHE EXTENSION OF FIRST PARTY PROPERTY INSURANCE RE-ASSESSED: EFFICIENCY DEFENCE OR SOLIDARITY EXCEPTION?

So far, the analysis has led to the conclusion that a compulsory catastrophe extension of voluntarily subscribed property insurance contracts, such as the French scheme for disaster coverage, causes anti-competitive effects that are at odds with the

basic principles of European competition law. In the last section of this article, this conclusion will be re-assessed. Two alternative lines of thought will be presented. Both approaches rely on the insight that the disadvantages resulting from anti-competitive restrictions can be made good by advantages in terms of economic and social welfare goals. The first line of reasoning is that efficiency savings may outweigh the harm caused to competition. Competition authorities may examine whether the existing mandatory insurance schemes for catastrophic loss create efficiency benefits that outweigh the losses resulting from the anti-competitive effects. An efficiency analysis, which is broader than the approach in the group exemption for the insurance industry, may provide new arguments to legalise the restrictions of competition. The second line of reasoning is inspired by the solidarity exception that has been created in the case-law of the European Court of Justice. From a global welfare perspective, rules restricting competition may be motivated by goals of national solidarity. In a welfare state, citizens may agree that persons in serious difficulties have a right to financial assistance. In recent judgments relating to health services and pension schemes, the European Court of Justice has created a solidarity exception, which precludes the applicability of Articles 81 and 82 of the EC Treaty. In the second part of this section, it will be investigated whether it is possible to apply a solidarity exception also in cases of natural disasters with the effect of excluding the applicability of competition law to a compulsory catastrophe extension of property insurance policies.

A. TOWARDS AN EFFICIENCY DEFENCE

1. Coverage of catastrophic loss and the problem of failing insurance markets

The previous section of this article implicitly provides arguments in favour of forms of public intervention, such as ad hoc solutions, leaving it to the government to decide whether compensation will be awarded after the occurrence of a particular catastrophe, or the establishment of compensation funds, which provide relief in a structural way. Under the latter forms of government intervention, there are neither fixed insurance premiums nor tying clauses, imposing upon holders of property insurance the duty to buy disaster coverage as well. Insurers are also left free to decide whether they will join co-reinsurance groups. A clear decision in favour of public intervention thus avoids conflicts with basic principles of competition law. However, the alternative schemes for providing compensation to victims of catastrophes have been criticised in the Law and Economics literature because they dilute the incentives of victims to take preventive measures or to look for alternative relief (see Section III).

The disadvantages of compensation funds or ad hoc solutions invite a re-assessment of the role private insurers may play in providing monetary relief to victims of catastrophes. Several authors have advocated a greater reliance on insurance markets to
guarantee compensation to victims of catastrophes. However, this suggestion implies that insurance markets for catastrophic risks may sufficiently develop without government intervention. Market solutions may not work because of lacking demand or restricted supply: either victims do not voluntarily seek to purchase disaster coverage or insurers systematically exclude the disaster risk from (property) insurance policies. Both instances of market failure will be further explained below.

Lacking demand may be caused by the fact that people systematically underestimate the risk of catastrophes ("it will not happen to me") or are unaware about the availability of insurance coverage. It may be assumed that citizens are averse to the risk of large (property) damage as a consequence of natural catastrophes and are willing to pay a premium to have that risk removed from them. However, there are a number of papers showing that there is a small demand for flood insurance or for earthquake insurance. If this low demand is caused by a lack of information, a compulsory catastrophe extension of first-party insurance would be a disproportionate remedy. If citizens do not purchase insurance because they lack information on the probability and magnitude of the risk and/or on the availability of insurance, information remedies are the appropriate answer to cure these information deficiencies.

Restricted supply may be the consequence of reluctance on the side of the insurance industry to offer coverage for catastrophic loss. In several European countries, natural disasters have been traditionally considered as uninsurable by the insurance industry and governments have stepped in to provide compensation to victims (either ad hoc or through payments by an compensation fund). It is well known from an abundant literature on insurance economics that it is not the size of the loss in itself but rather the problem of insufficient risk spreading (law of large numbers) and the danger of adverse selection that make certain risks uninsurable. If insurers can identify high risks, they may decide not to offer insurance coverage when the group of insured is too small to allow a sufficient risk spreading. In order to avoid that interdependent risks are insured, they may also decide not to offer coverage for single hazards (such as floods) and provide only a comprehensive package of natural hazards insurance (floods, earthquakes, landslides, avalanches, storms, etc.). Consequently, welfare losses will occur since high risk individuals will not be able to obtain insurance coverage even if they are willing to pay the actuarially fair premium. If insurers cannot perfectly distinguish between high risks and low risks, adverse selection will occur when the less

desirable risks and highest expected losses seek disaster coverage, whereas the low risks do not subscribe to such insurance contracts. Insurers will charge a uniform premium, which will be too high for low-risk businesses and individuals or the insurance contract will not satisfy the full demand for insurance coverage. The risk of adverse selection may be contained by risk classification, but due to information deficiencies and administrative costs this remedy will remain imperfect. Therefore, insurers may decide to reduce the extent of the insurance cover to cope with the adverse selection problem. In the worst case scenario, insurance coverage will no longer be available. Even though a compulsory catastrophe extension is a disproportionate remedy to cure information deficiencies on the demand side, it should be further investigated whether it is an appropriate remedy to cope with the described market failures in the provision of insurance coverage for catastrophic risks.

The important insight that insufficient risk spreading and adverse selection may lead to a breakdown of private insurance markets offers a useful start point to re-assess the conditions under which restrictions of competition may benefit from an exemption. At the outset, it must be stressed that competition is not a goal in itself. The dominant view in the current literature on the goals of competition law is that the prohibition of cartel agreements (or the abuse of a dominant position) is an instrument to achieve efficiency. This goal implies that production costs are minimised (productive efficiency), that consumers are offered their preferred set of goods and services at competitive prices (allocative efficiency), and that an optimal amount of innovative goods and services are offered on the market (dynamic efficiency). Efficient outcomes are not only endangered by restrictions of competition but also by other forms of market failure, such as information asymmetries. Even though competition authorities often pay lip service to such an economic approach, in deciding real-life cases there is a tendency to find an infringement of the competition rules wherever and whenever some form of competition is possible, without a further analysis of whether competition is the best suited instrument to reach efficient outcomes. Stressing efficiency as the ultimate goal makes it possible to broaden the debate on the desirability of exemptions by addressing other potential sources of inefficiency in insurance markets. The analysis below offers a different perspective on the desirability of compulsory insurance for catastrophic loss by balancing the anti-competitive effects and the need to achieve a sufficient risk spreading and to avoid adverse selection.

Even though the formulation of the group exemption seems too narrow to legalise the compulsory disaster insurance schemes discussed in this article, a broader efficiency defence may create scope for a more tolerant view. An argument can be made in favour of an individual exemption by showing that (1) compulsory insurance is needed to have an adequate spreading of risks and to avoid adverse selection and thus improves production since insurance markets could otherwise not sufficiently develop; (2)

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consumers benefit from the availability of disaster coverage; (3) a tie-in clause is the most efficient way to implement the duty to insure; and (4) there remains sufficient scope for competition between insurance companies offering disaster coverage. It is not suggested here that these conditions can be easily satisfied and that the French model of compulsory disaster coverage does not cause antitrust concerns. However, the wording of the group exemption and the opinion delivered by the Italian antitrust authority do not offer a complete picture of the advantages and disadvantages of compulsory disaster coverage. The purpose of the analysis below is to broaden the debate and to offer more refined criteria for an individual assessment of different types of mandatory insurance for catastrophic loss.

2. **Failing insurance markets for catastrophic loss and the conditions for an exemption from the cartel prohibition**

In this section of the article, it will be investigated whether there are efficiency benefits that may justify the introduction of a duty to insure catastrophic loss. Since the compulsory disaster coverage is achieved through tying property insurance and disaster insurance, it will also be examined whether the tie-in is able to generate advantages that outweigh the disadvantages resulting from the restrictions of competition. If this analysis leads to the conclusion that a compulsory catastrophe extension of first-party property insurance enables private insurance markets to expand the available insurance coverage and thus better satisfy the demand of potential insured, the tension between competition policy and the wish to provide adequate relief to victims of catastrophes may disappear.

Of course, a disadvantage of limiting the duty to insure against catastrophic loss to those people who have already purchased property insurance is that, in this way, only the latter group will enjoy the additional protection. There may thus still be people who choose not to insure their property at all and would not profit from the mandatory disaster insurance scheme. However, as will be further discussed below, the administrative costs of forcing all property owners to buy insurance coverage may be quite high. Even though it is not required in most countries, mortgage providers insist on the existence of insurance coverage, as a result of which most home owners are insured. Another concern is the danger that the State may discourage people from obtaining home insurance by forcing them to pay the additional premium for catastrophic loss. Thus, potentially, the amount of property which is entirely uninsured could increase. However, this seems not to be a serious problem since, as mentioned, mortgage banks and other financial institutions may take action to increase the availability of property insurance.

(a) **The first condition: improvement of production or distribution, or technical or economic progress**

When high risks can be identified, insurers may be reluctant to offer insurance policies to high-risk businesses or individuals. Flood insurance offers a good illustration.
The chance of flooding is geographically limited. Insurers are able to identify the risky areas and may consider it uneconomic to make flood insurance available if the risks are interdependent and the group of high-risk individuals is too small to profit from the law of the large numbers. This small pool of interested buyers will make it very difficult for the insurers to spread the risk in a satisfactory fashion. Adverse selection will occur when only people with the less desirable risks and higher expected losses choose to insure. Insurance coverage for harm caused by natural disasters is the more attractive the greater the exposure to risk and the higher the value of the insured property (houses, expensive furniture, modern technical equipment, fancy cars). Theoretically, if screening of risks was possible at zero costs, all risks willing to pay the actuarially fair premium would get coverage. In reality, information deficiencies in insurance markets prevent an efficient outcome. A duty to insure imposed upon low-risk individuals enlarges the insurance pool, prevents adverse selection and makes natural disasters insurable.

Remarkably, the French Insurance Code defines loss resulting from natural catastrophes as "non insurable direct material damage whose determining cause was the abnormal intensity of a natural agent . . .". Lawyers have criticised this definition since it seems confusing to call uninsurable a risk that the law makes insurable by compulsory coverage. However, the paradox disappears if one realises that compulsory insurance allows for a sufficient spreading of risks and functions as a remedy to adverse selection, which may make natural disasters uninsurable. By imposing a duty to insure the law transforms an uninsurable risk into an insurable one. Compulsory insurance may enable the private insurance market to cover harm caused by natural disasters in geographically limited areas. Floods and earthquakes are clear examples, but the French compulsory disaster insurance coverage also extends to snowfalls, droughts, heavy storms, terrorist attacks and technological catastrophes. Compared to floods and earthquakes, the risks of snowfalls, droughts and storms exist in larger geographical areas and, consequently, an adequate risk spreading can be achieved more easily. Also property insurance for terrorist attacks and technological disasters may be subscribed by a more diversified group of victims. If it is less easy to identify the locations where terrorist attacks can take place or technological disasters may happen, the argument that insurers will exclude cover for high risks loses strength. Hence, one should not too easily accept the argument that compulsory insurance is a response to insufficient risk spreading and adverse selection impeding the achievement of allocative efficiency in a competitive market. The merits of this reasoning must be decided on a case-by-case basis.

For the purposes of this article, the logical next question is whether the need to adequately spread risks and the danger of adverse selection may form the basis of an

46 Art. L. 125-1 par. 3. See: O. Moréteau, M. Cannarsa and F. Lafay, as note 2 above, nr. 19.
47 Ibid., nrs 19 and 84.
48 Ibid., nrs 19-25.
efficiency defence under Article 81(3) of the Treaty.\textsuperscript{49} It may be argued that devices coping with problems of insufficient risk spreading and adverse selection improve production, since they make forms of insurance coverage that would not be offered in a purely competitive market available. So far, European competition law does not seem to offer an easy escape route for agreements in the insurance industry that contribute to efficiency. The restrictive rules of the group exemption have already been discussed above: risks that previously existed but were not insured (floods) or risks whose nature changed significantly (terrorist attacks) are not considered to be "new risks". Competition authorities should realize that the mandatory disaster insurance schemes may create dynamic efficiencies by enabling a better development of an insurance market for catastrophic risks. On the one hand, according to the text of the group exemption, the European Commission is of the opinion that bundling unrelated risks hampers rather than promotes innovation, since it is a disincentive for insurers to offer a separate and specific insurance cover.\textsuperscript{50} On the other hand, according to the Guidelines of the European Commission on the application of Article 81(3) of the EC Treaty, both cost efficiencies and qualitative efficiencies can be advanced to argue that the first condition for an individual exemption is satisfied.\textsuperscript{51} Cost efficiencies include synergies from an integration of assets, economies of scale and economies of scope, and better planning of production. Qualitative efficiencies generate benefits in the form of improved goods and services, which would not have been possible without the restrictive agreement or would have been possible only with substantial delay or at higher cost. It could thus be argued that a sufficient supply of certain insurance products can only be guaranteed if a duty to insure is imposed on low-risk individuals and businesses. However, the examples given in the Guidelines are far remote from the arguments discussed here. The Commission mentions research and development agreements, license agreements and agreements with specialised distributors, but not the need to cure information asymmetries in competitive markets and problems of lacking supply. In sum, the achievement of qualitative efficiencies in the form of a sufficient supply of catastrophic risk policies is a powerful argument to justify a duty to insure, even though it may not be accepted easily by competition authorities.

The use of tying clauses may further reduce the chances to qualify for an exemption. Even if the argument that compulsory disaster coverage schemes are needed to allow for a sufficient risk spreading and to avoid adverse selection is accepted, the question remains why this goal is to be achieved by tying clauses. This raises the issue of the proportionality of the tying clauses, which is discussed below (see V.A.2.(c), below). Here, the basic insights about the possible efficiency benefits of tying are

\textsuperscript{49} The conditions for an exemption make clear that the goal of competition law is not total welfare. Losses to consumers cannot be made good by gains to producers, since the former must get a fair share of the resulting improvement of production. This does, however, not preclude an efficiency defence, provided that the argument is broadened by an analysis of distributive effects.

\textsuperscript{50} Regulation 358/2003, p. 10, nr. 17.

\textsuperscript{51} Guidelines on the application of Article 81(3) of the EC Treaty, OJ C 101, 27.4.2004, p. 97 ("Guidelines").
summarised and applied to the compulsory disaster insurance schemes under investigation. It is well known from the Law and Economics literature that tying may have both negative and positive consequences for economic welfare. The foreclosure explanation of tying is challenged by other theories stressing that firms may have several reasonable business rationales for tying. The literature also deplores that the efficiency benefits are not sufficiently taken into account by competition authorities. Hence, the question arises whether the most common efficiency justifications for tying hold in the case of mandatory disaster insurance. Tie-in sales are benign if they generate efficiencies. Many products are naturally and efficiently tied together or bundled. There is no reason for antitrust intervention when consumers desire assembled products. Another reason to engage in tying is quality assurance and the related protection from opportunistic behaviour. Generally, a firm may assure quality by forcing customers to buy another of its products or services and not use substitutes. For example, a manufacturer of durable goods may decide to operate through a network of exclusive dealerships forcing customers to purchase servicing from the network. Similar efficiency justifications may apply in the case of mandatory disaster coverage. Many individuals, who have voluntarily subscribed property insurance, may, if they are exposed to the risks of catastrophes, be interested in purchasing an extended cover for harm caused by catastrophes from the same insurer. Also the quality of the insurance services may increase if a single insurer offers both property damage and disaster damage coverage. This would be the case when, for instance, economies of scope in the handling of claims can be realised. Given the arguments supporting an efficiency defence of tying under the first condition of Article 81(3) of the EC Treaty, it will be further investigated below whether also the other requirements for an individual exemption can be satisfied.

(b) The second condition: benefits to consumers

To qualify for an exemption, it must be shown that consumers receive a fair share of the benefits resulting from the improvement of production. If compulsory insurance is able to allow an adequate risk spreading and to cope with the adverse selection problem in insurance markets for catastrophic loss and thus creates qualitative efficiencies, the effects on global consumer welfare must still be investigated. In the Commission's view, the second condition of Article 81(3) of the EC Treaty incorporates a sliding scale: "The greater the restriction of competition found under Article 81(1) the greater must be the efficiencies and the pass-on to consumers". Since the restrictions are indeed quite severe (mandatory coverage through tying and fixed premiums) the savings will need to be high and the benefits to consumers large.

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54 R. Van den Bergh and P. Camesasca, as note 44 above, p. 280.
55 Guidelines, as note 51 above, nr. 90.
The impact of mandatory disaster insurance on consumer welfare is ambiguous: some individuals and businesses will profit but others will be hurt by a mandatory catastrophe extension of their property insurance policies. It is likely that the high-risk groups will benefit from compulsory insurance, whereas the low-risk groups will be harmed. As explained above, in a competitive insurance market insurers may not offer full coverage of harm caused by natural disasters. When selection of risks is possible, insurers will not offer contracts to high-risk businesses and individuals if the group of potentially insured is too small to allow for a sufficient risk spreading. Consequently, individuals who can be identified as high-risk, such as people living in floodplain areas, suffer a welfare loss. A duty to insure imposed upon low-risk groups will enlarge the risk pool and allow insurers to offer coverage also to high-risk groups. However, this solution will reduce the economic welfare of the low-risk groups that are forced to buy insurance coverage against their will. The most substantial harm will be imposed on people who run no risk at all (for example, the person living in an apartment building on the twelfth floor, who is forced to buy flood insurance).

The overall effects on consumer welfare will depend on the size of each of the affected groups. The requirement of Article 81(3) of the EC Treaty that consumers should get a fair share of the benefit will be easily satisfied if the group of consumers who are forced to buy disaster insurance coverage against their will is relatively small. Under the French scheme, which covers a large range of natural catastrophes (not only floods but also heavy snowfalls and storms), there is a greater probability that every property owner may be harmed by a natural catastrophe (even though he is a low-risk individual) than under a system that covers only geographically limited risks (floods, earthquakes). The potential negative effects on consumer welfare of compulsory insurance can also be reduced if the duty to obtain coverage is limited to individuals actually exposed to the risk. The new Belgian Act of May 2003 restricts the duty to buy insurance coverage for floods to individuals living in specified risk areas. This regulatory scheme avoids individuals being forced to purchase insurance coverage for which they have no demand. Consequently, it can be more easily demonstrated that consumers get a fair share of the benefits, as required by Article 81(3) of the EC Treaty. But even when there is a general duty to insure (not limited to specific risk groups), the argument can be made that the gains of victims who receive compensation are (substantially) larger than the losses of individuals who have to pay an additional insurance premium. Under these circumstances, there is a Kaldor-Hicks improvement and the second condition for an individual exemption will be satisfied.

(c) **The third condition: requirement of proportionality**

The argument that compulsory insurance is needed to allow a sufficient risk spreading and to avoid adverse selection in private insurance markets is not sufficient to save the compulsory catastrophe extension of first-party insurance from the ban of cartel agreements. The reason is that there is no general duty to insure catastrophic risks, but only a compulsory extension of voluntarily subscribed property insurance contracts. Therefore, to qualify for an exemption, it must also be shown that tying property insurance and disaster insurance is the most efficient way to implement the duty to insure. By outlawing clauses that “impose comprehensive cover including risks to which a significant number of policyholders are not simultaneously exposed” (Article 6(1)(c)), the group exemption for the insurance industry is not hospitable to contracts which impose a mandatory catastrophe extension on holders of first-party property insurance, who are not exposed to the same risk. Also, the requirement imposed on the policyholder to obtain cover from the same insurer for different risks is excluded from the scope of the group exemption (Article 6(1)(i)). Hence, the only way to save the tying clause is by arguing that it is a proportional remedy to the inefficiencies in competitive insurance markets for disaster coverage and, therefore, merits an individual exemption.

An argument in favour of compulsory disaster insurance schemes, discussed in this article, is that the costs of enforcing the duty to insure would be prohibitively high if no use can be made of tying clauses. For some forms of compulsory (liability) insurance, such as the compulsory fire insurance for publicly accessible buildings in Belgium,\(^{57}\) the costs of controlling whether owners of buildings have purchased the required coverage may still be reasonable. Conversely, the costs of controlling whether every owner of a house or a car has purchased separate disaster coverage would be substantially higher. A compulsory disaster insurance imposed on all holders of property insurance contracts, as it can be found in the French law, will save on such enforcement costs. Tying arrangements seem to be the cheapest instrument to implement a compulsory insurance scheme for natural disasters. Property insurance (including fire insurance) is widely spread and a duty to expand the existing cover by including harm caused by natural disasters can be imposed at low administrative costs on persons who have bought such insurance policies. Individuals who have not yet purchased property insurance will either not become victims (because they do not possess property) or may not have a fixed residence and thus be less reliable debtors. Imposing tying clauses on solvent holders of property insurance thus saves on the costs of control related to a compulsory insurance for harm caused by natural disasters.

A further argument in favour of mandatory disaster insurance of the French type is that the administrative costs of identifying groups of individuals exposed to specific risks

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are very high. The fact that the Belgian legislation has not yet entered into force shows that there are substantial (also political) costs in identifying the specific risk areas. Therefore, an argument favouring compulsory disaster insurance achieved through a general compulsory extension of property insurance contracts is that tying clauses substantially save on the costs of identifying the groups that are specifically exposed to the risk. If these savings in administrative and enforcement costs are higher than the losses caused by the restrictions of competition, a generalised mandatory coverage of catastrophic loss (such as the one existing in France) may be warranted. A compulsory catastrophe extension of first-party insurance policies will be efficient from a total welfare perspective if the savings resulting from a reduction in costs of implementation and enforcement exceed the losses of the individuals and businesses that have no demand for disaster coverage. In sum, the argument that tying is the most efficient way to implement a duty to insure catastrophic loss (so that the risk becomes insurable) leaves the door for an individual exemption open.

(d) The fourth condition: a sufficient degree of remaining competition

To obtain an individual exemption, the last requirement to be satisfied is that the restrictions of competition may not allow undertakings to eliminate competition in respect of a substantial part of the products in question. The analysis above has provided arguments to be used in an efficiency defence of a compulsory catastrophe extension of property insurance contracts. This analysis was subject to the caveat that competition authorities will not easily grant an individual exemption to tying clauses. Nevertheless, the argument can be made that the need for sufficiently large risk pools and the danger of adverse selection may justify a duty to insure, that the overall impact of such a measure on consumer welfare may be beneficial and that tying property insurance and disaster insurance is a proportionate remedy to the described inefficiencies. Even if one accepts that the first three conditions for an individual exemption are satisfied, the requirement that sufficient room should be left for competition causes further problems.

If price competition on the market for the disaster coverage is totally excluded, the fourth condition of Article 81(3) of the EC Treaty may not be satisfied. By fixing the additional premium for the disaster coverage, the French government has limited price competition between insurers. There remains, however, scope for competition as far as the price for the property insurance (which can take the degree of risk exposure into account) and the contract terms of the disaster insurance (including deductibles) are concerned. However, it may doubted whether this can be considered a sufficient degree of remaining competition. Even though it may be argued that tying property insurance and disaster insurance can be saved upon the basis of the three first conditions of Article 81(3) of the EC Treaty, the fourth condition may thus not be satisfied. Also reinsurance by the State seriously distorts the market mechanism: insurance may be provided at a lower price than the market price and wrong signals may be given as far as
stimulating insurability is concerned. Contrary to the rules of the group exemption, private insurers are also not left free to decide whether they want to use the possibility of State reinsurance or not. The French model of compulsory disaster coverage totally eliminates competition in the co-reinsurance market. If fixed premiums and mandatory re-insurance through the State cannot be saved by relying on Article 81(3) EC Treaty, the question arises whether the French scheme of compulsory disaster coverage could benefit from a solidarity exception.

B. TOWARDS A SOLIDARITY EXCEPTION

So far, the analysis leads to the conclusion that the restrictions of competition resulting from the French model of compulsory disaster coverage do not easily satisfy all criteria for exemption in Article 81(3) of the EC Treaty. This outcome raises the question whether there is a possibility to escape the applicability of the general competition rules altogether, so that there is no need to prove that the requirements for an exemption are satisfied. For policy makers, not only competition concerns are relevant. The activities of the European Community not only include a “system ensuring that competition in the internal market is not distorted” (Art. 3(1)(g) of the EC Treaty) but also “a policy in the social sphere” (Art. 3(1)(j) of the EC Treaty). In a traditional vision of the welfare state, citizens are entitled to full restoration of damages caused by natural catastrophes as a manifestation of national solidarity. In this view, restrictions of competition may be presented as the price to pay for guaranteeing that victims of catastrophes are appropriately compensated.

The main features of the French model of compulsory disaster coverage may all be justified on grounds of national solidarity. First, a general duty to purchase disaster coverage is disadvantageous for victims who run only a (very) low risk. Consequently, in a competitive insurance market, individuals and businesses will not subscribe to insurance contracts if they are exposed to the risk of natural catastrophes only to a (very) limited extent. A generalised duty to insure causes a cross-subsidisation, whereby low-risk groups contribute to the insurance costs of high-risk groups. As it is the case with healthy people who are forced to pay the cost of care of sick people, a requirement on citizens living in areas not particularly subject to risks can be equally justified on grounds of national solidarity. By forcing the low-risk groups to contribute to financing the actual insurance costs of high-risk groups, insurance coverage will become available for the entire population. Second, when premiums are fixed in relation to the degree of risk, not everyone exposed to risk will be able to obtain and/or financially afford coverage in a competitive insurance market. A premium fixed by the State, which is the same for all of the insured, again reflects the solidarity principle. Third, the same reasoning applies to mandatory re-insurance organised by the State. From a perspective of national solidarity, it seems perfectly defensible that the State acts as an insurer of last resort. In this way, the State guarantees that citizens in serious difficulties receive financial assistance.
In a number of rulings, the European Court of Justice has created a solidarity exception, which allows certain health insurance funds and pension funds to remain outside the scope of the competition rules. First, the Court has argued that organisations charged with the management of certain compulsory social security schemes, based on the principle of solidarity, cannot be qualified as "undertakings" within the meaning of Article 81 of the EC Treaty, since they do not perform economic activities. To fall outside the scope of the competition rules, a social security system must be almost completely based on the principle of solidarity. This is the case when sickness funds have no influence over the contributions, are founded on the principle of national solidarity (operating on a redistributive basis) and are non profit making. A limited element of competition to encourage cost-effectiveness and efficiency does not change the nature of the non-economic activities. Second, even if bodies entrusted with the operation of social services can be qualified as undertakings, the pursuit of social objectives may justify that the State grants them exclusive rights to manage a supplementary pension scheme. In the first case, the competition rules do not apply since a substantive criterion of Article 81 is not satisfied. In the second case, restrictions of competition are justified under Article 86(2) of the EC Treaty since the application of the competition rules would obstruct the performance of a social task. Of particular interest, for the purposes of this article, is the Court's observation that solidarity makes compulsory affiliation to a supplementary pension scheme essential. "Otherwise, if good risks left the scheme, the ensuing downward spiral would jeopardise its financial equilibrium". This consideration shows that the risk of adverse selection is seen by the Court as an obstacle to the achievement of goals of solidarity.

Obviously, the compulsory disaster insurance systems discussed in this article differ from the health insurance systems and pension schemes analysed by the Court. First, insurance companies providing coverage for catastrophic loss operate on a commercial basis and are, therefore, to be qualified as undertakings for the purposes of competition law. Second, in the discussed systems of compensation of property loss

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60 Case C-67/96, Albany International BV and Stichting Bedrijfspensioenfonds Textielindustrie, [1999] ECR I-5751 at para 75. See also para 108 "The progressive departure of 'good' risks would leave the sectoral pension fund with responsibility for an increasing share of 'bad' risks, thereby increasing the cost of pensions for workers, particularly those in small and medium-sized undertakings with older employees engaged in dangerous activities, to which the fund could no longer offer pensions at an acceptable cost."

61 It may be added that the Court has also granted antitrust immunity to collective agreements between organisations representing employers and workers, arguing that the social objectives of collective agreements, aiming at an improvement of conditions of work and employment, would be seriously undermined if management and labour were subject to the competition rules of the EC Treaty. For a comment, see: R. Van den Bergh and P. Camesasca, Irreconcilable principles? The Court of Justice exempts collective labour agreements from the wrath of antitrust, European Law Review, 2000, pp. 492—508.
caused by natural disasters (France, Belgium, Italian proposal), there is no generalised
duty to buy cover for catastrophic risks but only a mandatory extension of voluntarily
subscribed first-party property insurance policies. By contrast, social health insurance
and supplementary pension schemes are based on compulsory affiliation. Third, in
compulsory social security schemes, benefits are identical for all those who receive
them and there is no equivalence between the financial contributions paid (which are
proportionate to income or an average contribution) and the received payments.
Conversely, the premium paid for disaster insurance may be linked to the degree of risk
in different areas (Belgian law, Italian proposal). Consequently, a compulsory
catastrophe extension of first-party property insurance does not seem to exhibit the
solidarity features that have been advanced by the Court in its rulings on health
insurance funds and pension schemes. Moreover, it may be doubted that there is
sufficient political support for extending the scope of the claims grounded on the
principle of solidarity, so that it would not only apply to healthcare and a minimum
income but also to compensation of harm to property.

In spite of these important reservations, the case-law discussed above invites
further thinking on the adaptations that would be necessary to make it possible for
compulsory disaster insurance schemes to profit from the same immunity. It also shows
that there is not necessarily a tension between competition and solidarity. The need to
overcome the problem of adverse selection is seen by the Court as a necessary
requirement to achieve solidarity goals. In this article, remedies to adverse selection,
such as the duty to insure, have been presented as instruments to improve the efficiency
of insurance markets. If one accepts that competition is not a goal in itself but an
instrument to achieve allocative efficiency, restrictions of competition can be justified
both on grounds of efficiency and solidarity.

VI. CONCLUSIONS

In European countries, there exist different schemes for compensating loss to
property caused by natural disasters. Compensation funds and ad hoc solutions, decided
after the occurrence of a specific disaster, are pure forms of public intervention. A
different approach is public-private cooperation in the framework of a regulatory
intervention in private insurance markets. The most prominent example is the French
scheme of compulsory disaster coverage. The French law requires a catastrophe
extension of voluntarily subscribed property insurance contracts, fixes the premiums for
the additional cover and also provides for re-insurance by the State. This scheme is
becoming increasingly popular: it has been introduced in Belgium and is currently
considered also in other European countries.

In the Law and Economics literature, insurance solutions are generally preferred to
pure forms of public intervention because they keep incentives for preventive measures
intact and allow for an adequate risk differentiation. However, private insurance markets
for catastrophic risks may not sufficiently develop without government intervention
because of lacking demand or lacking supply. Underestimation of the risk or unawareness of insurance availability may be cured by information remedies. Lacking supply may be due to the impossibility to sufficiently spread the risks or to adverse selection when only the highest risks seek insurance coverage. Compulsory insurance can be seen as a remedy to these problems and may enable private insurance markets to cover harm by natural disasters. Tying can be presented as a proportional remedy to the described inefficiencies, since it is the cheapest way to enforce the duty to insure.

The policy debate on compensation of property loss caused by natural disasters should take the anti-competitive effects of regulatory interventions in private insurance markets into account. However, the wording of the group exemption for the insurance industry and the negative opinion delivered by the Italian antitrust authority on the introduction of a compulsory extension of fire insurance policies do not offer a complete picture of the advantages and disadvantages of compulsory disaster coverage. An efficiency defence, which includes the need to create sufficiently large risk pools and to cure the problem of adverse selection, may provide new arguments to justify the tying clauses. Other features of a compulsory insurance scheme for catastrophic loss, such as fixed premiums for the disaster coverage and re-insurance by the State, may benefit from a solidarity exception. The concept of the welfare state essentially demands that anyone in serious difficulties be provided government assistance. This view may justify why certain social security systems (covering lost income and health care expenses) remain outside the scope of the competition rules. This article has initiated the debate on whether grounds of national solidarity may also justify anti-competitive regulatory measures to enable compensation for property damage caused by natural disasters. If competition is not seen as a goal in itself, both efficiency reasons and solidarity arguments may provide powerful arguments to justify a compulsory catastrophe extension of voluntarily subscribed property insurance contracts to cover the risk of natural disasters. From a global welfare perspective, public-private cooperation to cover loss to property caused by natural disasters will be superior if the alternative schemes create substantial costs because of their counterproductive effects on risk prevention and mitigation of the loss.