

# DRAKE LAW REVIEW

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Volume 28

1978-1979

Number 4

## THE INTERPLAY OF THE REGIMES OF ANTITRUST, COMPETITION AND STATE INSURANCE REGULATION ON THE BUSINESS OF INSURANCE\*

*Jon S. Hanson*<sup>†</sup>

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\* The author wishes to acknowledge that Parts II and III of this article draw heavily upon the Presentation on Behalf of the National Association of Insurance Commissioners for the Review of Antitrust Laws and Procedures, July 27, 1978, which the author participated in preparing. At the same time, however, the views expressed and the conclusions reached in this article are those of the author and do not necessarily reflect those of the National Association of Insurance Commissioners.

† A.B. 1960, Stanford University; J.D. 1963, University of Michigan. Mr. Hanson is presently Executive Secretary and Director of Research of the National Association of Insurance Commissioners.

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#### I. INTRODUCTION

##### A. *The Broad Issue: The General Application of Antitrust to the Business of Insurance*

In 1869, in *Paul v. Virginia*<sup>1</sup> the United States Supreme Court upheld a state statute which subjected a foreign insurance company and its local agents to a licensing requirement. The statute was challenged on the basis that it offended the commerce clause of the United States Constitution. The Court concluded that "[i]ssuing a policy of insurance is not a transaction of commerce."<sup>2</sup> For the following seventy-five years, *Paul* was construed to preclude insurance from being a part of interstate commerce<sup>3</sup> and therefore to

1. 75 U.S. (8 Wall.) 168 (1868).

2. *Id.* at 183.

3. *E.g.*, *New York Life Ins. Co. v. Deer Lodge County*, 231 U.S. 495, 510 (1913). As a

place insurance beyond the scope of federal legislative and regulatory authority. Consequently, as the need for regulation of the insurance business arose, the burden fell upon the various states. However, in 1944, the Supreme Court in *United States v. South-Eastern Underwriters Association*<sup>4</sup> overturned the precedent established by *Paul* and its progeny. In that antitrust action brought by the Department of Justice, the Court noted that "[n]o commercial enterprise of any kind which conducts its activities across state lines has been held to be wholly beyond the regulatory power of Congress under the Commerce Clause. We cannot make an exception of the business of insurance."<sup>5</sup> As a result,

[o]vernight, the entire legal basis for the immunity of combinations in rate-making, the cornerstone of the fire insurance business—and hence, at that time, of the dominant segment of the property-liability insurance business—was eliminated. Moreover, doubt was cast on the system of state regulation and taxation of the insurance business [as an unconstitutional burden on interstate commerce]. The decision precipitated widespread controversy and dismay. Chaos was freely predicted.<sup>6</sup>

Because of the fundamental concerns over the ability of the insurance business to continue to adequately perform its functions under the federal antitrust laws and the continued viability of state insurance regulation, Congress enacted the McCarran-Ferguson Act (often referred to as the McCarran Act) in 1945.<sup>7</sup> By virtue of this Act, Congress declared that (1) continued regulation of the insurance business by the states is in the public interest,<sup>8</sup> (2) no act of Congress shall invalidate, impair or supersede any state law regulating the business of insurance unless such act specifically relates to the business of insurance<sup>9</sup> and (3) the business of insurance shall be exempted

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consequence, subsequent efforts to challenge the validity of state insurance regulatory law were predicated on bases other than the federal power over interstate commerce, *e.g.*, due process. See, *e.g.*, *Hoopeston Canning Co. v. Cullen*, 318 U.S. 313 (1943); *Osborn v. Ozlin*, 310 U.S. 53 (1940).

4. 322 U.S. 533 (1944).

5. *Id.* at 553.

6. NEW YORK INSURANCE DEPARTMENT, *THE PUBLIC INTEREST NOW IN PROPERTY AND LIABILITY INSURANCE REGULATION* 71 (1969).

7. 15 U.S.C. §§ 1011-1015 (1976).

8. Congress declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States. *Id.* at § 1011.

9. 15 U.S.C. § 1012 reads:

(a) The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.

(b) No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: *Provided*, That after June 10, 1948, the Act of July 2, 1890, as

from the antitrust laws to the extent that the business is regulated by state law.<sup>10</sup> In short, the McCarran Act retained the principle of state insurance regulation but provided that the antitrust laws would apply to the extent the business is not regulated by the states. Since 1945, state insurance regulation was evolved within the framework of the McCarran Act.<sup>11</sup> By virtue of a series of enactments in such areas as rating laws and unfair trade practice acts,

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amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State Law.

10. See note 9 *supra*.

11. For a summary of insurance regulatory goals, see Hanson, *An Overview—State Insurance Regulation*, 31 CLU J. 20, 22-25 (1977). The same article briefly describes the basic functions of an insurance department as follows.

(1) Insurers must obtain and continue their licenses in order to do business. This, in turn, requires complying with statutes and regulations pertaining to formation; financial standards concerning assets, capital and surplus; permissible investments and adequacy of reserves; and qualifications as to character of management, experience and knowledge of the business. Licenses may be suspended or revoked for failure to comply with the law or when the public interest so requires.

(2) Insurers must file comprehensive annual and other periodic reports under oath in each state in which they do business.

(3) Insurers are subject to comprehensive periodic examinations which include, among other things, the financial condition of the company, a review of whether claims are paid on a fair and prompt basis and whether policyholder complaints are handled promptly and fairly.

(4) By virtue of statutory standards for policy content and the commissioners' policy form approval or disapproval power, much of the source of misrepresentation or other unfair practices is deterred in advance.

(5) Control is exercised over the pricing practices of property and liability insurers through implementing the standards that rates shall not be excessive, inadequate nor unfairly discriminatory. Health policies must meet the standard requiring benefits to be reasonable in relation to premium.

(6) Market practices are controlled by, among other things, laws governing the qualifications of agents and brokers, licensing of the same, prohibitions against certain practices such as prohibiting false and misleading advertising and representations defining standards of fair competition, control over policy forms, rate controls in several areas and establishing complaint system mechanisms.

(7) Various residual market mechanisms have been devised and implemented to assure the availability of certain types of insurance to less desirable risks (e.g., automobile insurance assigned risk plans, FAIR plans and medical malpractice joint underwriting associations).

(8) The insurance commissioner may, for a variety of causes (e.g., insolvency, refusal to comply with orders, failure to remove officers) apply for a court order of liquidation, rehabilitation or conservation.

(9) Among the sanctions available for enforcement of the insurance laws are criminal and civil penalties; cease and desist orders; injunctions; removal of officers and directors; fines; revocation of (or refusal to renew) licenses of agents, adjusters, brokers and insurers. These powers and sanctions plus the informal powers, sanctions and alternative modes of relief stemming therefrom extend far beyond what most industries are subject to.

coupled with judicial interpretation of the McCarran Act, federal antitrust law has played only a very limited role in shaping the evolution of the insurance mechanism.<sup>12</sup>

The latter part of the 1970's witnessed a growing interest in increased deregulation of various industries combined with an increasing reliance placed upon expanded application of the antitrust laws.<sup>13</sup> Although most of the focus has been directed toward the federal agencies, the insurance industry and state regulation thereof have not been isolated from this effort. In 1977, the Department of Justice published a report entitled *The Pricing and Marketing of Insurance*<sup>14</sup> which explored the relationship between the insurance industry and the antitrust laws. President Carter appointed the National Commission for the Review of Antitrust Laws and Procedures (hereinafter, the National Commission) to review (1) improving the procedures related to the complex and lengthy antitrust cases and (2) the various immunities to the antitrust laws, which includes the McCarran Act exemption for insurance.<sup>15</sup> From these and other activities have emerged a wide range of possible approaches to reform of the McCarran Act, such as those which follow.<sup>16</sup>

At one extreme is the repeal of the McCarran Act in its entirety, which would include repeal of the "business of insurance" immunity to the federal antitrust laws.<sup>17</sup> This would broadly apply the federal antitrust laws to the business of insurance except to the extent precluded by the state action doctrine.<sup>18</sup> The impact of such a broad repeal would not be limited to antitrust concerns, but also would remove the barrier to challenging the full range of state regulatory activity as an alleged burden on interstate commerce, and

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12. See J. HANSON, R. DINEEN, & M. JOHNSON, *MONITORING COMPETITION: A MEANS OF REGULATING THE PROPERTY AND LIABILITY INSURANCE BUSINESS* 217-48 (1974) [hereinafter, *MONITORING COMPETITION*]. However, recent cases suggest a judicial narrowing of the McCarran Act antitrust exemption. See, e.g., *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205 (1979); *St. Paul Fire & Marine Ins. Co. v. Barry*, 438 U.S. 531 (1978); *SEC v. National Securities, Inc.*, 393 U.S. 453 (1969).

13. See NATIONAL COMMISSION FOR THE REVIEW OF ANTITRUST LAWS AND PROCEDURES, *REPORT TO THE PRESIDENT AND THE ATTORNEY GENERAL* 180-85 (1979) [hereinafter, *NATIONAL COMMISSION REPORT*]. Perhaps the most vivid example is the dramatic scaling back of the Civil Aeronautics Board controls over the airline industry. See *id.* at 184-85.

14. U.S. DEP'T OF JUSTICE, *THE PRICING AND MARKETING OF INSURANCE* (1977) [hereinafter, *DJ REPORT*].

15. Exec. Order No. 12,022, 3 C.F.R. § 155 (1978) reprinted in 15 U.S.C.A. § 1, at 6 (Supp. 1979).

16. The following organization is patterned after that found in DIRECTOR R. MATHIAS, ILLINOIS INSURANCE DEPARTMENT, *INSURANCE REGULATION AND ANTITRUST: THE EFFECT OF THE REPEAL OF THE MCCARRAN-FERGUSON ACT* 19-21 (1979).

17. H.R. 1860, 96th Cong., 1st Sess. (1979). This is one of a package of bills introduced by Congressman LaFalce on February 5, 1979. One bill in the package would, in essence, repeal the McCarran Act with respect to state regulation but continue the Act with respect to state taxation. H.R. 1863, 96th Cong., 1st Sess. (1979).

18. For discussion of the state action doctrine, see text accompanying notes 239-343 *infra*.



thereby possibly preempting such activity under the supremacy clause of the United States Constitution.<sup>19</sup>

Also quite broad is the recommendation that the McCarran Act antitrust exemption, rather than the Act in its entirety, be repealed.<sup>20</sup> The antitrust consequences of this approach would presumably be essentially the same as those following repeal of the McCarran Act in its entirety.

Another approach is a partial repeal of the McCarran antitrust exemption pursuant to some type of dual chartering mechanism. The dual charter approach was originally raised by Massachusetts Senator Edward Brooke in 1976,<sup>21</sup> and ultimately embodied in a bill introduced in 1977.<sup>22</sup> The Department of Justice recommended a similar approach in its report<sup>23</sup> and included the dual charter concept as one of five options reviewed for the National Commission.<sup>24</sup>

In essence, the Department of Justice report recommended a dual system of regulation with insurers having the option of seeking a federal charter or of remaining subject to the full scope of state regulation. If an insurer obtains a federal charter, it would be exempt from state rate regulation, state restrictions on collective merchandising and direct writing of insurance, state guaranty funds and state solvency regulation. The price for these exemptions would be the general application of the federal antitrust laws and subjection to a new federal insurance regulatory agency.

Significantly, however, the Department of Justice recommendation that the application of the federal antitrust laws be limited to those insurers obtaining a federal charter represents a significant scaling back from its original thinking and proposals. In late 1975, background memoranda and a working draft of a bill to amend the McCarran Act were developed.<sup>25</sup> In the

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19. See text accompanying notes 189-192 *infra*.

20. H.R. 13863, 95th Cong., 2d Sess. (1978) introduced by Congressman LaFalce. The Congressman's more recent variant would repeal the antitrust immunity but permit the FTC to determine what essential collective activities in the insurance business should be exempted from antitrust regulation. H.R. 1865, 96th Cong., 1st Sess. (1979).

21. S. 3884, 94th Cong., 2d Sess. (1976).

22. S. 1710, 95th Cong., 1st Sess. (1977). For a discussion of the infirmities in the Brooke bill, see, e.g., *Federal Insurance Act of 1977: Hearings on S. 1710 Before the Senate Comm. on Banking*, 95th Cong., 1st Sess. 150 (1977) (statement of National Association of Insurance Commissioners); Hanson, *The Disadvantages of Federal Insurance Regulation as Highlighted by the Brooke Bill*, 13 *FORUM* 605 (1978).

23. DJ REPORT, *supra* note 14, at 359 *et seq.*

24. The Department of Justice provided staffing to the National Commission. In NATIONAL COMMISSION FOR THE REVIEW OF ANTITRUST LAWS AND PROCEDURES, STAFF PAPER ON INSURANCE 63 (Oct. 2, 1978) [hereinafter, STAFF OPTION PAPER] the Department of Justice staff reviewed the dual chartering approach as one of the five options for consideration by the Commission.

25. See U.S. Dep't of Justice, Antitrust Immunities Task Group, A Proposal to Amend the McCarran-Ferguson Act of 1945 in Order to Promote Competition in the Insurance Industry (1975) (unpublished memorandum) [hereinafter, Justice Dep't Proposal]; U.S. Dep't of Justice, Antitrust Immunities Task Group, Report on the Need for Reform of State Regulation of Insurance (1975) (unpublished memorandum); U.S. Dep't of Justice, Antitrust Immunities Task Group, Insurance Reform Act of 1976 (1975) (unpublished working draft).

area of rating, the recommendations would have prohibited the states from setting or approving rates as well as private ratemaking in concert. In the area of marketing, the recommendation would have precluded state restrictions on mass marketing and direct writing of insurance. Thus, the Department originally sought to apply the federal antitrust laws to all insurers, not only to those opting for a federal charter. Consequently, the permanency of the Department's position on a more limited application of antitrust to insurance is questionable. Since the original recommendations made no attempt to impose a new comprehensive federal insurance regulatory agency, the more recent tie to the Brooke bill suggested an attempt to "get the foot in the door" through a then readily available vehicle. In addition, the testimony of the Deputy Assistant Attorney General of the Antitrust Division before the National Commission further suggests that the Department of Justice looks upon its dual chartering recommendation only as an interim step to a broader application of antitrust to the insurance business.<sup>26</sup>

Another possible option is to narrow the McCarran antitrust immunity to only certain specified activities which appear to warrant special exemption from the federal antitrust laws,<sup>27</sup> such as joint collection and use of loss statistics for ratemaking purposes and joint participation in providing coverage for large risks and effecting reinsurance.<sup>28</sup>

One proposal to amend the McCarran Act focuses upon prohibiting the states from directly regulating rates in personal property and liability insurance (such as private passenger automobile and homeowner's coverages).<sup>29</sup> Antitrust law would still be applicable to any conspiracy to establish rates, rating plans, classifications or territories, or policyholder dividends. However, the states would not be prohibited from authorizing joint collection and use of information on loss experience, from requiring filing of rates after they become effective or from regulating plans assuring availability of coverage. Unlike the other options considered, this proposal would seek to prevent the application of the state action doctrine as a basis for continued state rate regulatory controls over personal lines coverages.

Another proposal would modify the McCarran Act by specifically defining the term "business of insurance" to embrace "only matters directly affecting the solvency and reliability of insurers, and those activities directly related to the underwriting of any risk."<sup>30</sup> The impact of this change on the

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26. See National Commission for the Review of the Antitrust Laws and Procedures, Hearings to Receive Testimony on Antitrust Immunities and Exemptions 80 (July 26, 1978, morning session).

27. STAFF OPTION PAPER, *supra* note 24, at 64.

28. See A. Foer, Statement before National Commission for the Review of Antitrust Laws and Procedures *re* McCarran-Ferguson Act 7-12 (Oct. 17, 1978).

29. State Farm Insurance Companies, Memorandum to the National Commission for the Review of Antitrust Laws and Procedures *re* the Public Benefits of Certain Amendments to the McCarran-Ferguson Act to Deregulate Insurance Ratemaking, Exhibit I (June 16, 1978).

30. H.R. 1862, 96th Cong., 1st Sess. (1979) (introduced by Congressman LaFalce on February 5, 1979).



scope of the McCarran antitrust exemption is unclear and has not been fully explored.

At the opposite end of the option spectrum from that calling for the repeal of the McCarran Act is the option recommending no change in the current law.<sup>31</sup> This option is predicated upon considerations of federalism, recent developments in state regulation, the need to reconcile various public policy concerns and the preference of permitting states to determine their own insurance regulatory methods and policies.<sup>32</sup>

The National Commission recommendations pertaining to insurance drew upon these several alternatives. In brief, the Commission calls for (1) legislative change resulting in the general application of the federal antitrust laws to the insurance business subject to (a) carving out some limited exceptions for essential collective activities and (b) the state action doctrine, (2) maximum reliance on competition by states in pursuing their regulatory objectives and (3) further study of insurance regulation particularly with respect to (a) equity and discrimination in insurance rates, (b) the availability and affordability of insurance, (c) the least anticompetitive regulatory techniques and (d) the appropriate role, if any, of federal legislation as to insurance.<sup>33</sup>

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31. STAFF OPTION PAPER, *supra* note 24, at 69.

32. *Id.* In addition, the Staff Option Paper raised two options for the National Commission which called for no immediate change in the McCarran Act. The first suggested a conclusion that continued broad insurance exemption from the antitrust laws is not justified and that a new insurance study commission or a congressional committee undertake a comprehensive review of state insurance regulation. *Id.* at 66-67. The second option recommended a policy statement favoring open competition over more restrictive state regulatory schemes and recommended that the courts apply a more vigorous interpretation of the antitrust exemption. *Id.* at 68. And finally, Congressman LaFalce introduced two additional bills to amend the McCarran Act. One would restrict the McCarran antitrust exemption to those activities constituting the business of insurance which are "effectively" regulated (not just regulated) by state law with the FTC being the determiner as to whether state regulation is effective. H.R. 1861, 96th Cong., 1st Sess. (1979). The second bill would establish a Federal Insurance Commission to regulate insurance unless the commission determines that a state has sufficient regulatory authority and that such authority is being effectively implemented. H.R. 1866, 96th Cong., 1st Sess. (1979). Both of these bills are directly aimed at the state versus federal regulation issue rather than the scope of the antitrust exemption issue which is the primary focus of this article.

33. 1. The current broad antitrust immunity for the business of insurance granted by the McCarran-Ferguson Act should be repealed. In its place, narrowly drawn legislation should be adopted to affirm the lawfulness of a limited number of essential collective activities under the antitrust laws.

2. States should place maximum reliance on competition in pursuing their regulatory objectives. Although the Commission recognizes that the state action doctrine would exempt from antitrust scrutiny private action compelled and effectively regulated by the state to achieve legitimate social goals, we nonetheless believe that narrowly targeted antidiscrimination, disclosure, and similar statutes are preferable to such anticompetitive economic regulation as state ratesetting.

3. Further study of economic regulation of insurance should be undertaken by the relevant congressional committees or by a special commission established by the President. The study should include:

The recommendations of the National Commission may very likely be, at least initially, the focal point when Congress undertakes serious deliberations concerning the scope of the McCarran Act antitrust immunity for insurance. At the same time, however, the Commission's recommendations are not the only ones which have been advanced. Furthermore, there is no indication that the Commission, during its relatively short existence, has exhausted the possible alternative approaches. Once the congressional process commences, the whole gamut of alternatives is likely to be examined.

Consequently, the purpose of this article is not simply to evaluate the specific recommendations of the National Commission, but rather, the effort will be primarily directed towards consideration of the basic issue: whether the public interest will better be served by a broad application of the federal antitrust laws to the business of insurance. In the course of the discussion which follows, however, some attention will be centered on particular alternative proposals.

### B. Antitrust, Competition and Insurance

The basic antitrust law is set out in four statutes: the Sherman Act,<sup>34</sup> the Federal Trade Commission Act,<sup>35</sup> the Clayton Act,<sup>36</sup> and the Robinson-Patman Act.<sup>37</sup> These laws were enacted over a period of time in response to perceived evolving needs. The Sherman and FTC Acts are general in nature in that their prohibitions are couched in very broad terms. In contrast, the Clayton and Robinson-Patman Acts focus upon specific abuses.

In 1890, Congress passed the Sherman Act, upon which the major body of judicial principles of antitrust law has been draped. The basic antitrust standards are enunciated in sections 1 and 2. Section 1 provides that "[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with

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- (a) the appropriate regulatory response to problems of equity and discrimination in insurance rates;
  - (b) the relationship between such regulation and the availability and affordability of insurance;
  - (c) procedures by which such regulatory goals may be achieved in the least anticompetitive manner; and
  - (d) the appropriate role, if any, of federal legislation with respect to the business of insurance.

NATIONAL COMMISSION REPORT, *supra* note 13, at 225.

34. 15 U.S.C. §§ 1-7 (1976).

35. 15 U.S.C. §§ 41-58 (1976). Technically, the Federal Trade Commission Act (FTCA) is not an antitrust law. See 15 U.S.C. § 12 (1976). However, the "Courts have construed the Federal Trade Commission Act as being 'in *pari materia*' with the Sherman and Clayton Acts. This construction allows for using cases decided under any of the antitrust laws in dealing with cases brought by the Commission." *Atlantic Refining Co. v. FTC*, 344 F.2d 599, 605-06 (6th Cir.), *cert. denied*, 382 U.S. 939 (1965).

36. 15 U.S.C. §§ 12-27 (1976).

37. 15 U.S.C. §§ 13-13b, 21a (1976).

foreign nations, is declared to be illegal. . . ."<sup>38</sup> This section reflected the common law concern over restraints in trade.

The "rule of reason" has been used to test the legality of conduct within the purview of the Sherman Act. Although the term "reasonable" does not appear in the Act, the courts have interpreted the Act to prohibit only those acts, contract agreements or combinations which prejudice the public interest by unduly restricting competition. However, some agreements or practices are presumed to be unreasonable without inquiry into factual circumstances or economic data. These are agreements or practices deemed to have a pernicious effect on competition and lacking any redeeming virtue. These are deemed illegal *per se*.<sup>39</sup>

Section 2 declares "[e]very person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony. . . ."<sup>40</sup> This section supplements section 1 in that it deals with the end product of unreasonable restraints: monopolies.

The Clayton Act was enacted in 1914 in response to disillusionment with the absence of results achieved under the Sherman Act. The Clayton Act was intended to supplement the Sherman Act by limiting or prohibiting several specific practices such as tying clauses, exclusive dealing arrangements, total requirement obligations contained in leases and sales, acquisitions, mergers and interlocking directorates.<sup>41</sup> The major provisions of the Clayton Act were designed to reach practices which, in their incipience, have potential anti-competitive effect. In comparison, the Sherman Act is not violated, except for *per se* violations, unless substantial adverse competitive effects have occurred.

The FTC Act was originally enacted in 1914. The FTC Act supplemented judicial enforcement under the Sherman Act with the creation of a new federal regulatory agency, the Federal Trade Commission. Section 5 establishes the basic standard. "Unfair methods of competition in commerce, and unfair or deceptive acts or practices in commerce, are declared unlawful."<sup>42</sup> Congress initially left to the FTC and ultimately to the courts the power to define the meaning of "unfair" as used in the statute.<sup>43</sup> The Supreme Court

38. 15 U.S.C. § 1 (1976).

39. [1979] 1 TRADE REG. REP. (CCH) ¶ 640-645. Those practices condemned as *per se* violations include price fixing, division of markets, group boycotts and tying arrangements. *Northern Pac. Ry. Co. v. United States*, 356 U.S. 1, 5 (1958).

40. 15 U.S.C.A. § 2 (Supp. 1979).

41. See 15 U.S.C. §§ 14, 18, 19 (1976).

42. 15 U.S.C. § 45(a)(1) (1976). Originally section 5 did not include the reference to unfair or deceptive acts or practices. The Wheeler-Lea Act, Pub. L. No. 447, added this language in response to a court decision that indicated the FTC could not curb unfair trade practices unless harm to competition could be demonstrated. *FTC v. Raladam Co.*, 283 U.S. 643, 647-49 (1931).

43. See, e.g., *FTC v. Beech-Nut Packing Co.*, 257 U.S. 441, 453 (1922); ABA SECTION OF ANTITRUST LAW, ANTITRUST DEVELOPMENTS 1955-68, at 252 (1968).

has made clear that activities which constitute violations of the Sherman or Clayton Acts can be attacked under Section 5 of the FTC Act,<sup>44</sup> although the FTC can challenge other practices as well.<sup>45</sup>

With respect to the body of antitrust laws, it has become well settled that immunity from their proscriptions is not to be lightly implied.<sup>46</sup> This stems from the concept that the antitrust laws were designed, as stated by the Supreme Court,

to be a comprehensive charter of economic liberty aimed at preserving free and unfettered competition as the rule of trade. [Antitrust law] rests on the premise that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress, while at the same time providing an environment conducive to the preservation of our democratic political and social institutions.<sup>47</sup>

However, it should be emphasized that a fundamental goal of national public policy is not the application of the federal antitrust laws *per se*, but rather the promotion of competition.<sup>48</sup>

This article will suggest that the general application of the federal antitrust laws to the business of insurance, even in their most idealized version, provides no panacea for solving insurance consumer problems. Whenever attempts are made to apply antitrust concepts, generally fashioned for unregulated businesses, to a regulated industry such as insurance, it is unrealistic not to expect serious problems. Furthermore, while much can be said for the basic thrust of the antitrust laws, antitrust is not an ideal or theoretically perfect body of law. Flaws in the antitrust laws have long been noted by critics of both their substantive principles and enforcement. A major conclusion of this article is that if the federal antitrust laws are generally applied to the insurance business and the states are prohibited from exercising regulatory control, particularly with respect to rates, the competitive objectives of national policy may be significantly and adversely affected and the ability of the insurance mechanism to serve the needs of the insurance-consuming public could be seriously impaired. This article provides elaboration on the development of this conclusion.

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44. 257 U.S. 441, 453 (1922).

45. See, e.g., *FTC v. Motion Picture Advertising Service Co.*, 344 U.S. 392, 394-95 (1953).

46. *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 348 (1963).

47. *Northern Pacific Ry. Co. v. United States*, 356 U.S. 1, 4 (1958).

48. "The general objective of the antitrust laws is promotion of competition in open markets." *REPORT OF THE ATTORNEY GENERAL'S NATIONAL COMMITTEE TO STUDY THE ANTITRUST LAWS* 1 (1955).

## II. THE IMPLEMENTATION OF THE PUBLIC POLICY OBJECTIVES OF FOSTERING AND PRESERVING COMPETITION IN THE BUSINESS OF INSURANCE IS NEITHER SIGNIFICANTLY DEPENDENT ON NOR SERVED BY THE APPLICATION OF THE FEDERAL ANTI-TRUST LAWS

The Department of Justice's avowed purpose is to bring the insurance-consuming public the benefits attributable to competition—a reliable insurance mechanism and economically fair prices.<sup>49</sup> But it must be asked whether the application of the federal antitrust laws and the corresponding limitation on state authority would significantly improve competition in the insurance business. The answer appears to be no, since vigorous competition already exists and the states seem better able to foster and preserve competition in the insurance business without antitrust restraints.

At the outset, it should be noted that the life and health insurance industry does not raise the same perceived antitrust concerns because of the absence of rating bureaus, the absence of widespread rate regulatory laws and the life insurance industry's assumption that it has always been subject to the antitrust laws. At one point the Department of Justice conceded that the application of antitrust law to the life and health insurance industry would not have significant impact.<sup>50</sup> This leaves approximately forty percent of the insurance business<sup>51</sup> (property and liability insurance) as the primary target of the antitrust proponents and the focus of this article.

### A. Absence of Need for General Application of Antitrust Since, at Best, Antitrust Would Have Minimal Impact on Enhancing Competition in the Insurance Business

The general application of the federal antitrust laws to the property and liability business could, at best, have minimal impact since vigorous competition already exists. Several factors illustrate and demonstrate this point.

#### 1. Competitive Structure and Performance of the Property and Liability Insurance Business

Economists have developed a model of perfect competition grounded

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49. See DJ REPORT, *supra* note 14, at 2-3.

50. "[T]he adoption of our proposals would have relatively little effect upon the health and life insurance fields. . . ." Justice Dep't Proposal, *supra* note 25, at 1. Although the 1977 Department report briefly discussed life and health insurance, the report did little to demonstrate that further application of the antitrust laws would affect upon the degree of competition. See DJ REPORT, *supra* note 14, at 11-14, 277-82, and 284-86.

51. The life insurance premium volume plus annuity consideration in 1976 in the United States was \$45.4 billion. AMERICAN COUNCIL OF LIFE INSURANCE, LIFE INSURANCE FACT BOOK 7 (1978). The health insurance premiums in 1976 (including Blue Cross-Blue Shield and other medical plans) were \$44.8 billion. HEALTH INSURANCE INSTITUTE, SOURCE BOOK OF HEALTH INSURANCE DATA 5 (1977-78). The property and liability insurance premiums (not including health insurance) for 1976 were \$58.7 billion. INSURANCE INFORMATION INSTITUTE, INSURANCE FACTS 11 (1978).



upon certain assumptions. If such conditions existed, the price and quantity levels of goods and services would maximize the efficiency of the economy. However, in the real world, the model of perfect competition is unobtainable since nowhere in the economy are all the assumptions of the competitive economic model met. Thus, the problem is one of determining whether the actual market situation leads to results which approximate those that would be competitively derived. If it does, the market situation is reasonably or workably competitive.<sup>52</sup>

The tests of workable competition have been categorized into three basic classifications. They are (1) market structure (number and relative size of firms, ease of entry and exit, homogeneity of products, etc.), (2) market performance (profitability, prices and availability, among others) and (3) market conduct (price fixing, boycotting, tying arrangements and the like).

Although market performance standards and results are essential in evaluating the workability of competition in a market situation, examining performance alone has a major drawback. Generally speaking, one can never be certain that the performance which is exhibited could not be improved under different market structures. For this reason, another approach to the determination of the workability of competition has centered around the market structure. Under the structuralist approach, if the conditions of the insurance market substantially conform to the assumptions underlying the competitive model, the market structure provides reasonable assurance that the beneficial competitive results will occur. This school of thought desires to maintain or create competitive situations and allow the market to provide the appropriate competitive results.

a. *Market Structure.* The primary concern of the structural approach to workable competition is the size, number and dispersion of firms. These measures attempt to indicate whether or not there are enough firms in a market so that no one firm is able to independently influence the price of the product. If there are many sellers in a market and if the market share of each seller is relatively small, it is felt that the firms will be price takers and not price makers. This is one of the key assumptions underlying the model of competition.

As to market structure, the National Association of Insurance Commissioners (hereinafter, the NAIC),<sup>53</sup> an organization of the state insurance regulatory officials, has compiled information on the concentration and entry and exit in the property and liability industry on a by-line by-state basis. Preliminary analysis of these data strongly suggests that the market structure, in general, is not concentrated and does not give rise to widespread negative implications for competition in most lines of insurance for most states.<sup>54</sup>

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52. For a summary description of workable competition, see P. ASCH, *ECONOMIC THEORY AND THE ANTITRUST DILEMMA* 118-24 (1970).

53. The NAIC, organized in 1871, is a voluntary association of the principal insurance regulatory authorities of the 50 states, D.C., Guam, Puerto Rico and the Virgin Islands.

54. See NAIC COMPETITION SUBCOMMITTEE, *NAIC PROGRAM TO MONITOR COMPETITION IN THE*



No effort will be made to belabor this point since the Department of Justice report confirms this conclusion. It notes that the industry possesses an "atomistic structure" and is only moderately concentrated; that no single group accounts for a major share of the overall market; that entry restrictions do not appear significant and that the vast majority of the business is written by 900 companies which generally operate on a nationwide basis; that there is an absence of significant economies of scale and that the product is essentially homogeneous.<sup>55</sup> In fact, the Department of Justice flatly concluded that the industry structure is "conducive to competition."<sup>56</sup> The National Commission has adopted this conclusion.<sup>57</sup>

b. *Market Performance.* As indicated earlier, a prime concern in ascertaining the existence of workable competition is the result derived, the performance results of the insurance industry. In the context of the model of perfect competition, socially desirable results are derived from the working of a competitive system. These results pertain to such areas as profits, prices and availability.

Most models of economic behavior are predicated upon the maximization of profit by firms. Profits are the means through which successful performance is rewarded. Profits are the spur to innovation. By striving for profits, firms assure the efficient allocation of resources and thereby maximize the production of goods and services available to society. The theory of a competitive market indicates that when abnormal profits are earned, there will be pressure for decreasing prices, and consequently decreasing profit levels; when profits are inadequate, there will be upward pricing pressure. On the other hand, if profits are persistently higher than "normal" profits over an extended period of time, this suggests that the requisite degree of competition is not present. One conclusion of the perfectly competitive model is that there would be no long-run excessive profits (excessive profits being defined in this instance as profits greater than those necessary to attract and retain capital).

Table I, obtained from the NAIC Statistical Reporting System, compares the overall profitability of the property and liability insurance industry with that of other industries. The profitability results for the industry for 1971-1978 compare quite closely with that of other industries. For the seven-year period 1971-1977, with the exception of transportation, the return on net worth for these other industries ranges from 10.1% to 12.4%. The return for the property and liability insurance industry of 11.6% over the same period of time falls in the middle of this range. Because of the complexities surrounding the measurement of profitability, particularly between different

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PROPERTY AND LIABILITY INSURANCE BUSINESS 1979 REPORT 7 (1979) (1977 data). For a detailed discussion of the industry structure, see *MONITORING COMPETITION*, *supra* note 12, at 248 *et seq.*

55. DJ REPORT, *supra* note 14, at 7-10, 348.

56. *Id.* at 348.

57. NATIONAL COMMISSION REPORT, *supra* note 13, at 226.

TABLE I  
COMPARISON OF INTER INDUSTRY RATES ON RETURN ON NET WORTH

	NAIC <sup>58</sup> Property/ Liability Insurance	Diversified Financial	Industry Means <sup>59</sup>			
			Banks	Utilities	Transportation	Industrial
1971	15.4%	12.0%	12.1%	9.5%		9.8%
1972	15.6	11.9	11.9	9.7	3.8%	10.9
1973	12.1	11.2	12.5	10.0	4.7	13.7
1974	5.8	7.5	12.8	9.8	6.5	14.1
1975	1.8	8.9	12.1	9.9	3.7	11.4
1976	11.1	12.1	11.5	10.6	8.8	13.5
1977	19.6	16.7	11.6	11.1	10.1	13.3
1978	19.8					14.2
1971- 1977	11.6	11.5	12.1	10.1	6.3	12.4
1971- 1978	12.7					12.6

industries, it is impossible, given the state of the art, to make precise and specific judgments and comparisons. Nevertheless, the several-year profit results on a nationwide all-lines basis suggests that the property and liability insurance results did not reach levels which could be deemed excessive in comparison to other industries. Thus, the market performance test of overall profitability does not suggest lack of workable competition in general.

Other performance tests of workable competition include availability<sup>60</sup> and prices.<sup>61</sup> To date, there has been no comprehensive study of pricing and availability data on a state by state, line by line basis in the context of applying the tests of workable competition. Thus, no firm positive or negative conclusions as to competition can be made at this time with regard to the application of these tests. However, the market structure and profit results support the overall conclusion that the property and liability insurance industry, in general, as to most lines and in most states appears to be structured and appears to perform in a competitive manner.

## 2. Competition Under the Property and Liability Rating Laws

During the 1800's when there was cut-throat competition, no rate regulation was imposed.<sup>62</sup> As industry efforts intensified to act in concert to control

58. NAIC REPORT OF PROFITABILITY BY LINE BY STATE FOR THE YEAR 1978, at 3 (1979).

59. Compiled from the *Annual 500 Issues of Fortune Magazine* for the years 1972-79.

60. See MONITORING COMPETITION, *supra* note 12, at 309-23.

61. See *id.* at 341-70.

62. In the 1800's, prior to significant government regulation, the property and liability insurance industry was characterized by cut-throat competition in terms of price cutting and the level of commissions offered to agents in order to attract business. Because of the low rates and high expenses, as well as only crudely developed methods to establish rate levels, insolvencies

rates through private agreements and organizations, several states enacted anticompetitive laws paralleling the enactment of the Sherman Act.<sup>63</sup> However, in the early 1900's, competition fell into such public disrepute that state legislatures were induced to sanction concerted ratemaking, which was concluded to serve the public interest by avoiding adverse consequences of destructive competition, such as inadequate rates, unfair discrimination and insolvencies.<sup>64</sup> In the ensuing years, state insurance rate regulatory jurisdiction was created, developed and refined to exercise control over a cartel-structured industry functioning, in large part, through rating bureaus.<sup>65</sup>

Following the *South-Eastern Underwriters* case<sup>66</sup> holding that insurance is commerce, the potential application of the antitrust laws to rating bureaus and pooling arrangements was thought to jeopardize the ability of the insurance industry to meet the public's insurance needs. Congress responded by enacting the McCarran Act, which bars the application of the federal antitrust laws to the extent the business of insurance is regulated by the states. The states responded by enacting fire and casualty rating laws in every state by 1951,<sup>67</sup> most of which were patterned after NAIC-drafted prior approval model bills.<sup>68</sup> "Based on traditional economic and regulatory theory and practice . . . [these prior approval laws] were appropriate responses to the then existing market conditions of cartel pricing."<sup>69</sup>

Market conditions in the late 1950's began to change drastically as several insurers acted independently of rating bureaus in manners sanctioned by the prior approval rating laws.<sup>70</sup> In the early 1960's the NAIC revised the model prior approval rating law to eliminate some of the obstacles to competition.<sup>71</sup> Rating bureau domination was broken.

The [prior approval] laws were devised for an insurance market that was

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cies were frequent, particularly in the aftermath of large fires in urban areas. In efforts to stabilize conditions, many insurers sought solution through private agreements to control rate levels and "excessive" commissions through various local, regional and national organizations established to enforce such agreements. VIRGINIA BUREAU OF INSURANCE, COMPETITION IN THE PROPERTY AND CASUALTY INSURANCE INDUSTRY: AN EVALUATION OF ALTERNATIVE METHODS OF RATE REGULATION 6 (1978) [hereinafter, VIRGINIA STUDY]; MONITORING COMPETITION, *supra* note 12, at 9-13. However, member companies and participating agents did not abide by such agreements for very long and private controls over competition proved to be fleeting and illusory. *Id.* at 13.

63. VIRGINIA STUDY, *supra* note 62, at 7. The Sherman Act at that time was deemed inapplicable to the insurance business because of *Paul v. Virginia*, 75 U.S. (8 Wall.) 168 (1869).

64. VIRGINIA STUDY, *supra* note 62, at 8-9.

65. See MONITORING COMPETITION, *supra* note 12, at 16-21, 78.

66. 322 U.S. 533 (1944).

67. A. MERTZ, THE FIRST TWENTY YEARS: A CASE-LAW COMMENTARY ON INSURANCE REGULATION UNDER THE COMMERCE CLAUSE 13 (1965).

68. See NAIC Model Fire, Marine and Inland Marine Rate Regulatory Bill, NAIC PROCEEDINGS 410-22 (1946); NAIC Model Casualty and Surety Rate Regulatory Bill, NAIC PROCEEDINGS 397-410 (1946). For a description of the prior approval approach, see text accompanying note 346 *infra*.

69. VIRGINIA STUDY, *supra* note 62, at 13.

70. MONITORING COMPETITION, *supra* note 12, at 40.

71. See *id.* at 46-48.

basically non-competitive. Since the enactment of that legislation in the late 1940's, marked changes have occurred in the fire and casualty business. In particular, the competitive setting has changed, bringing with it changes in the availability of insurance. Bureau domination of the rate structures with resulting uniform rates has been replaced by multi-priced rate structures made by insurers functioning independently. The requirement that member companies of Bureau must adhere to bureau rates is being relaxed; member companies can treat the rates as advisory and may deviate from them without permission.<sup>72</sup>

During the past ten years, in keeping with the increased competitiveness of the market and the demise of the rating bureau domination, a number of states have replaced the traditional prior approval rate regulatory system with some type of open competition rate regulatory system which places increased reliance on competition as the primary regulator of insurance rates.

The interrelationship between the different lines of insurance and the various rating laws provides a somewhat hard to describe scenario when attempting to evaluate the insurers' ability to function competitively thereafter. But, several factors lead to the same conclusion, that the property and liability insurance business can and does function in a competitive manner. These factors include the following:

(1) At least eighteen states have enacted some type of open competition rating law which does not require prior approval of rates and which prohibits insurers from agreeing to adhere to rates.<sup>73</sup> The common denominators underlying the open competition rating laws are the lack of a requirement of advance approval or disapproval of rates by the regulator prior to their use and the absence of any requirement for and the prohibition of any agreement among insurers to adhere to rating bureau filings. Typically, the rate standards are defined in terms of competition.<sup>74</sup> These open competition states

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72. 1 NAIC PROCEEDINGS 309-10 (1969).

73. See ARK. STAT. ANN. §§ 66-3101 to -3102 (Supp. 1980); CAL. INS. CODE §§ 1850-1860.3 (West 1972); COLO. REV. STAT. §§ 10-4-401 to 10-4-408 (1973); CONN. GEN. STAT. ANN. §§ 38-201a to 38-201t (West Supp. 1980); FLA. STAT. §§ 627.011-627.391 (Supp. 1977); GA. CODE ANN. §§ 56-501 to 56-539 (1977); IDAHO CODE §§ 41-1401 to 41-1441 (1977); MINN. STAT. ANN. §§ 70A.01-70A.23 (West Supp. 1978); MO. ANN. STAT. §§ 379.316-379.361 (fire, marine and inland marine), §§ 379.420-379.510 (casualty and surety) (Vernon Supp. 1979); MONT. REV. CODES ANN. §§ 40-3634 to 40-3669 (1978); NEV. REV. STAT. §§ 686B.010-686B.250 (1973); N.M. STAT. ANN. §§ 59-12-1 to 59-12-43 (1978); N.Y. INS. LAW §§ 175-179a (McKinney Supp. 1979); OR. REV. STAT. §§ 737.007-737.560 (1977); UTAH CODE ANN. §§ 31-18-1 to 31-18-20 (1974); VA. CODE §§ 38.1-279.29 to 38.1-279.57 (1976); WIS. STAT. ANN. §§ 625.01-625.35 (1979). In addition to these 17 states, Illinois is considered to be an "open competition" state even though its rating law expired on August 1, 1971. In the absence of further legislation insurers have set their rates in Illinois on a competitive basis without state intervention. See MONITORING COMPETITION, *supra* note 12, at 82-83.

74. However, the various statutes may differ in some respects as to the filing requirements, language in the rate standards, the ability to reimpose prior approval for those lines of insurance in which the regulator finds an absence of adequate competition, limitations on rating bureaus, etc. See generally MONITORING COMPETITION, *supra* note 12, at 395-422.

account for approximately forty-eight percent of the property and liability premium.<sup>75</sup> Although even open competition statutes may provide for some rate approval with regard to certain lines of coverage or residual market mechanisms, nevertheless a major segment of the business is written under competitive conditions.

(2) Many of the state prior approval laws are administered like open competition rating laws, thereby affording insurers a high degree of flexibility in rate changes. The manner in which a rating law is administered is as important as the actual statutory structure. An FTC staff member testifying before the National Commission noted that "insurers now have considerable freedom to price their product, in both 'open competition' and 'prior approval' jurisdictions. . . ."<sup>76</sup> In one large state, insurers have the option of filing under either a prior approval provision or an open competition provision.<sup>77</sup> Furthermore, the Department of Justice has recognized the "change in the regulatory climate in favor of competitively determined rates," reflected by the adoption of open competition rating laws, NAIC support of price competition as a means to regulate rates, and the liberalization of the prior approval laws to facilitate independent pricing.<sup>78</sup>

(3) As discussed earlier, the structure of the property and liability insurance industry is conducive to competition. The industry is inherently competitive. The performance measures applied to date do not detract from this conclusion. The Department of Justice recognizes the "emergence of price competition" in the industry.<sup>79</sup>

(4) Nevertheless, despite the competitive market structure and presumably because of the existence of rating bureaus, proponents of applying the federal antitrust laws find it difficult to perceive the intense competition which exists. In prior approval states, insurers may belong to a rating bureau which prepares rates and files them on behalf of its members for insurance department approval. The members may agree to adhere to such rates. In most open competition states the existence of bureaus is permitted under regulatory oversight but agreements to adhere are prohibited. Furthermore, rates do not require advance department approval.

On the surface, the mere existence of the bureaus suggests severe potential anticompetitive implications. But, the manner in which the insurance system functions militates against this conclusion for several reasons. First, except in very rare instances, an insurer is not compelled to belong to a rating bureau. Also, an insurer can opt to belong to a rating bureau for certain lines and remain completely independent as to other lines. Second, under the rating laws, an insurer may deviate from the bureau-filed rates either upwards or downwards. Third, even under the prior approval laws, insurers may

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75. Obtained from the NAIC Statistical Reporting System.

76. A. Foer, *supra* note 28, at 14.

77. MICH. COMP. LAWS §§ 500.2430, 500.2628 (1970).

78. DJ REPORT, *supra* note 14, at 27-28.

79. Justice Dep't Proposal, *supra* note 25, at 26. See also DJ REPORT, *supra* note 14, at 28.



file rates independently of what the bureau does. The Department of Justice stated that there appear to be "meaningful price differentials between bureau and off-bureau companies" in prior approval as well as in open competition states.<sup>80</sup> Thus, the structure of even the prior approval rating laws affords a high degree of opportunity for competition. Furthermore, in the open competition states, the major rating bureau (Insurance Services Office) does not make and file rates for its members. In these states member companies may utilize ISO data, but they must determine and file their own rates independently. The Department of Justice review of pricing practices in California under open competition and the NAIC review of two other open competition states<sup>81</sup> demonstrate that most business is written at other than bureau rates. Finally, it should be noted that the National Commission itself has concluded that "[n]o longer can the [property and liability] industry be characterized as dominated by tight cartels, or by uniform regulatory supervision of collective ratemaking."<sup>82</sup>

(5) The inherent competitive structure of the property and liability industry, combined with the competitive mechanisms available under the prior approval rating laws as well as the open competition laws, not only suggests that competition should exist but also has, in fact, led to vigorous pricing activity which belies rating bureau domination or control of the markets. For example, the data compiled in the NAIC study of the economics of the industry reflect a wide degree of variation in prices charged by the insurers for an essentially homogeneous product (such as automobile and homeowners' insurance).<sup>83</sup> Although it is virtually impossible to quantify, informed

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80. DJ REPORT, *supra* note 14, at 43.

81. See NAIC PROGRAM TO MONITOR COMPETITION, *supra* note 54.

82. NATIONAL COMMISSION REPORT, *supra* note 13, at 231.

*When one contrasts the present competitive situation in the industry of almost 3,000 competitors with the completely controlled and centrally directed industry as it existed in 1945, one can understand that an 180° change has occurred. An industry which may well have been the most highly controlled and most tightly structured of any major industry in the history of the United States has become what is likely the most competitive of any existing today.*

*All of this has occurred during the period of the McCarran Act exemption and under state regulation. In balance, if one considers the results, one finds it very difficult to criticize either the McCarran Act or state regulation for any substantial adverse effects on competition or to find alternate basic means of improving on the results.*

W. Pugh, *Competition Under the McCarran Act*, National Underwriter, Dec. 8, 1978, at 19, 20 (emphasis added). Deputy Attorney General Joe Sims of the Antitrust Division stated that in determining whether an antitrust exemption was a success, the structure and degree of competition of the exempt industry at the inception of the exemption should be compared with degree of competition now. W. Pugh, *Competition Under the McCarran Act*, National Underwriter, Nov. 24, 1978, at 27. Pursuant to this test, as above quotation suggests, the McCarran Act exemption would have to be judged a success.

83. See MONITORING COMPETITION, *supra* note 12, at 348 *et seq.* More recent work on two pilot states confirms continued variation in insurers' prices. See NAIC PROGRAM TO MONITOR COMPETITION, *supra* note 54, at 14-15. A more recent rate study of 19 states showed a wide diversity of pricing by insurers suggesting that "there is no strong attempt made by the compa-



persons have conservatively estimated that less than one-fourth of the business is written at bureau rates. Another significant illustration is that the largest personal lines insurers price their product independently.<sup>84</sup>

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nies to use a common rate level of any kind." ILLINOIS DEPARTMENT OF INSURANCE, ILLINOIS AUTOMOBILE RATE STUDY 2 (1979).

84. The National Commission stated, without providing supporting evidence, the prior approval rating laws discourage independent pricing and provide regulatory environment which "encourages uniform pricing." NATIONAL COMMISSION REPORT, *supra* note 13, at 226. But even the *Department of Justice Report* did not find uniformity in pricing when it compared one open competition and two prior approval rating law states. See DJ REPORT, *supra* note 14, at 39-50. The report concluded that at least 70% of the automobile insurance in California (open competition rating law) is priced independently of bureau rates as compared to 55% in New Jersey and 57% in Pennsylvania (prior approval rating laws) and that there is a more meaningful price differential between bureau and nonbureau rates in California. *Id.* at 49-50. However, the Department defined independent pricing to exclude insurers that deviate from bureau rates by some fixed or varying percentage despite the fact that such differing rates were part of price competition for business in the states under consideration. Regardless of the definitional problem, however, the basic fallacy in the report's analysis is its failure to demonstrate the significance of its findings. Under the economic theory of the competitive model, over a long term, competition will result in a uniform or nearly uniform price for a homogeneous product in a given market.

Well-informed consumers will tend to buy a homogeneous product (a product alike in kind and quality, including service) at the lowest price available. This tendency will force suppliers, engaged in a competitive struggle for larger shares of the market, toward a uniform price at about the reasonable level of the minimum-cost (maximum-efficiency) suppliers. . . . The price could not go below that level for very long because if it did invested supplier-capital would not make enough profit to hold invested capital (or attract new capital) in the face of competition from other forms of investment. The suppliers that will survive in an environment of effective competition are the minimum-cost (maximum-efficiency) producers previously discussed. Effective competition will, therefore, theoretically result in both a uniform price and a reasonable price for a homogeneous product.

L. BORCHERT, CALIFORNIA DEPARTMENT OF INSURANCE, COMPETITION UNDER THE CALIFORNIA RATING LAW AND ITS EFFECT ON PRIVATE PASSENGER AUTOMOBILE AND HOMEOWNERS INSURANCE 224-25 (1974).

That is, contrary to the understanding of some, differences in prices charged by different sellers in themselves do not imply price competition.

It might be argued that the greater the variability in prices in the insurance market, the less likely is the possibility that workable competition exists since such variability suggests either induced product differences and/or consumer ignorance, both of which detract from the competitiveness of the market. However, this argument ignores the fact that the formal economic model of competition is essentially a comparative static model. That is, it is concerned with instantaneous movement from one position of equilibrium to another. The lack of variation of price in the competitive model is a long-run phenomenon. The dynamics by which the uniform price is reached are not specified. In the short run, price variability is not necessarily inconsistent with the existence of workable competition.

This conclusion, however, has to be tempered by the fact that a noncompetitive economic model yields a single uniform price. However, because of the structure of the property and liability industry, at least with respect to most lines of coverage in most states, monopoly or oligopoly pricing seems unlikely. Thus, generally speaking, in the absence of collusive action (e.g., price fixing), a trend towards uniformity in price would suggest a competitive insurance market. In short, despite the Department of Justice report use of independent pricing as one

(6) The competitive devices for commercial coverages (in addition to those available in personal lines such as deviations and independent filings) which are sanctioned under the rating laws include the payment of dividends, a variety of experience and schedule rating plans and multiple peril package pricing. The wide variety of pricing techniques utilized in commercial coverage pricing, the insurance regulator recognition that commercial buyers are better equipped to protect themselves than individual purchasers and the competitive structure of the industry have all engendered fierce competition between insurers for commercial coverage business both in open competition and prior approval states.<sup>85</sup> Many company managements point to the intense price competition as being one of the primary factors underlying the industry's disastrous underwriting results in 1974 and 1975.<sup>86</sup>

(7) Commercial insurance, which tends to be highly competitive, accounts for over fifty percent of the property and liability business.<sup>87</sup> Of the personal lines coverages, roughly forty-eight percent is written in open competition states.<sup>88</sup> In addition, as indicated above, much of the business in prior approval states is quite competitive (either because of or despite the existence of rating bureaus).<sup>89</sup> Thus, it is reasonable to assume that approxi-

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reason to conclude that the antitrust laws should be applied to insurance, its analysis on this point, in fact, tells us nothing other than the fact that the rating bureaus are not a dominant factor in the price levels for insurance. This is further highlighted by the fact that the report itself says that there appear to be "meaningful price differentials between bureau and off-bureau companies (as well as a meaningful variation of prices among all insurers) in all three [prior approval and open competition] states. . . ." DJ REPORT, *supra* note 14, at 43.

85. The Department of Justice readily admits that in commercial lines "insurers are generally free to set their own prices. . . ." DJ REPORT, *supra* note 14, at 341. The report based the conclusion on "the availability of state-authorized rating plans which permit insurers to individually price risks based essentially on their business judgment and competitive pressures." *Id.* From this the report questions the need for state rate regulation. From the same basis, however, a stronger argument can be made not to undergo radical and fundamental shifts in regulatory framework which will have little or no effect.

86. Currently, the business press is replete with articles on the intense competition in the commercial lines in particular. *E.g.*, *Price Cutting Runs Rampant in New Competitive Market*, Business Insurance, Dec. 25, 1978, at 1; Brenner, *Insurance Seen Buyer's Market—Competition is Keen*, J. of Commerce, Feb. 9, 1979, at 1.

87. Obtained from the NAIC Statistical Reporting System. See also A.M. BEST Co., BEST'S AGGREGATES & AVERAGES: PROPERTY-CASUALTY 6 (1978).

88. Obtained from the NAIC Statistical Reporting System.

89. One insurance industry trade association testified that:

*[i]n reality, competition and trends in loss experience are the primary determinants of insurance rate levels, whether the rates are regulated or not. The effect of regulation on rate levels is usually short term, and almost always involves delays which means that rates tend to lag behind actual experience in an inflationary economy. Moreover, regulation often means reductions in proposed rate increases.*

Alliance of American Insurers, Insurance Regulation: The McCarran-Ferguson Act, Statement Before the National Commission for the Review of Anti-Trust Laws and Procedures 9 (1978) (emphasis added). The more probable result of replacing state regulation with federal antitrust regulation "would be a reduction in both the number of competitors and the ability of consumers to make meaningful price and product comparisons among surviving companies." *Id.*

mately seventy-five percent of the property and liability insurance business is being written under competitive rating law provisions. The bureau rates must be responsive to what is occurring in the major share of the market. Consequently, the extent to which the industry is even arguably not competitive is relatively small (such as in those very few areas of state-made rates or state-compelled adherence to bureau rates).

(8) The poor underwriting results suffered by the property and liability insurance industry in 1974 and 1975<sup>90</sup> demonstrate that insurance is not priced to exploit the public. As noted earlier, lack of excessive profits is one performance measure indicating that competition exists. Furthermore, among the performance criteria which the economists use to determine whether an industry is competitive is the profitability of the industry in comparison to other industries. The above profit figures suggest that the insurance business not only has been in no position to exploit the purchasers but also that vigorous competition does exist.

### 3. NAIC Activity to Foster and Preserve Competition

In recent years the states, both individually and collectively through the NAIC, have worked toward increasing the application of competitive concepts in governing the conduct of the insurance industry. During the middle 1960's, for example, the NAIC undertook an extensive review of the rating laws and issued a landmark report in 1968 which stated:

[r]ate regulation, like all insurance regulation, should be responsive to current conditions in the insurance marketplace. It is the sense of the Subcommittee, therefore, that, where appropriate, reliance be placed upon fair and open competition to produce and maintain reasonable and competitive prices for insurance coverages wherever such competition exists, thus conserving the resources of insurance departments for other important areas of public interest. . . ."

In addition, the NAIC report recommended:

[i]n states where an increase in competition indicates that a combination of mechanisms for meeting the availability problem and placing of greater reliance on competition in the regulation of rates would be appropriate, we recommend legislation which would, in general, either:

- (a) authorize the commissioner to suspend the prior approval requirement for any line, subdivision, or class of insurance where conditions warrant such action; or
- (b) repeal the requirement of prior approval (except for certain unique and specified lines) and replace it with a "no-prior-approval" procedure, under appropriate safeguards including the power in the commissioner to reimpose prior approval for any line,

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90. See INSURANCE INFORMATION INSTITUTE, *OPERATING RESULTS: FIRE, CASUALTY AND ALLIED LINES AS REPORTED TO CALIFORNIA INSURANCE DEPARTMENT THROUGH DEC. 31, 1978*, at 1 (1979).

91. 1 NAIC PROCEEDINGS 310 (1969).

subdivision, or class of insurance in which he finds that competition is insufficient or irresponsible.<sup>92</sup> 072

With the adoption of this report, "the NAIC lent its support and prestige to increasing reliance upon competition as a regulator of rates. . . . [The] report unequivocally reaffirmed the NAIC original view as to the importance of competition as an appropriate rate regulatory mechanism."<sup>93</sup> This NAIC report has been described as a "turning point" in the movement toward open competition rating laws.<sup>94</sup>

Late in 1971, the NAIC Executive Committee authorized the NAIC staff to research and prepare a comprehensive study on competition and the regulation of the property and liability insurance industry. The result was a two-volume study entitled *Monitoring Competition: A Means of Regulating the Property and Liability Insurance Business*.<sup>95</sup> This study continues to serve as the basis of a continuous review and effort by the NAIC to implement competitive concepts. One outgrowth of the study has been the establishment of a series of tests of workable competition in insurance markets by-line by-state to better enable commissioners to monitor and evaluate the effectiveness of competition as the primary regulator of rates. In addition, the study has laid groundwork for an NAIC-established statistical gathering mechanism to develop data on an on-going basis for use in applying the tests of workable competition. To date, data on a by-line by-state basis has been compiled concerning the structural tests of market shares, concentration ratios, and entries and exits and the performance tests relating to profitability. In addition, pricing information has been compiled on two pilot project states.<sup>96</sup> Individual states have also conducted in-depth studies in the area of monitoring competition therein.<sup>97</sup>

Consequently, an increasingly widespread recognition has emerged among insurance regulators that insurance regulation, being economic regulation, is concerned with, among other things, the failure of the market mechanism. The creation and maintenance of competitive conditions provide a

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92. *Id.*

93. MONITORING COMPETITION, *supra* note 12, at 53.

94. Hartman, *New Era of Insurance Rate Regulation*, 25 CPCU ANNALS 153, 154 (1972).

95. See note 12 *supra*.

96. See note 81 *supra*.

97. See, e.g., L. BORCHERT, CALIFORNIA DEPARTMENT OF INSURANCE, COMPETITION UNDER THE CALIFORNIA RATING LAW AND ITS EFFECT ON PRIVATE PASSENGER AUTOMOBILE AND HOMEOWNERS INSURANCE (1974); NEW YORK INSURANCE DEPARTMENT, CARTELS VS. COMPETITION: A CRITIQUE OF INSURANCE PRICE REGULATION (1975); NEW YORK INSURANCE DEPARTMENT, THE OPEN RATING LAW AND PROPERTY-LIABILITY INSURANCE: AN EVALUATION OF INSURANCE PRICE REGULATION (1977); VIRGINIA STUDY, *supra* note 62. An Ontario legislative committee, as part of its comprehensive review of that province's insurance laws, recommended the implementation of a system to monitor the effectiveness of competition in insurance markets on a formal on-going basis and suggested that the NAIC monitoring system serve as a starting point for the development of such a system. SELECT COMMITTEE ON COMPANY LAW OF THE ONTARIO LEGISLATIVE ASSEMBLY, THE INSURANCE INDUSTRY—THIRD REPORT ON GENERAL INSURANCE 264 (1979).

primary remedy for such market failures. That is, a fundamental regulatory tool available to the regulator is the removal of those impediments to competitive market forces which are readily subject to regulatory corrective action. Although regulation cannot compel insurers to compete, it may be able to impact on those conditions causing the market failure through the remedying of anticompetitive regulatory inhibitions and monitoring the extent of competition.<sup>98</sup> Because of the substantial public benefits stemming from a viable competitive economy, the NAIC has adopted as regulatory objectives the fostering and monitoring of competition subject to appropriate balancing with other important regulatory goals such as market availability and has undertaken a series of activities to further the achievement of these objectives.<sup>99</sup>

#### 4. Summary

In attempting to reverse a long standing fundamental national policy of leaving the regulation of the insurance business to the states, the proponents of a broad application of the federal antitrust laws to insurance have the burden to make a substantial case for change. To do so they should demonstrate that the application of the antitrust laws and elimination of state insurance regulatory authority over rates will significantly improve competition in the insurance business. This neither the Department of Justice nor the National Commission has done. Several considerations, such as (1) the current competitive structure and performance of the industry, (2) the competitive flexibility under the rating laws and (3) the regulator efforts through

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98. At its December 1978 meeting, the NAIC authorized its Competition Subcommittee to survey both state insurance departments and various segments of the insurance industry as to those regulatory and industry activities which impede and promote competition in the various states. I NAIC PROCEEDINGS 342 (1979).

99. Providing impetus in the pursuit of these objectives by state insurance regulators, the NAIC recently adopted the following charge to its Competition Subcommittee:

The Subcommittee undertake a review of the NAIC model property and liability rating laws with the view of placing more reliance on competition where reasonable assurances are found that it is effective and placing more reliance on regulatory authority where competition does not appear to be sufficiently viable.

The Subcommittee undertake a review of the appropriate role of private rating bureaus in today's current economic and political climate, and

The Subcommittee undertake the development of means to better inform the consumer as to the nature, quality and price of competing products in the insurance markets.

Report of NAIC Competition (B3) Subcommittee, I NAIC PROCEEDINGS 339, 341-42 (1979).

Following up on these charges, the Subcommittee, at its June 5, 1979 meeting, authorized a series of task force efforts in the areas of (a) developing a system to monitor competition; (b) consideration of a model open competition rating law; (c) exploring the appropriate role of rating bureaus in an open competition environment; (d) developing methods to provide meaningful consumer information; (e) focusing on the competitive impact of acquisitions and mergers, etc. Report of NAIC Competition (B3) Subcommittee, June 5, 1979, 267, II NAIC PROCEEDINGS (1979).



the NAIC to preserve and foster competition, suggest that the positive impact on competition of applying antitrust to insurance will be minimal at best.

Most agree that there will be very little impact on life and health insurance, which makes up more than half of the total industry. With respect to property and liability insurance, recent years have witnessed a trend toward open competition rating laws with over one-third of the states having already enacted such laws. Similarly, many prior approval states are often administered like the open competition laws. Not only has the regulatory climate become much more conducive to competition, the structure of the property and liability industry is inherently competitive. Despite the existence of rating bureaus, both the prior approval and open competition laws permit and encourage competitive devices in pricing, such as deviations and independent filings as well as product changes. The combination of the industry's competitive structure and the sanctioning of competitive techniques by the rating laws has led to vigorous competition. Competition for commercial business, which is approximately fifty percent of the property and liability business, is even more intense. When the competitive commercial lines coverages (fifty percent) are combined with the personal lines coverages written in open competition states, to which can be added the competitive business in most prior approval states, the segment of business which is not competitive becomes relatively small. The underwriting and profit performance over the years indicates that competition is working. Furthermore, economic analysis has indicated widespread competition. With the support of the NAIC, state insurance regulation is increasingly attempting to foster and preserve competition in insurance markets.

Consequently, the conclusion seems clear that the application of the federal antitrust laws to the property and liability insurance industry, at best, would have minimal impact on furthering competition.<sup>100</sup> Furthermore, it seems ironic that after, in effect, confessing that the insurance industry under state regulation is one of the most competitive industries in our economy, the Department of Justice, in order to promote competition, wants to substitute statutory controls under which less competitive industries flourish. Fostering and preserving competition in the insurance industry is not dependent upon the application of the federal antitrust laws, and as will be suggested subsequently, such application may even harm the level of competition in the industry.<sup>101</sup>

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100. Testimony before the National Commission by a member of the FTC staff stated: "We are impressed with the healthy competitive forces manifested in recent years within the auto and home segments of the industry, and we believe that their structures are well-suited for vigorous competitive rivalry." A. Foer, *supra* note 28, at 13.

101. Significantly, the members of the National Commission's Economic Advisory Panel responsible for the insurance area concluded that "the repeal of the McCarran-Ferguson Act alone will have little if any effect on the extent of price competition in the industry." Joskow, *Competition and Regulation in the Property/Casualty Industry* at 9, in REPORT OF THE ECONOMIC ADVISORY PANEL TO THE NATIONAL COMMISSION FOR THE REVIEW OF ANTITRUST LAWS AND



B. *The States Are Better Able to Preserve and Foster Competition in the Insurance Business*

Presumably, the recommendations in the Department of Justice Report to oust state rate regulation and to apply the federal antitrust laws in their place are premised on the belief that adequate competition can only be stimulated under the federal antitrust laws. This assumption not only fails to perceive the extensive competition as it currently exists but also overstates the "goodness" or "effectiveness" of federal antitrust law. The federal antitrust laws have been the subject of mounting criticism by economists and lawyers as to both various defects in substantive standards and ineffective enforcement. In fact, the current Chairman of the FTC, in a major policy speech, recognized that "there is a widespread perception that antitrust has failed to deal significantly with significant problems. In the clear, cold light, there appears a failure of philosophy, a failure of resources, and, most important, a failure of political courage, of will."<sup>102</sup> Thus, before even considering substituting the federal antitrust laws for a major segment of state insurance regulation, the defects of the antitrust laws should be carefully analyzed.

1. *Substantive Law*

It is beyond the scope of this article to undertake a detailed analysis of the federal antitrust laws. Nevertheless, it has become clear even to a lay observer that although antitrust law is founded on the concept of competition as a means to yield optimum allocation of economic resources, the legal aspects of antitrust often diverge from economic concepts. The legal and economic literature is replete with demonstrations that antitrust concepts, as currently applied, often make little economic sense, have little positive and perhaps sometimes a negative impact on competition, and may not be worthwhile in terms of time and effort expended.<sup>103</sup> Concern over such defects is sufficiently widespread that this area was the primary focus of the August, 1977, American Bar Association Section of Antitrust Law meeting<sup>104</sup> and that

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PROCEDURES (1978). However, Professor Joskow does believe that restriction on the ability of the states to regulate rates would be a more potent means to enhance competition. *Id.* One insurance industry trade association conducted an interesting survey of its member insurance companies and reached the conclusion that "[t]his would inevitably result in less competition in the industry, and a shrinking of the market for all type coverages." Alliance, *supra* note 89, at 23. For more detail of the results of the survey, see *id.* at 18-23.

102. Address by Michael Pertschuk, Competition Policy, Eleventh New England Antitrust Conference (November 18, 1977) (reprinted in [1977] TRADE REG. REP. (CCH) 3 (Supp., Nov. 22, 1977)).

103. See, e.g., P. ASCH, ECONOMIC THEORY AND THE ANTITRUST DILEMMA (1970); R. BORK, THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF (1978) [hereinafter, BORK]; R. POSNER, ANTITRUST LAW: AN ECONOMIC PERSPECTIVE (1976) [hereinafter, POSNER]; and McGee, *Why Not "De-regulation" for Antitrust?*, 46 ANTITRUST L.J. 777 (1977).

104. A basic issue under consideration at the meeting was the adequacy of the federal antitrust laws. The major contributors to the discussion at the ABA meeting subsequently published their opinions in the *Antitrust Law Journal*. See Green, *Have the Antitrust Laws*

during the meeting both supporters and detractors of the antitrust laws found significant faults requiring correction.

One particularly forceful indictment of the interpretation and application of the antitrust laws, by Professor of Economics John S. McGee of the University of Washington, provides a series of illustrations reflecting some fundamental antitrust problems. For example:

[t]here is something fundamentally wrong when, over many years, meat-packing firms are prevented from entering and competing in new markets on the grounds that they would lower costs and prices, attract customers, and intensify competitive pressures by doing so. The net effect of such law—all in the name of antitrust—is perverse regulation of the same kind that hurts consumers in transportation and elsewhere. It excludes some competitors from markets because they might hurt other competitors, and therefore 'competition,' by offering consumers a better deal!<sup>105</sup>

And there is something fundamentally wrong when sellers of frozen pies are beaten because they catered more cheaply to the consumer's sweet tooth, contributed to a 'deteriorating price structure,' and undermined the dominant position of a local producer.<sup>106</sup>

[L]aw is coming to attack concentration in and of itself. More specifically, law penalizes the superior performance of the most efficient firms. This misconceives both the nature and results of hurtful monopoly. Apart from limitations by governments, including franchises, licensure, certificates of convenience and necessity, and the like, there is one effective, and beneficial, way to discourage new entry or the expansion of other firms already in a market. It consists of offering a good product at a price that other firms are unable to beat. Firms do not—and should not—enter or expand when the going price is too low to cover their costs. They do not, and should not, enter or expand when, at the going price, they cannot produce an equally good product. If existing firms prosper at those prices, this means that they are superior. They have earned their place. Out of given resources, they offer more to consumers than others can. In a better world, this would also earn them praise, which is not so in the world of antitrust. For, if one or more firms are superior in these ways, they are clearly at hazard from *Alcoa* and other such perverse precedents.<sup>107</sup>

Among Professor McGee's conclusions are that "peculiar notions of 'competition,' and a systematic inattention to consumer interest, have come to contaminate the whole body of antitrust law"<sup>108</sup> and that "[a] rule of law that punishes such superiority, or demands that those who are responsible cannot gain from it, will fatally blunt the incentive to excel."<sup>109</sup>

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*Promised Too Much and Accomplished Too Little? Answer: Yes*, 46 ANTITRUST L.J. 752 (1977); Holmes, *Have the Antitrust Laws Promised Too Much and Accomplished Too Little?*, 46 ANTITRUST L.J. 764 (1977).

105. McGee, *supra* note 103, at 781.

106. *Id.*

107. *Id.* at 785 (emphasis added).

108. *Id.* at 780.

109. *Id.* at 786. The National Commission recommendation that Congress amend the

Nor is Professor McGee alone in his criticism. Professor Richard A. Posner of the University of Chicago Law School has referred to the "unwillingness or inability of most Supreme Court justices to apply economics or any other body of systematic thinking to antitrust problems"<sup>110</sup> and observed that the "judge-made rules of antitrust are inconsistent with the fundamental, and fundamentally economic, objectives of the antitrust laws."<sup>111</sup> Furthermore, it is said that apart from hard core violations such as price fixing, "the aims and content of antitrust appear in many respects to be in disarray."<sup>112</sup> And in his recent book on antitrust, former Solicitor General and now Professor at Yale Law School Robert H. Bork has severely indicted the federal antitrust laws. Professor Bork writes that

[antitrust] must either undergo a difficult process of reform, based upon a correct understanding of fundamental legal and economic concepts, or resume its descent to the status of an internal tariff against domestic competition and free trade.<sup>113</sup>

More recent extensions of law have been anticompetitive . . .<sup>114</sup>

A consumer-oriented law must employ basic economic theory to judge which market structures and practices are harmful and which beneficial. Modern antitrust has performed this task very poorly.<sup>115</sup>

These comments are only illustrative of antitrust criticism.<sup>116</sup> On the other hand, criticism of antitrust law is not universal. Antitrust law continues to draw strong support from a wide range of sources, including many of the

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antitrust laws to require companies having a certain amount of market power to be broken up regardless of how fair their competitive behavior, suggests increased application of the "peculiar notions of competition" under the antitrust laws. NATIONAL COMMISSION REPORT, *supra* note 13, at viii. It has been suggested that "by weakening the role price cuts can play in defending a company against an antitrust charge, the proposed changes would make big companies more cautious about making price cuts." Wall St. J., Feb. 5, 1979, at 16, col. 1.

110. POSNER, *supra* note 103, at 5.

111. *Id.* at 7. "Guided for a generation by the sterile concepts of structuralist economies, big antitrust is mired in Kafkaesque trials which exalt doctrine over realities." Rowe, *Antitrust Challenges Today*, 29 CONFERENCE BOARD INFORMATION BULLETIN 6 (1977).

112. Bork, *Overview*, 29 CONFERENCE BOARD INFORMATION BULLETIN 1 (1977).

113. BORK, *supra* note 103, at 7.

114. *Id.* at 415.

115. *Id.* at 7.

116. At the conclusion of a review of the National Commission Report, the Wall Street Journal perceptively commented:

[i]n the past several years there's been a growing body of antitrust scholarship arguing that the antitrust laws have often been used in ways that have actually harmed our economic efficiency and consumer welfare. The commission's recommendations for changes in the Sherman Act proceed in cheerful defiance of these arguments, and so seem strangely out of tune with the current state of debate in the field. But the recommendations do testify quite clearly to the extent to which antitrust practitioners—in government and out, prosecutors and defense—have created a system sturdily impervious to assaults of self-doubt or intellectual challenge.

*Review & Outlook: The Antitrust Report*, Wall St. J., Feb. 5, 1979, at 18, col. 1.

critics themselves. Nevertheless, indictments by respected antitrust experts at least suggest that extreme caution should be observed before substituting *carte blanche* federal antitrust law for the state insurance regulatory mechanism.<sup>117</sup>

The Department of Justice, under the Sherman Act, is constricted to function within the ambit of court-imposed definitions of the legal standards involving monopoly and restraint of trade. In contrast, state insurance regulators have the inherent potential to apply the standards under the rating laws to give better effect to a result which makes more economic sense without, for example, having to find an implied conspiracy in restraint of trade. The open competition statutory standard of excessive rates is couched in terms of "competition" which is an economic concept unlike the more legalistic standard in the Sherman Act.<sup>118</sup> From the standpoint of the substantive standards, the state rating standards possess a greater potential to foster competition in the property and liability sector than does the application of the federal antitrust laws.

## 2. Enforcement Capabilities

a. *Comparative Inherent Capabilities.* Under the economic concept of competition, the marketplace is the sole regulator of results. In sharp contrast, both the antitrust and the insurance laws contain substantial government enforcement mechanisms. The states possess a wide array of enforcement tools to implement the open competition rating as well as other insurance laws.<sup>119</sup> These include comprehensive financial statements, financial condition and market conduct examinations, civil and criminal penalties, injunctions, revocation of licenses to transact business, liquidation and rehabilitation proceedings, seizure and a variety of commissioner orders, including cease and desist orders and orders under ratemaking authority. In addition, in several of the open competition rating law states, there are requirements for informational filings of rates, rate examinations and reimposition of prior approval if adequate competition does not exist. Some of these are not found in the antitrust arsenal (such as the power to withdraw the insurer's license to do business). On the other hand, the states possess the same type of enforcement tools as are used by the Department of Justice.<sup>120</sup>

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117. This is not intended to suggest that these critics of antitrust would necessarily favor the continuance of the primacy of state regulation through retention of the McCarran Act antitrust exemption. However, in this article they are being cited for the expertise as to the flaws of antitrust.

118. Virtually all rating statutes provide that rates shall not be excessive, inadequate or unfairly discriminatory. Except in open competition states, these standards generally lack further statutory definition. Typically, the open competition statutes provide that no rate shall be deemed excessive if a reasonable degree of competition exists. The basic standard of "excessive" could be interpreted in the same way under a prior approval statute.

119. See *MONITORING COMPETITION*, *supra* note 12, at 478 *et seq.*; Pfennigstorf, *The Enforcement of Insurance Laws*, 1969 Wis. L. Rev. 1026.

120. Similarly, the Department of Justice can bring criminal actions to punish violations

In addition to possessing a smaller range of sanctions than do state insurance regulators, the Department of Justice lacks certain basic attributes which detract from its ability to monitor and foster competition in the insurance market. First, the Department of Justice is a judicial enforcement agency. To prosecute violations, it must proceed through the courts with all the difficulties inherent in that process.<sup>121</sup> The standards applied are those handed down by the courts. The Department sets no standards of its own, promulgates no regulations and does not act in an administrative capacity. In short, it is not a full regulatory agency.

Second, implicit in the judicial approach is supervision on a case by case basis. There is a general absence of continuous oversight. These court trial procedures are ill-adapted to the litigation of complex economic issues.<sup>122</sup> Antitrust litigation can drag on for years.<sup>123</sup>

Third, the Department of Justice's jurisdiction extends not only nationwide but also across industry lines. Its responsibilities cover individuals, firms, companies, industries and associations. These entities can be active in an infinite variety of fields. Consequently, inherent limits exist as to the amount of expertise which department personnel can acquire concerning the operations, practices, and personalities of a given industry, such as the insurance industry.

In contrast, a state insurance department is a regulatory agency. It is not limited to the judicial process. The insurance department can hold hearings, issue orders and promulgate rules and guidelines. Consequently, it can respond to developing situations more rapidly by establishing a clearly-articulated policy through its rulemaking authority. The insurance department's responsibility is concentrated on insurance. As a consequence, knowledge and experience developed over a period of time better enable the department personnel to monitor the conduct of persons, companies and associations. Also, the insurance department exercises continuous supervision over insurance companies doing business in its state. Such supervision is not merely limited to rate matters. Thus, the department is in a position to

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by fines and/or imprisonment under 15 U.S.C. §§ 1-3, 13a and 24, as well as seek injunctions against future violations under 15 U.S.C. § 4. Additionally, the FTC can issue cease and desist orders, the violation of which is subject to civil monetary penalties and which are enforceable through equitable remedies under 15 U.S.C. § 45.

There is one exception to both state and federal enforcement techniques. It is uncommon for a state to seek a divestiture, dissolution or divorcement of a portion of a defendant's business. However, even in the antitrust field, the courts have not been inclined to apply this remedy (resulting in "legal victories devoid of economic meaning"). ASCH, *supra* note 103, at 256 (1970). Furthermore, it has been suggested that "[s]tructural remedies such as divestiture are slow, costly, frequently ineffectual, and sometimes anticompetitive." POSNER, *supra* note 103, at 223.

121. "The monstrous, indeed grotesque, proportions of the modern antitrust suit are difficult to convey to the uninitiated." POSNER, *supra* note 103, at 232.

122. *Id.*

123. In fact one of the major areas of inquiry by the National Commission was the problems relating to complex antitrust litigation. NATIONAL COMMISSION REPORT, *supra* note 13, at 1.



obtain and maintain a broad overview of an insurer's entire operation. Because of the broad scope of its regulatory interest and powers and because of its continuous exercise of jurisdiction, an insurance department possesses significant regulatory leverage which the Department of Justice lacks. Furthermore, the enforcement of an administrative agency is more likely to show a consistent and rational pattern than judicial enforcement which depends on courts and potentially conflicting judgments.

Unlike the Department of Justice, the FTC is a regulatory agency with power to promulgate regulations, hold hearings and issue cease and desist orders. In this respect, it is more similar to state insurance departments than is the Department of Justice. However, unlike the insurance departments, the FTC's responsibilities extend across a multitude of industries. Furthermore, FTC activity has been primarily on a case by case basis rather than the exercise of continuous jurisdiction. Finally, involvement of the FTC would inject potentially different determinations by conflicting regulatory agencies.

Increasing enforcement of antitrust through private litigation contributes further to the *ad hoc* and conflicting decision-making process under the antitrust laws.<sup>124</sup> Conflicting determinations, in turn, pose additional problems in the context of the fundamental issue of state versus federal regulation of insurance.<sup>125</sup>

In addition, the various states, both individually and through the mechanism of the NAIC, have the facility to establish a comprehensive statistical mechanism to monitor competition. Currently, the NAIC is in the process of developing a statistical system specifically designed to compile the necessary information to apply the economic tests of workable competition. The combination of the NAIC annual statement, upon which a significant proportion of the statistics of the insurance business is based, and the states' continuous jurisdiction over insurers affords a potential for monitoring competition which does not exist with respect to any other industry under federal antitrust jurisdiction.

b. *Weakness in Federal Enforcement Efforts.* Congressional criticism of the antitrust enforcement effort must be noted. The Senate Judiciary and Commerce Committees have referred to "the ineffectiveness of our antitrust enforcement effort,"<sup>126</sup> the "severe staffing shortage of experienced antitrust litigators,"<sup>127</sup> and the "meager" resources available,<sup>128</sup> among other criticisms. The joint report went on to state that "present economic conditions are to some extent the result of inadequate enforcement of the antitrust laws."<sup>129</sup> Private sources have voiced similar criticism about antitrust enforcement

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124. See text accompanying note 164 *infra*.

125. See text accompanying notes 449-512 *infra*.

126. S. Rep. No. 498, 94th Cong., 1st Sess. 1 (1975).

127. *Id.* at 2.

128. *Id.* at 4.

129. *Id.* at 5.



resources and efficiency.<sup>130</sup>

The Antitrust Enforcement Authorization Act of 1975 seeks to establish a program of assistance and grants to states to improve their antitrust enforcement capabilities on the basis that "[t]he States represent an untapped source of substantial potential in the antitrust area."<sup>131</sup> Subsequently, Congress enacted the *parens patriae* provision which permits state attorneys general to recover monetary damages on behalf of state residents injured by violations of the federal antitrust laws.<sup>132</sup>

It seems quite anomalous for the federal antitrust agencies to seek jurisdiction over an entire new industry when at the same time they are subject to serious criticism as to their enforcement effectiveness in the areas over which they currently have jurisdiction. It seems a further anomaly to attempt to tap state antitrust potential in general and at the same time attempt to withdraw from state insurance regulators, who are more and more utilizing competition as a regulatory tool, their ability to regulate.<sup>133</sup>

Furthermore, antitrust enforcement is severely impeded by the procedural labyrinth inherent in primary reliance on the courts as the enforcement mechanism. This is evidenced by the National Commission's charge to consider procedural improvements in dealing with complex antitrust cases. One case took twenty-seven years to complete and several others have either gone on or are anticipated to go on for many years.<sup>134</sup>

The complexity of such trials, the scope for procrastination and the ineffectiveness of remedies meted out by the courts after trials lasting an average of eight years, have made big antitrust cases into expensive farces.<sup>135</sup>

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130. "The resources of the public agencies—the Justice Department and the Federal Trade Commission—are limited to what the Congress appropriates each year, and traditionally the appropriations for antitrust enforcement have been quite parsimonious in relation to the universe of potential antitrust suits." POSNER, *supra* note 103 at 228.

More recently, the head of the Antitrust Division of the Department of Justice stated that the management of the Division is twenty-five years out of date. Examples of this include a very poor library, lack of adequate para-legal support, lack of a general approach to document organization and lack of adequate training for young lawyers. He also noted the understaffing, the high turnover rate in the Division and the inexperience of many of the lawyers. Oral remarks of John H. Shenefield, Assistant Attorney General, SMU Short Course on Antitrust: Law and Litigation, July 27, 1979, Colorado Springs, Colorado. Furthermore, the basic nature of the FTC functioning in the antitrust area has been severely criticized on the basis that the FTC acts as a prosecutor, judge and jury. See Vaill, *To Corporate America, FTC Serves as Prosecutor, Judge and Jury*, L.A. Times, Feb. 19, 1978, § 7, at 2, col. 1.

131. See note 126 *supra* at 8.

132. 15 U.S.C.A. § 15(c) (Supp. 1979).

133. In this context, it is important to note that Chairman Pertschuk of the FTC has said "[a]ntitrust is one instrument of competition policy." He did not say it is the *only* instrument. Also, he emphasized that "the implementation of competition policy need not—indeed, should not—be made by a single governmental agency." Pertschuk, *supra* note 102, at 3, 10.

134. THE ECONOMIST, Jan. 6, 1979, at 43.

135. *Id.*

The irony of the [National Commission's] Report is that the very court system, which by the Commission's own admission is backlogged and overburdened, is recommended for use to enforce insurance rate regulation.<sup>136</sup>

Although the National Commission has developed a series of recommendations to alleviate this major problem in antitrust enforcement,<sup>137</sup> only a period of several years will tell whether they will be implemented and if they are, whether they will be effective.

Finally, perhaps the greatest concern is the charge that the federal antitrust enforcement agencies have, in fact, undertaken their enforcement activities in a manner to deter competition rather than to foster it. Professor Bork, among others, has flatly stated that "[i]n modern times, if not in earlier antitrust history, the government has, more often than not, represented the anti-free market position and the defendant the free market position."<sup>138</sup>

### 3. Summary

The National Commission's conclusions and recommendations concerning antitrust immunities and regulation in general began by stating:

1. Free market competition, protected by the antitrust laws, should continue to be the general organizing principle for our economy.
2. Exceptions from this general principle should only be made where there is compelling evidence of the unworkability of competition or a clearly paramount social purpose.<sup>139</sup>

These recommendations contain two implicit assumptions which are not only fundamental to the Commission's recommendations as to the repeal or modification of the McCarran antitrust immunity but which also are highly vulnerable to challenge. First, the recommendations tend to equate the application of the antitrust laws to the achievement of competition in the economic (not just legal) sense. Second, the recommendations assume that there are no alternative (and perhaps even superior) means to foster competition in some segments in the economy in lieu of primary reliance on federal antitrust law.<sup>140</sup> The foregoing discussion strongly suggests that the first assumption,

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136. Remarks by Richard L. Mathias, III, Director of Insurance, A Critique of the Report of the National Commission on Antitrust Policies and Procedures, Consumer Federation of America Annual Meeting, at 3 (Feb. 8, 1979).

137. NATIONAL COMMISSION REPORT, *supra* note 13, at i-vii.

138. BORK, *supra* note 103, at 415 (emphasis added).

139. NATIONAL COMMISSION REPORT, *supra* note 13, at 177.

140. Similarly, Roger Noll reviewed the rationale for such exemptions in Noll, *Antitrust Exemptions: An Economic Overview* 2-19, in REPORT OF THE ECONOMIC ADVISORY PANEL TO THE NATIONAL COMMISSION FOR THE REVIEW OF ANTITRUST LAWS AND PROCEDURES (1978). These were broken down into three categories, (1) income distribution, (2) economic regulation and unstable competition (including discussion of natural monopolies), and (3) informational market failures.

in general, is far from accurate and that the second assumption, at least with respect to the insurance segment of the economy, is also incorrect.

Despite the fact that these fundamental issues were raised during the National Commission's hearings,<sup>141</sup> the Commission ignored them in its report. It is difficult to conceive how an objective set of recommendations leading towards a substantial supplanting of one major body of law (state insurance law) with another body of law (federal antitrust law) can be reached without considering the weakness of the latter (antitrust law) as well as the perceived problems of the former (state insurance law) and comparing the real world effectiveness of both in achieving the major and sometimes conflicting public policy objectives involved. The Commission failed to do both, thereby undermining the validity of its recommendations.

In summary, not only would the general application of the federal antitrust laws have little impact on enhancing competition in the insurance industry, but such an approach would also substitute the primacy of federal antitrust law for that of the state insurance regulators in fostering and preserving competition, despite the fact that the states are in a better position to do so. The substantive law of antitrust is replete with court-imposed concepts and standards which contradict the economic concept of competition. The state insurance regulatory enforcement mechanism provides a superior vehicle to promote competition to that available at the federal antitrust level. Thus, general application of antitrust law would not serve the implementation of a competitive public policy in the business of insurance, and in fact would impede such policy to the extent the states are precluded or deterred from fostering a procompetitive policy.

Lastly, to the extent that substantive antitrust law and federal antitrust enforcement activities prohibit or deter competition from functioning, the proponents of a broad application of federal antitrust law have far more fundamental concerns to worry about than the scope of limited antitrust immunities. The very foundation of antitrust law is in doubt. Until federal antitrust law is rebuilt on a sounder basis, one must question extending its scope to additional areas, particularly those which are functioning competitively.

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Nowhere did this economic overview consider the possibility of a superior alternative to antitrust as a means to foster competition as an additional rationale for continued exemption to the antitrust laws. Similarly, Alfred E. Kahn, as Chairman of the Civil Aeronautics Board and a member of the National Commission, testified before the Commission that an exemption from the antitrust laws must be rationalized in terms of demonstrated defects in the competitive market. National Commission Hearings, *supra* note 26, at 10. Here again there is a failure to recognize the possibility that competition can better be fostered by means other than applying the federal antitrust laws.

141. See Presentation on Behalf of the NAIC to the National Commission for the Review of Antitrust Laws and Procedures, 1 NAIC PROCEEDINGS 1046-49 (1979).

### III. GENERAL APPLICATION OF THE FEDERAL ANTITRUST LAWS WOULD ADVERSELY EFFECT THE INSURANCE-BUYING PUBLIC

#### A. *The Benefits of Competition Are Less Likely to Accrue to the Insurance-Consuming Public Under a General Application of the Antitrust Laws*

To a large extent, the benefits of competition occur in the insurance business as in other industries. Thus, to the extent consistent with other major public policy objectives, competition should be fostered and preserved. The state insurance regulators, through the NAIC, have adopted this position and are pursuing its implementation.<sup>142</sup> For reasons discussed earlier, the general application of the antitrust laws to the insurance business and the corresponding restraints on state insurance regulatory activity not only would have minimal impact on improving the degree of competition but also promise to severely limit or preclude the states from doing so. This is true despite the fact that the states are in a better position to regulate. It makes little sense to substitute a less effective for a potentially more effective system to implement a pro-competitive policy. Thus, to the extent the public benefits from competitive markets in the insurance business, the public could be hurt by shifting reliance to the general application of the federal antitrust laws.

#### B. *Potential Limitation of Coordinated Insurer Activity Through the General Application of Antitrust is Inconsistent With Many Needs of Insurance Buyers*

Several aspects of insurance involving legitimate and necessary cooperative activities do not lend themselves to treatment under the federal antitrust laws. These include, but are not necessarily limited to, (1) pooling of statistics, (2) insurance pools, (3) residual markets and (4) guaranty funds.

##### 1. *Pooling of Statistics*

The treatment of risk by insurance requires the anticipation of loss by prediction. The degree of accuracy in prediction depends upon the stability accruing from dealing with a large number of homogeneous units of exposure such as automobiles or houses. Consequently, the ratemaking process depends to a large extent on the accumulation of a large pool of statistics. Some large insurers (at least with respect to some insurance lines) develop a sufficient body of data from their own experience to lessen or eliminate their reliance on the pool of information developed by others. Many insurers, however, are not as well situated. Thus, pooling information is essential to the continued survival of many small and medium-sized companies as well as to the writing of some lines of insurance by large insurers.

Two conditions of effective competition are (1) the existence of numerous competing sellers and (2) the ease of entry into the market. The availability

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142. See text accompanying notes 91-99 *supra*.

of pooled information contributes to both. If the federal antitrust laws were applied, insurers' continued ability to pool information would be thrown into doubt.<sup>143</sup> New and small insurers would find their continued existence virtually impossible in the absence of recourse to a substantial body of credible experience statistics upon which to base their rates. Thus, a statistical or rating bureau, in some form, is essential to continuing and viable competition which stems from small insurers and new entrants. Furthermore, some larger insurers may abandon some insurance lines due to the lack of available credible data, thereby leaving the business to an increasingly concentrated market. These results would not contribute to a workable competitive market.<sup>144</sup> In contrast, the McCarran Act antitrust immunity has assured that needed insurer cooperative activity in the collection, compilation and dissemination of pricing information essential to the competitive process in the insurance business is not impeded by vulnerability to an antitrust charge of price fixing *per se*.<sup>145</sup> At the same time, however, the cooperative activity is subject to state regulatory oversight for possible abuses and appropriate changes.<sup>146</sup>

## 2. Insurance Pools

The term "pool" refers to an association of insurers who share premiums and losses among the members concerning one or more specified insurance coverages. Such pools may assume different forms. A simple pool may utilize a small staff to whom members report their premiums and losses on pooled business. The staff then redistributes the premiums and losses among members in the proportions set out in the pool agreement. This requires that each member use a common manual of classifications, rates and rating plans. At

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143. See text accompanying notes 350-354 *infra*.

144. In most businesses, the entrepreneur knows the basic cost of his product at the time he prices it. Consequently, the businessman can reasonably well price his product without obtaining the price or cost information from his competitors. This is not true in insurance. Rates are established for coverages whose actual costs will not be known for years when all the claims thereunder have been settled. Compilation and utilization of a large body of data is essential to making even educated guesses and appropriate rate levels. As one industry trade association pointed out:

[b]ecause of these unique characteristics of the insurance function, voluntary cooperative action between competitors in compiling past experience and converting it into basic future pricing projections is not designed or used to *restrain* competition in our business, but to *facilitate* it. Cooperative action is needed to provide the essential informational foundations or springboards from which companies can continue intelligently to exercise their competitive pricing and marketing prerogatives.

Arthur C. Mertz, President of the National Association of Independent Insurers, Statement before the National Commission for the Review of the Antitrust Laws and Procedures, at 5 (Oct. 17, 1978). This comment is particularly interesting coming from an organization whose member companies were among the leaders in breaking the rating bureaus domination which existed in the 1940's and early 1950's.

145. For a discussion of antitrust vulnerability in the absence of such immunity, see text accompanying notes 350-354 and 370-386 *infra*.

146. See MONITORING COMPETITION, *supra* note 12, at 409-19.



the other end of the spectrum, a pool may be staffed to underwrite and issue policies, to provide inspection and claim services and, in general, to function much like an individual insurer.

The formation of pools serves any one of several essential purposes:

- (1) To afford a market for insureds seeking extraordinarily large amounts of insurance to be provided in a single policy, which amounts the member companies are unwilling or unable to provide individually;
- (2) To afford a market for classes of insureds whose operations are such as to require special service facilities not ordinarily furnished by many individual insurers;
- (3) To afford a market for insureds whose operations present an exceptionally great hazard, especially in instances in which there are relatively few insureds engaged in such operations;
- (4) To afford a market for insureds whose insurance is not acceptable to the individual insurers which comprise the pool;
- (5) To afford a medium for insuring special classes of insureds at rates and under rating procedures which differ from those used by the individual company members, and
- (6) To afford small companies a means of competing with large ones by making available to each pool member the combined capacities of the group.

For example, the nuclear fission pools have been created in view of the overwhelming potential liability stemming from peaceful uses of nuclear fission. Other pools touch such areas as ocean marine hull insurance, concentrated hazards met in insuring negative films for motion pictures, exceptionally large insurance amounts required by industrial operations, property insurance for rolling stock and fixed properties of railroads, insurance for oil refineries, and insurance for aviation hazards, among others.

Formalized pools are not the only method of handling such risks. In addition, individual insurers may join together on particular risks without the organization of a formal pool. Coordinated activity by insurers through joint underwriting or joint reinsurance serves to spread risks among a number of insurers for those businesses with large risk exposure.

Because of the coordinated activity, including the use of the same rates, these pools and joint underwriting operations could run afoul of the federal antitrust laws if they were applicable to insurance.<sup>147</sup> In contrast, a major goal of insurance regulation is the ready availability of needed coverage. The pools provide a market for risks that otherwise would be unserved since no single insurer would be able or willing to handle such potential liability. A competitive market composed solely of individually acting competing insurers could not meet the demands for such insurance coverage. Thus, a blanket applica-

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147. See text accompanying notes 350-354 and 403-417 *infra*.

tion of the federal antitrust laws to the insurance industry could bring many legitimate and essential functions of the insurance business to a virtual standstill. This would not only adversely affect the insurance industry, it would adversely affect those persons (individuals, companies and industries) unable to obtain needed protection.

### 3. *Residual Market Mechanisms*

Unlike a firm in other industries, an insurer has the ability to affect its success not only by the price it charges or the quality it provides but also by the customers it selects. The process of selection is called underwriting. Underwriting precludes some persons from obtaining coverage in the voluntary market and reduces the options for some others regarding the amounts or type of coverage. This characteristic of the insurance market provides one basis for distinguishing insurance from other products and services and for fashioning a series of special rules unique to its problems and circumstances.

To meet at least the basic insurance needs of automobile drivers unable to obtain coverage in the voluntary market at standard rates due to selective underwriting, assigned risk plans are created. (Insurers doing automobile business in the state are compelled to be members of the assigned risk plan.) Under the assigned risk plan, drivers with high risk characteristics are assigned to member insurers in proportion to the insurer's share of the automobile insurance business in the state. The insurer issues its own policy to the applicant, services the policy and receives the premium. Typically, the plan is administered by a manager and a governing committee representing member insurers. A national industry committee provides assistance to the state plans. The plan sets out eligibility for coverage, exclusions, amounts and types of coverage, matters concerning premiums, the commission level and a uniform policy form. The rates charged and policy forms for assigned risk policy coverages are submitted by the plan for commissioner approval or disapproval.<sup>148</sup>

A common residual market pooling arrangement is a FAIR plan, which exists in approximately half the states.<sup>149</sup> FAIR plans, which are sanctioned and fostered by federal law as well,<sup>150</sup> are primarily aimed at making property insurance coverage available in the inner cities when it is not available to an individual, family or business in the voluntary market.

Another more recent manifestation of pooling arrangements is the development of a state-compelled mechanism to assure the availability of medical malpractice insurance. The absence of such coverage can and has led to a lessening of quantity and quality of health care service as various health care provider groups have either refused to practice or have reduced their practice

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148. For further discussion of assigned risk plans, see Report of the NAIC Special Committee on Automobile Insurance Problems, II NAIC PROCEEDINGS 541 (1969).

149. I NAIC PROCEEDINGS 773 (1979).

150. 12 U.S.C.A. § 1749 bbb-3 (Supp. 1979).

in fear of no insurance protection against liability.

Nor are the pooling arrangements necessary only to the property and liability business. The NAIC, for example, has adopted a model comprehensive health insurance bill,<sup>151</sup> which, among other things, would mandate that health insurers participate in a pool to guaranty the availability of comprehensive health insurance to all persons.

These residual market mechanisms attempt to achieve the basic goal of ready availability of coverage. If the federal antitrust laws were applied to insurance, these mechanisms might have to be discontinued or substantially altered. If current antitrust laws were applicable, whenever insurers coordinate their activities as to providing coverage and setting prices through plans, agreements or the like, such activity could be subject to antitrust challenge. In contrast, both the open and nonopen competition rating laws typically provide an express sanction for residual market mechanisms which are monitored by the commissioner.<sup>152</sup>

#### 4. *Guaranty Funds*

A major function of insurance is to provide security. A primary objective of insurance regulation is to assure that security is in fact provided. Achievement of this regulatory objective is sought in two ways: (a) the prevention of insolvencies, to the extent possible, through various regulatory techniques, and (b) the establishment of guaranty fund mechanisms. With respect to the latter, forty-eight states and the District of Columbia have enacted some type of guaranty fund legislation for property and liability insurance<sup>153</sup> and at least twenty-seven states have established some type of fund for life and health insurance.<sup>154</sup> Most such legislation is patterned after the NAIC State Post Assessment Guaranty Association model bills.

The NAIC property and liability model bill,<sup>155</sup> for example, contemplates two primary functions: (1) to avoid financial loss to policyholders or claimants because of the insolvency of an insurer by paying claims against insolvent insurers from funds raised through assessment of other insurers, and (2) to assist in the detection and prevention of insurer insolvencies. Both functions are carried out through an insurance guaranty association to which all companies authorized to write insurance in the state must belong. The association operates through a board of directors according to a plan of operation,

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151. NAIC Comprehensive Health Insurance and Health Care Cost Containment Act, II NAIC PROCEEDINGS 407-37 (1976); I NAIC PROCEEDINGS 42-45 (1977).

152. See, e.g., CAL. INS. CODE §§ 11620 *et seq.* (West 1972); MICH. COMP. LAWS §§ 500.3301 *et seq.* (1970).

153. See NATIONAL COMMITTEE ON INSURANCE GUARANTY FUNDS, DIRECTORY OF STATE INSURANCE GUARANTY FUND BOARDS (1979).

154. AMERICAN COUNCIL OF LIFE INSURANCE, LIFE AND HEALTH INSURANCE INSOLVENCY GUARANTY LAWS (1979).

155. NAIC Post Assessment (Property & Liability) Insurance Guaranty Association Model Bill, I NAIC PROCEEDINGS 253-62 (1970).

both of which are subject to the approval of the insurance commissioner.

The prevention function contemplates reports to the commissioner by the board of directors when it has knowledge that an insurer may be in hazardous financial condition. In addition, the board may request and the commissioner must then conduct, at the expense of the association, an examination of the company believed to be in hazardous financial condition. The board must also report on the causes of each insolvency and may present to the commissioner proposals for their prevention.

At least in some respects, such an association might be vulnerable to antitrust attack if the federal laws were made applicable to the insurance industry. As to the detection and prevention functions, among other things, the board of directors of the association is under a duty to notify the commissioner of any information indicating that a member insurer may be insolvent or in a hazardous financial condition. Furthermore, the board may request that the commissioner shall begin such examination. The federal antitrust laws, presumably, frown upon a group of companies combining to make recommendations as to whether a competitor should continue to function. Certainly a strong argument can be made under the antitrust laws that this would be a combination in restraint of trade. In contrast, when viewed from an insurance regulatory context, this mechanism can make a positive contribution to the prevention of insolvency, thereby taking a significant step towards assuring security, which is the predominant theme underlying the entire insurance function. Furthermore, if any insolvency does occur, the guaranty fund provides a means to assure that claims will be paid.

The above discussion illustrates a few of the activities which insurers perform in coordination with each other. As with most combinations, the potential for abuse exists, especially when viewed in the context of the impact on competition. Nevertheless, these activities have been determined to be important, if not essential, to achieve various fundamental insurance regulatory objectives. Thus, blanket application of the federal antitrust laws would provide a substantial disservice to the insurance-consuming public.<sup>156</sup>

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156. In addition, increasing pressure is brought upon the insurance industry to undertake activities which would help contain the underlying cost of insurance so as to reduce its escalating cost. For example, the President of the NAIC recently challenged the insurance industry to improve its performance in helping to reduce the cost of insurance.

On the other hand, to the extent that the insurance industry *CAN* control its underlying costs, it renders a disservice to the insuring public and must be held accountable. Too many members of the insurance industry view themselves only as funnels through which premiums are collected and losses paid, with no thought to controlling underlying costs. They think cost containment is somebody else's job, and they're wrong! In 1977 the property and liability insurers paid about \$35 billion in claims. Don't tell me that a buyer of this much goods and services can't exercise some control over the underlying costs of insurance. Failure to wield this economic clout is a failure to serve the public interest.

The funnel mentality not only fails to contain the underlying costs of insurance, it actually encourages cost escalation. The availability of insurance funds provides a

### 5. Department of Justice Response

The Department of Justice response to these legitimate and necessary needs of insurers, insurance buyers and insurance claimants is three-fold. As to residual market mechanisms, the Department has conceded the need for continued state regulation.<sup>157</sup> As to guaranty funds, the Department recommends a federal mechanism.<sup>158</sup> However, as to the need for pooled statistical information and insurance pooling, the Department has responded through a lengthy and detailed summary of its interpretation of antitrust law.<sup>159</sup> In essence, the Department argues that these necessary functions could be conducted under existing antitrust law without the protection of the McCarran Act. Apparently, the National Commission accepted the Department's analysis of the antitrust law.<sup>160</sup>

It is not the purpose of this article to provide a detailed legal brief in opposition, but rather to point out serious concerns with the Department of Justice position. First, the Department's interpretations are simply Department interpretations couched in very general language and based in many instances on older case law applied to business areas other than insurance. As applied to the conduct of the insurance business, they are not law. They have not been firmly established by the courts. Consequently, they provide

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fertile field for the unscrupulous. Arson for profit is a major problem. Fraudulent claims and commercial fraud rings are becoming all too commonplace. The insurance industry is short on appropriate policy design and altogether too reluctant to make a vigorous fight against invalid claims, so more money has to be poured into the funnel so more money can come out at the bottom. The funnel mentality not only fails to reduce insurance costs, it is truly part of the cost problem.

As state insurance regulators, we applaud those members of this industry who have taken positive steps to contain the cost of insurance. The trouble is, not enough of them have taken such steps. We now must turn our attention to those who haven't done anything yet. First, we'll have to reject the notion that the industry is helpless to influence the cost of insurance. The industry is going to have to realize that in the future it is going to be held accountable for failure to develop and implement measures that will indeed help contain the underlying cost of insurance.

II NAIC PROCEEDINGS 9-10 (1978). However, when insurers have attempted to do so, they are frequently met with antitrust litigation brought by those persons seeking avoidance of cost containment efforts. See, e.g., *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205 (1979), (medical costs); *Proctor v. State Farm Mutual Automobile Ins. Co.*, 561 F.2d 262 (D.C. Cir. 1977), *vacated*, 440 U.S. 942 (1979) (auto repair costs); ABA Task Force on Antitrust Exemption, Statement to National Commission for Review of Antitrust Laws and Procedures, at 6-7 (June 16, 1978). Although further consideration of loss reduction and cost containment activities is beyond the scope of their article, the substantial impact of wide-spread application of antitrust to insurance on these public-benefit-oriented activities should receive serious consideration before any decision to significantly reduce the insurance antitrust immunity is made. There is no evidence in the National Commission's report that this was done.

157. DJ REPORT, *supra* note 14, at 367-68.

158. *Id.* at 362-64.

159. *Id.* at 91 *et seq.*

160. See NATIONAL COMMISSION REPORT, *supra* note 13, at 235.



only a very questionable base for insurers to rely upon in the conduct of their business.<sup>161</sup>

Second, the courts are not always predictable in their decisions, particularly in areas such as antitrust which involve very general statutory standards, complex legal and factual issues, and important economic policy. Thus, whatever the status of the law today, there is no assurance as to what it will be tomorrow.

Third, it is ironic and significant that the Department which suggests that the antitrust laws now be construed to protect certain conduct is the same Department which prosecuted and lost some of the cases upon which it now relies. Since the function of the Department is to find and prosecute antitrust violations—finding factual distinctions from former cases where necessary or developing new interpretations or theories through “creative lawyering” as expressed by Assistant Attorney General Shenefield<sup>162</sup>—it is little wonder that many in the insurance community are wary of relying on the Department staff interpretations.<sup>163</sup>

161. For example, one antitrust lawyer has stated that although the analysis of the case law in the Department of Justice Report is basically sound,

[t]he conclusion I reach from it, however, is that bureau development of pure premium is, absent the exemption, fraught with antitrust risk. Moreover, the distinction the report attempts to draw between collection and dissemination of past loss and expense data and trended loss and expense data—even if the trending is performed by an independent advisory organization—is to me a bit strained and, therefore, non-comforting. Perhaps I have been unduly unnerved by recent Antitrust Division prosecutions for parallel pricing practices and price “signalling” and by recent speeches by the Assistant Attorney General in charge of the Antitrust Division and by the Attorney General himself promising a more sophisticated approach in the investigation of suspected price-stabilization through use of economists in the analysis of price patterns and through inferences of price-fixing drawn from more-or-less parallel price movements.

What I am saying is that the very cases upon which the Report relies give me, as an antitrust lawyer, concern for any bureau or advisory organization role that might, after the fact, be deemed to have contributed to a stabilization of rates, to a tendency towards more nearly uniform rates or to a rate structure that, so it will be alleged, was higher than might otherwise have been the case.

Whiting, *The Case for Retaining the Exemption* 10-11, ABA NATIONAL INSTITUTE ON APPLICATION OF ANTITRUST LAW TO THE BUSINESS OF INSURANCE (1978). With respect to the Department of Justice Report analysis of antitrust cases involving joint ventures and their analogy to joint underwriting or pooling of insurance, the same commentator remarked:

[s]uffice it to say that few antitrust lawyers that I know would counsel their clients to assume that a practice is free from antitrust risk because a *district* court in the context of a *different* industry upheld something *similar* 25 years ago—particularly in the light of today’s increased sanctions for violations, the advent of an aggressive plaintiff’s antitrust bar and the omnipresent threat now of class action and *patriae* suits.

*Id.* at 15.

162. THE ECONOMIST, Jan. 6, 1979, at 44.

163. A comparison between the Department of Justice role in *United States v. United States Gypsum Co.*, 438 U.S. 422 (1978) and the assurances in its insurance report vividly suggest

Fourth, reliance cannot be solely placed upon the Department of Justice assurance that a particular practice is probably lawful under antitrust and will not be challenged by the government, since a major portion of antitrust activity comes in the form of private actions. In 1960, 228 private antitrust actions were brought. By 1977, the number had increased to 1,611. In contrast, the Justice Department institutes less than 100 actions in a given year. Increasingly, major decisions, new doctrines and refinements of current doctrines occur in private cases over which the government has no control and about which its assurances have little relevance.<sup>164</sup>

Fifth, the Sherman Act, among other things, is a felony statute. Violations are now punishable by up to three years in prison and a \$100,000 fine for individuals and a \$1 million fine for corporations.<sup>165</sup> Griffin Bell, former Attorney General of the United States, has focused attention on the fact that "[t]he Antitrust Division is now engaged in a vigorous drive on criminal price-fixing."<sup>166</sup> The Attorney General went on to point out that

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the Department's assurances be viewed with a healthy skepticism. In reviewing the application of the antitrust laws in the context of exchange of price information through the insurance rating bureau mechanism, the Department report stated:

[I]n other words, when activities involving the exchange of information are challenged on the basis of their effect, the Court will require more than a finding that the exchange of information resulted in stable or uniform prices. The evidence must also establish that the activity actually, or necessarily, produced artificial price levels, i.e., prices set in a non-competitive fashion.

DJ REPORT, *supra* note 14, at 115. Yet in its brief filed in the *Gypsum* case in the same year, the Department argued without qualification that price information exchanges are unlawful, if they have the effect of fixing or stabilizing prices. Mertz, *supra* note 144, at 8. It is not difficult nor unrealistic to anticipate that at some time the Department of Justice or private litigants will read "some degree of 'price stabilizing effect' into virtually any form of cooperative activity involving production and/or exchange of insurance pricing data." *Id.* This concern assumes even greater reality and immediacy in view of the recently reported FTC complaint charging that competing companies can violate the antitrust laws by merely announcing their prices to the press since such announcements can "signal" prices to competitors. Fish, *Antitrust Theory Will Be Tested*, J. of Commerce, June 7, 1979, at 1, col. 4. At the very same time, the FTC has issued an extensive report stating that in the life insurance area consumers and agents should be "provided with sufficient clear information to compare the benefits and costs of different life insurance policies." Staff of the FTC, LIFE INSURANCE COST DISCLOSURE 97 (1979). The FTC in particular and antitrust in general appear to be speaking with conflicting voices. That is, in effect suppliers of goods and services are being told to disclose the price (cost) of their products and services and then submit to prosecution under the antitrust laws for making such disclosure. In this type of climate, the Department's "iffy" assurances that its current interpretation of the current case law affords adequate protection to the businessman lend small comfort or aid to the insurance management confronted with the responsibility for decision making. See DJ REPORT, *supra* note 14, at 10-13.

164. Whiting, *supra* note 161, at 19-20. It is important to note that private enforcement of the antitrust laws is not directed at achieving, nor should it be equated to, the public interest. Shenefield, *supra* note 130.

165. 15 U.S.C.A. §§ 1-3 (Supp. 1979).

166. Address by U.S. Attorney General Griffin Bell to *Harvard Law Review*, Boston, Mass., at 3 (Mar. 19, 1977). See also Assistant Attorney General Donald Baker, To Make the Penalty Fit the Crime: How to Sentence Antitrust Felons, Presentation before the 10th New

[f]elony charges are becoming more common. They should be a deterrent. The stigma of becoming a convicted felon is difficult to reconcile with a business leadership status in the community.

Even more significant is the fact that prison sentences for those convicted—which have been extremely rare for antitrust violators—may become more commonplace under the new felony authority.

. . . . .  
I believe firmly that hard-core price-fixing is a serious crime and should be prosecuted accordingly. I support the guidelines the Antitrust Division recently issued to its attorneys for recommending sentences in criminal antitrust cases.

The guidelines make clear to price-fixers that the Antitrust Division will move against them individually (and not just against their corporations) and that the Division will recommend stiff prison sentences upon securing convictions.<sup>167</sup>

Few insurers and their managements desire to expose themselves to this type of liability simply in order to meet insurance buyers' needs for coverages.<sup>168</sup>

Insurance involves spreading the risks of a few among the many. Individual insurers are the first line of defense, but where the risks are too great for a single insurer to accept, they must be spread among a number of insurers who cooperate for that purpose. Against this background, few view with equanimity the possibility that agents, brokers, and insurers, engaged in the placement of large risks with multiple insurers, and insurers providing coverage for large risks through pools and syndicates, might be exposed to conviction as felons and subject to heavy fines and jail sentences while the Department of Justice and the courts are going through the shake-down process in determining whether concerted activities of this kind are proper or improper. In civil actions, it can be expected that private parties will litigate these issues with a view toward treble damages. Further, violations of the FTC Act can result in the issuance of a cease and desist order which places government restraints on future activities. Violations of such order can result in penalties

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England Antitrust Conference (Nov. 20, 1976); Baker, *Recommendations for Sentencing in Antitrust Felony Cases*, reprinted in *TRADE REG. REP. (CCH)* (Supp., Mar. 1, 1977).

167. Bell Address, *supra* note 166, at 3-5.

168. In the context of a price information exchange case involving a criminal action under the antitrust laws, the Supreme Court concluded that action undertaken *with knowledge of its probable consequences* and having the requisite anticompetitive effects can be a sufficient predicate for a finding of criminal liability under the antitrust laws. *United States v. United States Gypsum Co.*, 438 U.S. 422 (1978) (emphasis added). It is not necessary in order to sustain a conviction to provide that the disputed conduct had the "conscious object" of producing the anticompetitive effect. *Id.*

It might be argued that in ambiguous areas of the antitrust laws, the Department of Justice has not commonly brought a criminal action. To the extent this is true, it is a matter of administrative policy which can change according to circumstances or over a period of time. Furthermore, the insurance area provides a vivid example of a criminal indictment brought under the antitrust laws. See *United States v. South-Eastern Underwriters Association*, 322 U.S. 533 (1944).

as high as \$10,000 per day.<sup>169</sup>

Confronted with these prosecutorial and treble damage risks, agents, brokers and insurers are apt to avoid these transactions, despite the Department staff interpretation of the law.<sup>170</sup> If this were to happen, insurance would not be available to many businesses for many risks throughout the country. This could have a severe effect upon the economy and upon the large number of employees of these firms.

Furthermore, as a result, it can be anticipated that substantial amounts of insurance business would be exported to foreign insurers, a result which would not only be contrary to this nation's economic interest but which also would deprive American insurance buyers of the regulatory protection afforded them in this country. In contrast, the existing system of state regulation has long provided a solution to the need for certain types of joint action in the insurance field.

Finally, it is relevant to note that the antitrust concerns raised as to the various pooling arrangements of insurance are not raised by the insurance buyers. The purchasers from these pooled arrangements are typically sophisticated commercial entities. The lack of any significant complaint from such a group as to the functioning of the system strongly suggests that the current system is working well and should not be sacrificed upon the altar of any antitrust theology.

To a limited extent, the National Commission accepts the need for antitrust immunity for some collective insurer activities in such areas as compilation and distribution of data underlying rates and pooling of resources to make available coverage on a joint basis. However, the Commission approach is to statutorily carve out specific limited antitrust immunity.<sup>171</sup> Further discussion of the "carving out" approach appears later in this article.<sup>172</sup>

### *C. General Application of the Antitrust Laws Fails to Recognize the Need to Balance the Unique Nature of Competition in Insurance and the Insurance Principle of Spreading the Risk*

A basic function of insurance is to provide protection against large and uncertain losses in exchange for small but certain premium payments. That is, through the insurance mechanism, risk of loss of one individual is spread among many. In this way, the insured can protect himself from an economic catastrophe in the event the loss occurs to him.

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169. 15 U.S.C.A. § 45(1) (Supp. 1979).

170. See Letter from Richard L. Mathias, Director of Ill. Dept. of Ins., to John Schene-  
field, Chairman, National Commission on Antitrust Policies and Procedures (Jan. 12, 1979).

171. See NATIONAL COMMISSION REPORT, *supra* note 13, at 225, 236-39. An FTC Assistant  
Director for Special Projects reached a similar conclusion, saying "[I]t is possible that these  
exemptions could be achieved through judicial application of the 'rule of reason.' But we see no  
reason for Congress to leave such basic issues in doubt by passing this judgment off on the court."

A. Foer, *supra* note 28, at 9.

172. See text accompanying notes 185-188 *infra*.

A basic principle of insurance pricing is that costs should be assessed equitably among policyholders so that each pays according to the expected loss and expense that the insurance entails for the class of insureds in which the policyholder falls. Rates are established on the basis of the average experience for this class. An insurer maximizes profits by beating the averages. That is, the insurer attempts to write insurance on those insureds in the class whose loss experience the insurer believes will be better than that of the class average. Ultimately, the insured whose loss experience is perceived to be worse than average either will not be able to obtain coverage except through the residual market mechanism or will find himself in a new class which has a higher rate. It is to the insurer's advantage to continually identify those within a class which have better, worse and average perceived loss expectation. The better risks within the class are actively competed for by insurers.

As the classes become more refined, the rate differential between insureds of different classes becomes substantially greater. If classification refinements are carried to their logical extreme, each individual would constitute a class and would pay a rate commensurate with his expected loss experience. In short, the more a classification system is refined, the more the fundamental insurance principle of spreading the risk is undermined.

Today we are witnessing widespread public reaction to extremely high rates for some groups of persons, often the disadvantaged; for example, auto insurance rates for young single male drivers in urban areas who happen to be black may be quite high. Pressures are increasing to limit the extreme differential in rates as public notions as to what is fair and unfair discrimination are brought to bear through the political processes at both the federal and state levels. Consequently, the insurance industry reflects a constant tension between insurer efforts to compete for profitable business, the insurers meeting the fundamental insurance need of spreading the risk and the political reaction to public notions of fairness as between insureds in the pricing and availability of insurance.

Under the current system, state insurance regulation is in a position to continually monitor and balance the conflicting public policies of competition, spreading the risk and fairness in the insurance markets. If the antitrust laws are applied with the corresponding removal of state authority, the forces of competition would be given full sway to the disregard of other public concerns.<sup>173</sup> Unrestrained competition, by fatally undermining the spread of risk concept, could result in the insurance institution failing to perform one of its basic and most important functions for a substantial portion of the insurance-consuming public.

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173. The following passage appears in a letter from Richard L. Mathias, Director of Illinois Department of Insurance, to John Shenefield, Chairman, National Commission on Antitrust Policies and Procedures (Jan. 12, 1979).

[T]here is the real possibility that a rush to repeal of McCarran-Ferguson Act could accrue to the disadvantage of the poor, minorities, the aged and the handicapped, those who are the most likely to be hurt and excluded in a system based solely on economic competition without consideration of the place of societal needs.



D. *Competing Public Policy Objectives Require Rational Coordination*

Even assuming *arguendo* that the general application of antitrust law to insurance would enhance competition, despite the economic and other benefits accruing from competitive markets, total reliance on competition is not in the public interest. One basic reason is that there are other public objectives (for example, reasonable price, availability, insurer reliability, affordability and social notions of fairness)<sup>174</sup> which may conflict with the results of a highly competitive market.<sup>175</sup> This is particularly true in the regulated insurance industry which embodies several regulatory objectives. Thus, one prime responsibility of the insurance regulator is to achieve an appropriate balance between the public benefits which can be derived from highly competitive markets and other public policy objectives.<sup>176</sup>

Even strong proponents of broad application of the federal antitrust laws acknowledge that there must be some recognition of public policy objectives other than simply fostering and maintaining competition. For example, the Department of Justice dimly recognizes the need to balance the policy of competition with that of preventing unfair discrimination and public policy notions of fairness.<sup>177</sup> But instead of leaving some rate regulatory authority in the states, the Department glibly recommends substituting federal regulatory prohibitions as to classifications and unfair discrimination in a very skeletal, unsophisticated manner in lieu of state controls.<sup>178</sup> As a result, the burden for enforcement would be shifted to the individual victim and the already overloaded courts. That is, while recognizing the need, weaker protection (including no regulatory monitoring or enforcement mechanism) would be provided to the public so that the Department could protect the integrity of its ill-founded conclusion to oust state regulatory authority.

The National Commission more adequately recognizes the fact that "regulators may have an obligation to intervene in the functioning of the market to ensure that the pricing and availability of insurance comport with social objectives of equity and fairness. . . . The Commission believes that

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174. See W. J. Kinder, Calif. Ins. Commissioner, Statement to the National Commission for the Review of Antitrust Laws and Procedures, I NAIC PROCEEDINGS 1025 (1979).

175. See note 173, *supra*. "Competitive markets mediate efficient resource allocation, not distributional justice." SRI INTERNATIONAL, CHOICE OF A REGULATORY ENVIRONMENT FOR AUTOMOBILE INSURANCE 25 (1979). At least two economists have raised strong reservations about the efficacy of regulatory efforts to achieve social income redistribution through the regulation of rates. See Joskow, *supra* note 101, at 21-29; Noll, *supra* note 140, at 2-5.

176. The Director of the Office of Policy Planning of the FTC has noted that "the free market, left completely to its own devices, may not be adequate to fully protect consumers." Reich, *Reappraising the State-Federal Regulation of Insurance* 4, ABA NATIONAL INSTITUTE ON APPLICATION OF ANTITRUST LAW TO THE BUSINESS OF INSURANCE (1978). This is a particularly significant observation in that it comes from a person representing one of the two major antitrust enforcement agencies.

177. See DJ REPORT, *supra* note 14, at 331-39.

178. *Id.* at 337.

such concerns are legitimate. . . ."<sup>179</sup> The Commission took "no position on the ultimate merits of the issues raised by arguments for and against increased regulation of insurance to achieve social objectives."<sup>180</sup> However, it did urge the states not to preclude reliance on market forces to establish rates for most policyholders and to reconcile the maintenance of competition with social objectives.<sup>181</sup> Furthermore, the National Commission recognized the need for additional study of insurance regulation in the context of problems of equity and discrimination in insurance rates, availability and affordability of insurance.<sup>182</sup> And finally, the current Chairman of the FTC has espoused an antitrust policy in general which encompasses a wider range of public policy objectives than simply fostering competition.<sup>183</sup> These recognitions highlight the need for an appropriate mechanism to reconcile competing public policy objectives.

The distinction between the regulated and nonregulated (or antitrust) sectors of the economy has become increasingly blurred. More and more, antitrust law is being injected into the regulated industries as the Department of Justice and the FTC have attempted to apply the Sherman and the Clayton Acts to regulated companies. At the same time, regulation is penetrating into the formerly nonregulated or so-called competitive sectors of the economy. As a result, it has been said that a fundamental problem is achieving a rational coordination of antitrust and regulation for the various segments of the economy. Litigation brought to apply the antitrust laws to a regulated industry, in the absence of a clear Congressional purpose, has shifted the burden to the judiciary to determine the appropriate mix between antitrust and regulation. Such decisions require careful policy judgments affecting large industries. Yet, these decisions are being determined in the narrow context of an adversary proceeding. Professor Milton Handler, for one, has maintained that this is a grossly inadequate system of reconciling the appropriate role of regulation and antitrust.<sup>184</sup> In contrast, the state regulatory system, with its increasing promotion of and reliance upon competition within the balanced framework of other regulatory goals, offers the most promising means to achieve such rational coordination on behalf of the insurance-consuming public.

Implicit in some of the Department of Justice's, and explicit in the National Commission's, recommendations is the notion that to the extent coordination is needed between the antitrust laws and insurance regulation, such coordination could be achieved by carving out a limited portion of insurer activities for exemption from antitrust applicability.<sup>185</sup> Several rea-

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179. NATIONAL COMMISSION REPORT, *supra* note 13, at 241.

180. *Id.* at 242.

181. *Id.* at 242-43.

182. *Id.* at 243-44.

183. See Pertachuk, *supra* note 102.

184. Handler, *Regulation Versus Competition*, 43 ANTITRUST L.J. 277, 280 (1974).

185. The National Commission recommended that (a) the repeal of the McCarran Act be

sons lead to a negative response to this approach.

First, if the definition of what is to be exempt from federal antitrust law is narrow or frozen to existing mechanisms or problems, the states would have withdrawn from them the flexibility to meet new problems and insurers would be unable to provide coverages for new and special risk situations needed by the public.<sup>186</sup> If the definition of the exemption is broad, the effort to apply the antitrust laws would be emasculated so as not to warrant the efforts and problems engendered by their application to insurance.

Second, the tension and needed balancing between competition and the spreading of risk principle is so fundamental and pervasive as to defy rational efforts to carve out an exemption. Third, determining how to meet availability and other special problems is a regulatory, not an antitrust, problem. To interject the Department of Justice and the FTC into these areas would convert these federal antitrust enforcement agencies into a federal insurance regulatory mechanism.

Fourth, some of the residual market mechanisms directly serve the disadvantaged, such as inner city residents. Through the residual market mechanisms, it is possible under state regulatory rate control, to achieve "social pricing," that is, to allocate a greater than proportionate cost to some so as to subsidize others. This cannot be achieved under the normal application of the antitrust laws.

Fifth, carving out exemptions would create a mixture of state regulation and antitrust law being enforced by three separate agencies (state insurance departments, Department of Justice and FTC) at two different levels of government (state and federal). One could hardly create a greater potential for regulatory chaos. This is particularly true since

[i]nsurance transactions are basically of a localized nature such that state regulation of some or all of their aspects is as logical today as it was in 1945. Even the Justice Department's federal alternative contemplates a continued states' role in taxation and over such matters as residual market mechanisms, policy forms, policy cancellation, financial responsibility laws, licensing of agents and systems of liability such as No-Fault. All of these, of course, impact upon underwriting. Even assuming a federal ban on bureau rate-making, the states must continue to retain some sort of review function over rates to insure that they are not unfairly discriminatory, excessive or, to guard against insolvency, inadequate. *To permit the federal antitrust laws to roam at large in these state-regulated areas would be to invite chaos by having insurers subjected to contradictory "regulation" through the processes of ad hoc antitrust litigation.* A whole

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combined with narrowly drawn legislation to affirm the lawfulness of a limited number of essential collective activities and (b) a study be undertaken as to the appropriate regulatory response to problems of equity, availability and affordability. NATIONAL COMMISSION REPORT, *supra* note 13, at 225. One FTC staff member also recommended the "carving out" approach. A. Foer, *supra* note 28, at 9 *et seq.*

186. *Contra*, A. Foer, *supra* note 28, at 11-12.

new body of law predictably would develop involving application to the insurance business of doctrines of implied immunity, exclusive and primary jurisdiction, exhaustion of administrative remedies and state action—doctrines confusing enough in their present antitrust settings. *Where anticompetitive abuses appear, there is no reason why they could not be dealt with under the state regulatory regimes—including invocation of once-all-but-dormant, now-very-much-alive state antitrust laws.*<sup>187</sup>

The chaos caused by the mixture of state regulation and federal agency antitrust activity would be further exacerbated by the increasing and uncontrolled propensity to bring private litigation to enforce the antitrust laws.<sup>188</sup>

Sixth, the substantive economic and enforcement defects of antitrust law should not be engrafted upon the insurance industry. But rather, through the open and non-open competition rating laws relevant antitrust concepts and standards can be drawn upon and inappropriate ones rejected. Tailoring antitrust law to the insurance industry and insurance regulatory goals while avoiding the defects of antitrust law can best be achieved through the state insurance regulatory mechanism in a manner to avoid the problems enumerated above.

#### IV. ALTERNATIVE MEANS OF REPEALING OR MODIFYING THE McCARRAN ACT ANTITRUST IMMUNITY POSE FUNDAMENTAL INSURANCE REGULATORY IMPLICATIONS

Part II of this article leads to the conclusion that not only is there an absence of need for a general application of the antitrust laws to the business of insurance, since at best such laws would have minimal impact on enhancing competition in insurance, but also that the states are better able to preserve and foster competition in the business of insurance. Consequently, the implementation of public policy of fostering and promoting competition in insurance is neither dependent upon nor significantly served by the general application of the antitrust laws. Part III of this article reviews several major areas in which the general application of the antitrust laws would result in a serious adverse impact upon the insurance-buying public.

However, the degree to which these conclusions hold true is dependent in part upon the precise way in which the McCarran Act is repealed or modified. Since the proposals for change cover a wide gamut, reviewing the implications of each is beyond the scope of this article. However, consideration of three alternatives will highlight some of the major issues and implications inherent in modifying the current McCarran Act framework. These alternatives are (A) repeal of the McCarran Act antitrust immunity with no limitation on state insurance regulatory activity, (B) repeal of McCarran Act antitrust immunity plus Congressional limitations on state insurance rating laws and (C) implementation of federal standards for state insurance rating laws.

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187. Whiting, *supra* note 161, at 8-9 (emphasis added).

188. See text accompanying note 164 *supra*.

A. *Repeal of the McCarran Antitrust Immunity with No Limitation of State Insurance Regulatory Activity*

One approach would be simply to repeal the antitrust immunity provided by the McCarran Act with no explicit corresponding limitation on state insurance regulatory authority. (The National Commission recommendation to repeal the insurance immunity, subject to carving out some limited exceptions, is a modification of this general approach.) Such an amendment to the McCarran Act poses the question as to what state insurance regulatory activity would continue to be valid. This, in turn, raises the sub-issues relating to the application of the preemption and state action doctrines.

1. *Preemption Doctrine in General*

a. *Foundation of the Preemption Doctrine.* The McCarran Act has barred successful challenges to the viability of state regulatory authority over the "business of insurance" which were premised upon the federal commerce power and the supremacy clauses in the United States Constitution.<sup>189</sup> The commerce clause provides that "Congress shall have the Power . . . To regulate Commerce . . . among the several States."<sup>190</sup> The supremacy clause states that the "Constitution, and the laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land . . . any Thing in the Constitution or Laws of any State to the Contrary notwithstanding."<sup>191</sup> Since the federal antitrust laws were enacted pursuant to Congress' authority under the commerce clause,<sup>192</sup> such laws would be supreme over state insurance regulation in the absence of some immunity. Consequently, the proposal to amend the McCarran Act to remove the antitrust immunity for the "business of insurance" opens the entire gamut of insurance regulation to challenge.

The continued validity of various aspects of state insurance regulation, in the context of general applicability of the antitrust laws to the "business of insurance," depends in large part upon the manner in which the courts apply the preemption doctrine under the directive of the supremacy clause. The preemption doctrine serves to define the spheres of federal and state governmental authority within our federal system.<sup>193</sup> To provide a frame of reference in discerning the potential implications for state insurance regula-

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189. In *Prudential Ins. Co. v. Benjamin*, 328 U.S. 408, 431 (1946) the Court said that by virtue of enacting the McCarran Act Congress "clearly put the full weight of its power behind existing and future state legislation to sustain it from any attack under the commerce clause. . ." (emphasis added).

190. U.S. CONST. art. I, § 8, cl. 3.

191. *Id.* at art. VI, cl. 2.

192. See *United States v. South-Eastern Underwriters Ass'n*, 322 U.S. 533, 534 (1944).

193. Note, *The Preemption Doctrine: Shifting Perspectives on Federalism and the Burger Court*, 75 COLUM. L. REV. 623, 624 (1975) [hereinafter, *Shifting Perspectives*].



tion, some rudimentary understanding of the preemption doctrine is essential.<sup>194</sup>

The scope of preemption of state law has moved in cycles.<sup>195</sup> In the early 1900's, Congressional action in a particular field was by itself enough to preempt concurrent state law even if the state statute was compatible with the federal scheme.<sup>196</sup> By the 1930's, however, "the Supreme Court abandoned expansive judicial assessments of federally regulated subject matter, transferring to the Congress primary responsibility for accomplishing preemption."<sup>197</sup> Unless there was an actual conflict between state and federal law, preemption would arise only if Congressional intent to occupy the field was "definitely and clearly" shown.<sup>198</sup> Although the Court preferred Congressional expression of specific intent to occupy the field, the Court permitted such intent to be inferred.<sup>199</sup> However, during this period of judicial solicitude of state interests, the Court sustained state law in federally regulated fields on the basis of its reluctance to infer Congressional intent to preempt state efforts to exercise its police powers. "Once the state presumption was triggered, only a strong showing of Congressional intent to occupy the field could effectively rebut it."<sup>200</sup> Similarly, the Court applied a state presumption in favor of state law validity in conflict situations. Minor conflicts, which were only peripheral to federal purpose, were either overlooked or avoided by focusing upon the dominant federal purpose. The preemption doctrine was flexibly applied to permit the magnitude of the conflict to be balanced against the interests of the state.<sup>201</sup>

In 1941, *Hines v. Davidowitz*<sup>202</sup> inaugurated a period of judicial solicitude of federal interest. The Court declared that its "primary function is to determine whether . . . [the state] law stands as an obstacle to the accomplish-

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194. As used in this article, the preemption doctrine relates to invalidating state law for incompatibility with a federal scheme. In this sense, since preemption implies the existence of federal legislation (which is true in our main area of interest—the antitrust laws), invalidation of a state law under the commerce clause of the Constitution in the absence of a federal statute in the manner of traditional commerce clause cases, falls outside the definition of preemption. This is the manner in which the term preemption is used in *Shifting Perspectives*, *supra* note 193, at 624 n.7.

195. The summary which follows draws substantially upon the work of *Shifting Perspectives*, *supra* note 193.

196. See *Charleston & Western Carolina Ry. Co. v. Varnville Furniture Co.*, 237 U.S. 597, 604 (1915).

197. *Shifting Perspectives*, *supra* note 193, at 627.

198. *Mintz v. Baldwin*, 289 U.S. 346, 350 (1933). Similar phrasing has been used in *Maurer v. Hamilton*, 309 U.S. 598, 614 (1940) ("clearly indicated") and *H. P. Welch Co. v. New Hampshire*, 306 U.S. 79, 85 (1939) ("definitely expressed").

199. *Shifting Perspectives*, *supra* note 193, at 627. See also *Maurer v. Hamilton*, 309 U.S. 598, 614 (1940).

200. *Shifting Perspectives*, *supra* note 193, at 628.

201. See, e.g., *Keeler v. Department of Public Safety*, 369 U.S. 153, 174 (1962); *Huron Portland Cement Co. v. City of Detroit*, 362 U.S. 440, 441-46 (1960); *Shifting Perspectives*, *supra* note 193, at 629.

202. 312 U.S. 52 (1941).

ment and execution of the full purposes and objectives of Congress."<sup>203</sup> In *Hines*, there was an absence of a showing of congressional intent to occupy the field and actual conflict between the federal and state law. Thus, in effect, the Court erected a presumption in favor of federal preemption by retreating from a vigorous intent standard and thereby breaking new constitutional ground.<sup>204</sup> "[The decision] amounted to a judicial assumption of competence to find preemption, notwithstanding the absence of clear Congressional intent to occupy the field or actual conflict, when the nature of the federal regulation called for exclusive operation."<sup>205</sup>

In *Rice v. Santa Fe Elevator Corporation*,<sup>206</sup> in applying the intent standard, the Court enunciated considerations such as pervasive regulation, dominant federal interest and unhampered operation. This reflects the view that a strict definition of congressional intent is inadequate since Congress focuses on the development of its own policies with little attention directed at the ramifications with respect to state law. "By discounting intent as an absolute limitation on the permissible sources of preemptive findings, *Hines* and *Rice* expanded the judicial role in occupation-of-the-field [intent] cases."<sup>207</sup>

Prior to *Hines* and *Rice*, in conflict cases, the Court restricted preemption to situations involving *actual* conflict with federal regulatory schemes. Subsequently the Court voided state law by perceiving a *potential* conflict.<sup>208</sup> "The adoption of a potential conflict standard accented the drift toward a federal-directed preemption doctrine, by beckoning judicial consideration of a federal statute's operational requirement and inviting preemption on speculative assessments of conflict."<sup>209</sup> However, just as the federally favored preemption doctrine acquired the appearance of some degree of permanence, the Court again began to change direction.

In a series of decisions commencing in 1973, the Court once again incorporated a solicitude of state interests in its preemption analysis. In *Goldstein v. California*,<sup>210</sup> the Court narrowly construed the preemptive capability of the constitutional copyright clause by holding that federal copyright power is exclusive only when a similar exercise by the states would be "absolutely and totally *contradictory* and *repugnant*."<sup>211</sup> To ascertain "repugnancy," the

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203. *Id.* at 67-68.

204. See *Shifting Perspectives*, *supra* note 193, at 630-32. Although the federal statute involved alien registration, which was not grounded on the federal commerce power but rather upon foreign affair power, nevertheless the *Hines* principle influenced the intent standard in subsequent occupying the field cases. *Id.* at 632.

205. *Id.* at 631.

206. 331 U.S. 218 (1947).

207. *Shifting Perspectives*, *supra* note 193, at 634. In this judicial activist era, the Court sometimes looked to additional preemptive bases rooted in considerations of public policies beyond the congressional statute or legislative history. See *id.* at 634-36.

208. See, e.g., *San Diego Bldg. Trades Council v. Garmon*, 359 U.S. 236, 244 (1959); *Pennsylvania v. Nelson*, 350 U.S. 497, 509-10 (1956).

209. *Shifting Perspectives*, *supra* note 193, at 636.

210. 412 U.S. 546 (1973).

211. *Id.* at 553.

Court fashioned the test that exclusive federal power exists over "matters which are necessarily national in import."<sup>212</sup> The *Goldstein* case not only articulated a flexible concept of federal-state relations in lieu of absolute federal supremacy, but also added a state-oriented standard of "necessarily national" in defining the "repugnancy" standard, thereby marking the re-emergence of a more state-oriented preemption doctrine.<sup>213</sup>

In *New York State Department of Social Services v. Dublino*,<sup>214</sup> the Court held that a work incentive program of the Social Security Act did not occupy the field in determining whether state work rules were preempted.<sup>215</sup> The Court affirmed the state's legitimate interest in promoting worker self-reliance and appropriate allocation of limited state welfare funds.<sup>216</sup> In avoiding preemption, the Court resurrected the specific intent requirement that was in vogue during the state solicitude pre-*Hines/Rice* period.

If Congress is authorized to act in a field, it should manifest its intention clearly. It will not be presumed that a federal statute was intended to supersede the exercise of the power of the state unless there is a clear manifestation of intention to do so. The exercise of federal supremacy is not lightly to be presumed.<sup>217</sup>

*Dublino's* intent standard would seem to implicitly reject the assumption upon which the *Rice* factors were based, that is, Congress cannot be assumed to have concerned itself with the implication for state law when formulating its own program. Furthermore, the rejection of the preemptive significance of the comprehensive nature of the federal program casts further doubt on the continuing vitality of *Rice*.<sup>218</sup>

In conflict cases, as well as occupy-the-field-intent cases, the Court has recently accorded substantial weight to state interests.<sup>219</sup> Furthermore, the Court has cut back on the *Hines/Rice* cases potential conflict standard as a basis for preemption. The *Goldstein* "necessary" conflict requirement indicated the Court's dissatisfaction with the potential conflict concept. Al-

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212. *Id.* at 554. Strictly speaking, *Goldstein* is not a preemption case since it involved the copyright clause rather than a federal statute preempting a state law. However, the Court employed the analytical tools of preemption which posed broad implications for future preemption analysis. *Shifting Perspectives*, *supra* note 193, at 639-40. It is also important to note that the Court used the commerce clause analysis rather than draw an analogy to the foreign affairs power model of *Hines* which found federal exclusivity. *Id.* at 640.

213. See *Shifting Perspectives*, *supra* note 193, at 641-42.

214. 413 U.S. 405 (1973).

215. *Id.* at 422. However, the Court remanded the case on the issue of whether some particular sections in the state work rules conflicted with a federal requirement.

216. *Id.* at 413.

217. *Id.* (emphasis added).

218. "Given the complexity of the matter addressed by Congress . . . , a detailed statutory scheme was both likely and appropriate, completely apart from any questions of preemptive intent." *Id.* at 415.

This language was quoted approvingly in *De Canas v. Bica*, 424 U.S. 351, 359 (1976).

219. *Shifting Perspectives*, *supra* note 193, at 646-47, 649.

though in *Dublino* the Court declined to pass directly on conflict, it noted that "[c]onflicts, to merit judicial rather than cooperative federal-state resolution should be of substance and not merely trivial or insubstantial."<sup>220</sup> By remanding the case on the conflict issue, the Court chose not to examine the federal and state statutes for latent conflicts thereby suggesting that *Dublino* heralds the demise of *potential* conflict as the basis for preemption.<sup>221</sup> In 1978, in *Exxon Corp. v. Governor of Maryland*, the Court stated that the "teachings of this Court's decisions . . . enjoin seeking out conflicts between state and federal regulation where none clearly exists"<sup>222</sup> and that "[t]his sort of hypothetical conflict is not sufficient to warrant pre-emption."<sup>223</sup> Going one step further, *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Ware*<sup>224</sup> resulted in a state law surviving an admitted conflict when the conflict was in an area peripheral to the federal law's main purpose.<sup>225</sup>

b. *Summary of Current Formulation of the Doctrine.* Any attempt to precisely define the preemption doctrine as a basis of prediction is hazardous at best. Not only has the Court's basic view of state-federal relations evidenced a cyclical pattern, but also within a given period, the standards have been reformulated or rephrased in multiple instances. Nevertheless, an effort to briefly summarize the prevailing formulation of the preemption doctrine, while not totally reliable, will assist in at least discerning the potential implications of repealing the McCarran Act antitrust immunity.

In 1977, in *Jones v. Rath Packing Co.*,<sup>226</sup> the Court attempted to summarize the "path" to be followed in determining whether state law is preempted.<sup>227</sup> The first inquiry is whether Congress prohibited state regulation of the particular aspects of commerce under consideration in a given case. The Court starts "with the assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress."<sup>228</sup> However, when Congress has "unmistakably . . . ordained," that is, has expressed a "clear and manifest purpose," that *its* enactments alone are to regulate, state regulation is preempted<sup>229</sup> whether or not state regulation impairs the operation of federal law. Congressional intent may be found in an explicit statutory command or

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220. 413 U.S. at 423 n.29.

221. *Shifting Perspectives*, *supra* note 193, at 647.

222. 437 U.S. 117, 130 (1978).

223. *Id.* at 131.

224. 414 U.S. 117 (1973).

225. See *Shifting Perspectives*, *supra* note 193, at 648-49. The Court said that the rules of the New York Stock Exchange (promulgated pursuant to federal law) should preempt conflicting state law "only to the extent necessary to protect the achievement of the aims of the Securities Exchange Act." 414 U.S. at 127.

226. 430 U.S. 519 (1977).

227. *Id.* at 525-26.

228. *Id.* at 525. "This assumption provides assurance that the 'federal-state balance' will not be disturbed unintentionally by Congress or unnecessarily by the courts." *Id.*

229. *Id.* (emphasis added).

sumption was not overcome. Since the program derived its authority from the legislature and could not have existed without it, the program was not a product of individual action. In contrast, the Sherman Act is a "prohibition of individual and not state action."<sup>242</sup> Consequently, the Court held that the state's activity was exempt from the Sherman Act. *Parker* confirmed that actions taken by a state acting as a sovereign are not within the Sherman Act prohibitions.<sup>243</sup> In short, the *Parker* Court held that "the Sherman Act does not apply to official action taken by a state even when that action . . . is implemented at the behest of private parties and constitutes a direct restraint upon competition in interstate commerce."<sup>244</sup>

However, *Parker* does not immunize all state law from Sherman Act challenge. The Court expressly stated "a state does not give immunity to those who violate the Sherman Act by authorizing them to violate it, or by declaring that their action is lawful. . . ."<sup>245</sup> The Court in *Parker* clearly distinguished between a state statute which is merely permissive of private anticompetitive conduct and one that substitutes a policy of governmental regulation in lieu of the procompetition policy of the antitrust laws.<sup>246</sup> "The former statute is preempted by the Sherman Act's prohibition of private anticompetitive behavior, while the latter enactment represents a sovereign governmental decision not prohibited by the Sherman Act."<sup>247</sup>

Furthermore, *Parker* made plain that neither a state nor its agents enjoy antitrust immunity merely by reason of their status as sovereign.<sup>248</sup> This principle was reiterated recently in *City of Lafayette v. Louisiana Power & Light Co.*<sup>249</sup> in which the assertion that state action immunizes state and municipal conduct was rejected. The Court held that a municipality's conduct is subject to antitrust regulation unless such conduct complies with sovereign state governmental policy designed to replace competition with regulation.<sup>250</sup>

*Parker* enunciated the state action doctrine, that state action is not

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242. *Id.* at 352.

243. Rogers, *The State Action Antitrust Immunity*, 49 *COLO. L. REV.* 147, 154 (1978). The *Parker* decision used "carefully selected language which plainly limited the Court's holding to official action taken by state officials." *Cantor v. Detroit Edison Co.*, 428 U.S. 579, 591 (1976). The defendants in *Parker* were various officials administering the prorate act. Although raisin producers were on the program committee, they were defendants only in their official capacity. The court indicated that although the producers had to petition for the plan and producers had to affirmatively vote upon it, it was the state itself which adopted and enforced the plan. 317 U.S. at 352.

244. Davidson & Butters, *Parker and Usury: Portended Constitutional Limits on the Federal Interdiction of Anticompetitive State Action*, 31 *VAND. L. REV.* 575, 583 (1978) [hereinafter, Davidson & Butters].

245. 317 U.S. at 351.

246. Davidson & Butters, *supra* note 244, at 583.

247. *Id.* at 583-84.

248. See 317 U.S. at 351-52.

249. 435 U.S. 389 (1978).

250. *Id.* at 413.



subject to the Sherman Act. The state action doctrine dictates that some accommodation be achieved between the federal interests in antitrust enforcement and the principles of federalism and comity which commend federal deference to the police power authority of the states.<sup>251</sup> The fundamental question entails a definition of "state action."<sup>252</sup> *Parker* was ambiguous in this regard with respect to two areas. First, when does state action apply to private individuals whose conduct in some way was regulated by the state? Second, what amount of state regulation is necessary to trigger the application of the state action doctrine?<sup>253</sup>

In the thirty-plus years following the *Parker* decision, lower courts have applied the state action exemption in a variety of contexts.<sup>254</sup> One decision went to the point of finding a state action exemption for private conduct merely because it fell within a state agency's power to regulate.<sup>255</sup> Other courts have more closely scrutinized state-regulated industries. A variety of approaches have been employed, including examining the amount of state supervision over the regulated activity,<sup>256</sup> determining whether the state had specifically directed that anticompetitive schemes be utilized to achieve the state regulatory goals<sup>257</sup> and ascertaining whether the state was acting in a governmental or a proprietary capacity.<sup>258</sup> The variety of approaches evinced a need for guidance from the Supreme Court, but, when faced with a *Parker* problem, the Court denied certiorari in nearly every case.<sup>259</sup> As a consequence, from 1943 when the Court decided *Parker*, to 1975 when the Court decided *Goldfarb v. Virginia State Bar*,<sup>260</sup> lower court judges applied the state action doctrine to a wide variety of state regulatory programs without clear guidance from the Supreme Court.

*Goldfarb* was the first of a series of Supreme Court cases commencing in 1975 attempting to more clearly define the scope of the state action exemp-

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251. Blumstein & Calvani, *State Action as a Shield and Sword in a Medical Services Antitrust Context: Parker v. Brown in Constitutional Perspective*, 1978 DUKE L.J. 389, 395.

252. Delineating the contour of state action attempts to resolve two distinct but related tensions. First is the tension between reliance upon the market and decentralized decision making as the primary technique for structuring economic activity in a manner to achieve efficiency and equity objectives and reliance upon regulation to achieve public policy goals. Second is the tension between federal and state or local policies. The state action doctrine of *Parker* reflects a judicial sensitivity to these questions of federalism. See *id.* at 395-97.

253. Comment, *The Parker Perplex: A Study of the Changing Effects of Parker v. Brown on the Antitrust Laws and the Federal Trade Commission Act*, 51 TEMP. L.Q. 281, 287-88 (1978).

254. For a listing of cases see Sklar, *Parker v. Brown: What's Left After Cantor v. Detroit Edison?*, ABA NATIONAL INSTITUTE ON APPLICATION OF ANTITRUST LAW TO THE BUSINESS OF INSURANCE 6 n.3 (June 10, 1978).

255. *Washington Gas Light Co. v. Virginia Electric & Power Co.*, 438 F.2d 248, 252 (4th Cir. 1971).

256. Comment, *supra* note 253, at 290.

257. *Id.* at 291-92.

258. *Id.* at 292.

259. *Id.* at 292-93.

260. 421 U.S. 773 (1975).

tion to the antitrust laws. *Goldfarb* involved a challenge to a state-bar-enforced minimum fee schedule on the basis that this involved a price fixing violation of the Sherman Act. The Supreme Court held that *Parker* did not apply to exempt the state bar association's anticompetitive activity.<sup>261</sup> The state supreme court was authorized by statute to govern the conduct of lawyers in the state and the state bar association was to act as an administrative agency of the court to investigate violation of the court's rules. The bar, however, not the court, issued and enforced the fee schedule. Since the state, acting through its supreme court, had neither required nor approved the fee schedule, there was insufficient state involvement to invoke the state action doctrine.<sup>262</sup> The Court stated "[t]he threshold inquiry in determining if an anticompetitive activity is state action of the type the Sherman Act was not meant to proscribe is whether the activity is required by the State acting as sovereign."<sup>263</sup> The Court emphasized that "[i]t is not enough that . . . anticompetitive conduct is 'prompted' by state action; rather anticompetitive activities *must be compelled by direction of the State acting as a sovereign*."<sup>264</sup> In this case it was not the state that required compliance with the fee schedule. Thus *Goldfarb* clarified one of the ambiguities in *Parker* by emphasizing that the state action doctrine may apply to private individuals only if the challenged activity is state-compelled.<sup>265</sup>

*Cantor v. Detroit Edison*<sup>266</sup> further delineated the boundaries of the state action doctrine despite the confusion engendered by a four part opinion.<sup>267</sup> In *Cantor*, the defendant public utility distributed light bulbs to its customers for no extra charge. The cost of the program was included in the charge for providing electricity and thus paid for by all of the utility's customers whether or not they exchanged old bulbs for new ones. The utility rates were subject to the approval of the state public service commission and could not be changed without approval. Approval of the rates included implicit state approval of the program. Thus, the utility argued that the bulb distribution program was required by state law. The plaintiff, a retail druggist selling light bulbs, asserted that the bulb exchange program violated the antitrust laws by using monopoly power in the distribution of electricity to restrain competition in the sale of bulbs. The commission pervasively regulated the distribution of electricity but not the distribution of bulbs.<sup>268</sup>

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261. *Id.* at 793.

262. *Id.* at 790-91.

263. *Id.* at 790.

264. *Id.* at 791 (emphasis added).

265. This is consistent with *Parker*, which emphasized that it was the state itself which regulated the raisin market. See 317 U.S. at 350-51.

266. 428 U.S. 579 (1976).

267. Justice Stevens wrote the plurality opinion joined in by Justices Brennan, Marshall and White. Chief Justice Burger filed a concurring opinion and joined in Parts I and III of the plurality opinion, resulting in a majority as to those sections. Justice Blackmun wrote a separate opinion concurring in the judgment and Justices Stewart, Powell and Rehnquist joined in a dissenting opinion.

268. 428 U.S. 581-85.

Although *Goldfarb* implied that the state action doctrine might apply to private individuals if their actions are compelled by the state,<sup>269</sup> the *Goldfarb* decision provided little guidance as to how much state involvement constituted state action.<sup>270</sup> The Court, among other things, addressed this issue in *Cantor* but nevertheless left the answer unclear.

The Court concluded that the public utility was not entitled to the protection of the state action doctrine. The plurality opinion confined the application of *Parker* to official acts of state officers. Additionally, since *Cantor* involved no public official or agency as defendants in the action and since no claim was made that state action violated the antitrust law, *Parker* was deemed not to be controlling.<sup>271</sup> This rationale, however, did not command the support of the majority of the Court.<sup>272</sup>

The portion of the plurality opinion joined in by Chief Justice Burger constitutes the majority opinion of the Court. The majority set out two situations in which the Sherman Act might not apply to private conduct required by state law. First, courts should ascertain whether it would be unfair to hold a private individual liable for violating the antitrust laws merely because he followed the commands of his state.<sup>273</sup> State action immunity to antitrust is not conferred merely by "state authorization, approval, encouragement, or participation in restrictive private conduct. . . ." <sup>274</sup> When initiation and enforcement of the challenged program involves "a mixture of private and public decision-making," despite state participation, the private party may exercise "sufficient freedom of choice to enable the Court to conclude that he should be held responsible for the consequences of his decision."<sup>275</sup> The Court concluded that the public utility had the option to have the free bulb exchange program.<sup>276</sup> Distinguishing between state regulation of the distribu-

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269. The implication was that if the fee schedule had been state compelled, the state bar association would have assumed the role of a state agency and been protected by the state action doctrine. Comment, *supra* note 253, at 296 n.117.

270. *Id.* at 296.

271. *Cantor v. Detroit Edison Co.*, 428 U.S. 579, 591-92 (1976). It has been suggested that this portion of the plurality's opinion involved notions of federalism embodied in the eleventh amendment which limits the susceptibility of states to suits in federal courts. See Blumstein & Calvani, *supra* note 251, at 414-19. U.S. CONST. amend. XI provides: "The judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State. . . ." If the plurality's understanding of *Parker v. Brown* is to be rooted in 11th amendment concerns about litigation against sovereign states in federal courts, the opinion's focus on the identity of the parties in *Cantor* is both understandable and crucial to the decision. Blumstein & Calvani, *supra* note 251, at 415.

272. Although concurring in the judgment and part of the plurality opinion in *Cantor*, Chief Justice Burger expressly disagreed that *Parker* "can logically be limited to suits against state officials." 428 U.S. at 603-04. Justice Blackmun, while concurring in the judgment, wrote a separate opinion based upon a differing rationale. *Id.* at 605-14; see also note 282 *infra*.

273. 428 U.S. at 592.

274. *Id.* at 592-93.

275. *Id.* at 593.

276. *Id.* at 594. The Court noted that the program was initiated before the state regulatory

tion of electricity and state nonregulation of the distribution of light bulbs, the Court inferred that the state policy was "neutral" on whether the utility should have such a program.<sup>277</sup> The Court did recognize, however, a possible situation "in which the State's participation in a decision is so dominant" that holding the private party responsible would be unfair.<sup>278</sup>

The second situation pointed to by the Court in which private conduct required by state law may be exempt from antitrust regulation may arise if Congress did not intend to superimpose antitrust law in an area regulated by the state.<sup>279</sup> In concluding that Congress would not have intended to exempt the bulb exchange program, the Court gave two major reasons. First, although public utility regulation is necessary to protect against the abuse of a natural monopoly position, no necessity existed to regulate the light bulb market which was not a natural monopoly. Since exemptions from the antitrust laws are not favored, the Court determined that, while Congress intended the public utility aspect to be exempt from antitrust regulation, such intent did not extend to the light bulb market.<sup>280</sup> Second, since federal agencies can exempt regulated conduct only to the minimum extent necessary, the Court reasoned that Congress did not intend state agencies to have greater exemptive power. Consequently, since the sale of light bulbs is essentially an unregulated part of the economy and since regulation of such sale was not necessary to make the state's public utility regulation work, the Court concluded Congress could not have intended the bulb exchange program to be exempt.<sup>281</sup>

In short, the majority in *Cantor* enunciated two tests under which private conduct required by the state could invoke the state action doctrine, the fairness test and the congressional intent test.<sup>282</sup> The fairness test, with its reference to "dominant" participation of the state in the decision-making process appears to be a rephrasing or an elaboration of the state compulsion test in *Goldfarb*.<sup>283</sup> This test applies in a situation where the state does not assume a dominant (compelling) role in the decision-making process.<sup>284</sup> The

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agency was even created. *Id.*

277. *Id.* at 584-85.

278. *Id.* at 594-95.

279. *Id.* at 592.

280. *See id.* at 595-96.

281. *See id.* at 596-98.

282. Justice Blackmun, in his separate opinion, sought to apply a rule of reason approach which would judicially balance the benefits and harms of state sanctioned anticompetitive activity. *See id.* at 610-11.

283. The idea of state compulsion finds support in the first part of Justice Stevens' test which speaks of exempting individuals in instances where the state had so dominant a role in ordering activity that the individual could not fairly be held responsible for his part in its implementation. The first part of Justice Stevens' test is similar to the *Goldfarb* state compulsion test.

Comment, *supra* note 253, at 300.

284. Rogers, *supra* note 243, at 160 concludes that "[a]fter *Cantor*, antitrust immunity is no longer guaranteed even though the state acts as a sovereign in compelling certain conduct."

majority framed the second test in terms of congressional intent which revolved around a determination as to whether the exemption from the anti-trust laws is necessary for state regulation to work. If yes, then the immunity extends only to the minimum necessary.<sup>285</sup> It might even be said that the second test is not a state action test at all but rather an application of the preemption doctrine<sup>286</sup> in the event the state action immunity does not apply.<sup>287</sup>

A more recent decision of the Supreme Court dealing with the state action doctrine of *Parker* is *Bates v. State Bar of Arizona*.<sup>288</sup> In this case, two attorneys challenged the state supreme court disciplinary rules banning advertising of attorney services and charges. The state bar association brought a disciplinary proceeding. The Court ultimately struck down the advertising ban on first amendment grounds.<sup>289</sup> However, the Court stated that the state bar's actions were protected against antitrust challenge by *Parker*. In *Bates*, the rule prohibiting lawyer advertising was found to be the "affirmative command of the Arizona Supreme Court."<sup>290</sup> Since that court derived its authority to govern the practice of law from the state's constitution, the restraint on advertising was "compelled by the direction of the State acting as sovereign."<sup>291</sup>

The Court distinguished *Cantor* on three grounds. First, the *Cantor* case was directed at a private party rather than a public agency.<sup>292</sup> Second, in *Cantor* the state had no independent regulatory interest in the bulb market, whereas it has a great interest in the functioning of administering the system of justice.<sup>293</sup> Third, the governmental role in *Cantor* was simply "acquiescence," whereas in *Bates* "the state policy is so clearly and affirmatively expressed and . . . the State's supervision is so active."<sup>294</sup>

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According to Rogers, *Cantor* established a four post-threshold criteria (i.e., after determination of finding compulsion) before antitrust immunity can be granted. See *id.* at 161-62. But see *id.* at 174-75. Also "[t]he Court indicated that the presence of either of these reasons would justify private [party] immunity. Thus the court appeared to recognize two separate tests for determining whether private immunity exists: a fairness test and a state preemption test." Shores, *The State Action Doctrine After Goldfarb and Cantor*, 63 IOWA L. REV. 367, 370 (1977) (emphasis added).

285. *Cantor v. Detroit Edison*, 428 U.S. at 597.

286. For a summary of the discussion of congressional intent in the context of preemption, see text accompanying notes 226-232 *supra*.

287. One commentator describes the second test as the "preempting test." Shores, *supra* note 284, at 371.

288. 433 U.S. 350 (1977).

289. *Id.* at 384.

290. *Id.* at 360.

291. *Id.*

292. Although the defendant was the State Bar Association, the Court said that the "Arizona Supreme Court is the real party in interest. . . ." *Id.* at 361.

293. *Id.* at 361-62.

294. *Id.* at 362. Despite the fact that Justice Blackmun wrote the opinion in *Bates*, the balancing of federal-state interest approach which he espoused in *Cantor* did not play a significant role in *Bates*, suggesting that it may have little role in future state action cases. See



The most recent Supreme Court decision involving the state action doctrine, *New Motor Vehicle Board of California v. Fox*,<sup>295</sup> was handed down in December, 1978. A state law required an automobile manufacturer to obtain approval of a state board before opening or relocating a retail dealership within the market area of an existing franchise if the latter protests. The manufacturer and a new franchiser argued, among other things, that the state law conflicted with the Sherman Act and was invalid. Citing *Parker*, *Bates* and *City of Lafayette*, the Court held:

[t]he dispositive answer is that the Act's regulatory scheme is a system of regulation, clearly articulated and affirmatively expressed, designed to displace unfettered business freedom in the matter of the establishment and relocation of automobile dealerships. The regulation is therefore outside the reach of the antitrust laws under the "state action" exemption.<sup>296</sup>

In summary, in *Parker*, the Supreme Court clearly established the state action doctrine, that state action is not subject to the strictures of the Sherman Act. The subsequent cases have neither added nor subtracted from this basic principle, but rather have attempted to delineate a satisfactory test or set of tests to identify those situations which involve state action. State action concerns have arisen in two contexts. One facet relates to the issue of whether antitrust law applies to governmental acts. This has been referred to as governmental immunity. The second facet relates to the application of the doctrine to private conduct required by state law. This has been referred to as private immunity.<sup>297</sup>

As to governmental immunity, the Court has made clear that the mere status as a governmental agency is insufficient to invoke the state action doctrine. *Parker* evidences this fact by explicit recognition that a state or its municipality could be a participant in a private agreement in violation of the Sherman Act.<sup>298</sup> *City of Lafayette* reaffirmed that "for purposes of the *Parker* doctrine, not every act of a state agency is that of the State as a sovereign."<sup>299</sup> Thus, something more than the governmental status is necessary before the state action doctrine applies.

The meeting of at least two standards appears to be necessary for governmental activity to fall within the scope of the state action doctrine. First, there must be a clear state policy to supplant competition, and, second, there must be active state supervision of the scheme chosen to replace competition as the regulator of the market place.<sup>300</sup>

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Davidson & Butters, *supra* note 244, at 592-95. "Such a balancing test has no place in the state action doctrine, however, because it does not address the only constitutionally significant issue—whether the activity under review is sovereign regulatory conduct not subject to antitrust proscription." *Id.* at 592.

295. 439 U.S. 96 (1978).

296. *Id.* at 109.

297. Shores, *supra* note 284, at 368.

298. 317 U.S. at 351-52.

299. 435 U.S. 389, 410 (1978).

300. Davidson & Butters, *supra* note 244, at 589. See Note, *The State Action Exemption*

In *Parker*, in sustaining the state action immunity, the Court was emphatic in that (a) the pro-rata program "derived its authority and its efficacy from the legislative command [the clear public policy] of the state"<sup>301</sup> and (b) the state, acting through a commission, adopted and enforces the program with civil and penal sanctions "in the execution of governmental policy."<sup>302</sup> In *Goldfarb*, the Court was unable to identify any state statute or supreme court rule that directed the establishment of a minimum fee schedule. Thus the first criterion of a clear public policy was not met and the state action immunity was unavailable. In *Cantor* there was no articulated state policy as to light bulbs and the state review of rates as to the light bulb program was not active. On the other hand, both criteria were met in *Bates*. The Court found the rule prohibiting advertising to be an "affirmative command [policy]." *Goldfarb* was distinguishable on the basis that Virginia did not require anticompetitive conduct. Furthermore, the Court, in *Bates*, explicitly stated that "we deem it significant that the state policy is so clearly and affirmatively expressed and that the State supervision is so active."<sup>303</sup> Similarly, in *City of Lafayette*, the Court noted its emphasis on the twin criteria in *Bates*<sup>304</sup> and concluded that "the Parker doctrine exempts only anticompetitive conduct engaged in as an act of government by the State as sovereign . . . pursuant to state policy to displace competition with regulation or monopoly public service."<sup>305</sup> Since the clear policy criteria was not met in this case, the Court had no occasion to consider the second test of active supervision. And finally, in *Fox*, the Court clearly indicated that these two criteria were "dispositive" of the issue.<sup>306</sup> In short, governmental immunity to antitrust regulation under the state action doctrine is not derived merely by the entity's status as a government agency. Rather, a state acts as sovereign and is entitled to immunity when the acts are conducted pursuant to a clear state policy to supplant competition and there is active or meaningful state supervision of such activity.

The scope of the state action immunity for private persons acting under state law may be somewhat more circumscribed than the government's immunity. Meeting the clear policy and active state supervision criteria presumably is a precondition to private immunity, since otherwise, there is no state action as defined by the Court to which the private action can attach.

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and Antitrust Enforcement Under the Federal Trade Commission Act, 89 HARV. L. REV. 715, 723-25 (1976).

301. 317 U.S. at 350.

302. *Id.* at 352.

303. 433 U.S. at 362 (emphasis added).

304. 435 U.S. at 410.

305. *Id.* at 413. This case involved an investor-owned utility antitrust counterclaim charging a municipally owned competitor with an antitrust violation. If a state chooses not to supplement competition but rather chooses to compete, it must observe the antitrust laws like any other competitor. The lower court decision directing that further inquiry be made to determine whether the municipal utility's actions were directed by the state was affirmed.

306. 439 U.S. 96, 110.

In addition, however, *Goldfarb* and *Cantor* make clear that the availability of private immunity depends upon whether the anticompetitive conduct is "compelled by direction of the State acting as a sovereign"<sup>307</sup> although *Cantor* restyled the compulsion test in terms of fairness to the private party and the degree to which the state plays a dominant role in the decision-making process.<sup>308</sup> Even if the state policy sanctions anticompetitive activity and provides an active supervision scheme, if the state acquiesces, encourages or authorizes private anticompetitive conduct rather than compels such conduct, such private conduct does not appear to give rise to the state action immunity to antitrust.

*Cantor* also suggests that if private conduct does not qualify for state action immunity under the compulsion (fairness) test, an alternative test is also available, the congressional intent test. However, as noted earlier,<sup>309</sup> this alternative appears to fall under the preemption rather than the state action doctrine.

Before leaving the discussion summarizing the state action doctrine, it is worth noting a recent Supreme Court decision, *St. Paul Fire and Marine Insurance Co. v. Barry*,<sup>310</sup> which poses an intriguing possibility as to the state action doctrines as applied to the business of insurance. In this case, Rhode Island physicians brought an action against four medical malpractice insurers alleging a private conspiracy in which three insurers were said to have concertedly refused to sell medical malpractice insurance to the physicians so as to compel the purchase of claims made (rather than the desired occurrence) policies from St. Paul. The McCarran Act bars antitrust actions to the extent the business of insurance is regulated by state law except that nothing renders the "Sherman Act inapplicable to any agreement to boycott, coerce, or intimidate. . . ."<sup>311</sup> The district court held that the term boycott, as used in the McCarran Act, did not extend to the insurer-policyholder relationship but rather was limited to encompass only those actions directed against insurers and agents.<sup>312</sup> (This conclusion was based on legislative history and the fact situation in the *South-Eastern Underwriters* case which led to the McCarran Act.) The First Circuit Court of Appeals reversed and adopted a broad definition of boycott which includes the relationship between the policyholder and the insurer.<sup>313</sup> The Supreme Court upheld the broader definition of boycott and held that the alleged conduct by the insurers fell within the definition of boycott.<sup>314</sup>

Importantly, however, the Court rendered no definitive decision as to the

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307. 421 U.S. 773, 791 (1975).

308. See text accompanying notes 273-278 *supra*.

309. See text accompanying notes 286-287 *supra*.

310. 438 U.S. 531 (1978).

311. 15 U.S.C. § 1013(b) (1976).

312. *Barry v. St. Paul Fire & Marine Ins. Co.*, 555 F.2d 3, 6 (1st Cir. 1977).

313. *Id.* at 12.

314. *Barry v. St. Paul Fire & Marine Ins. Co.*, 438 U.S. 531, 552.

state insurance regulatory concerns posed by the case. Instead, the Court pointed out that:

[w]e emphasize that the conduct with which the petitioners [insurers] are charged *appears to have occurred outside of any regulatory or cooperative arrangement established by the laws of Rhode Island. There was no state authorization of the conduct in question . . .* and petitioners [insurers] do not aver that state law or regulatory policy can be said to have required or authorized the concerted refusal to deal with St. Paul's customers.<sup>315</sup>

In this context it should be noted that the Rhode Island residual market mechanism for medical malpractice insurance did not go into effect until after the alleged actions occurred and the complaint was filed and in any event, the mechanism did not authorize the four insurers to agree to refuse to write medical malpractice coverages outside the mechanism's framework. Thus, as the Court said, the complaint alleged an attempt at regulation by private combinations and groups. The Court went on to say:

this is not a case where a State has decided that regulatory policy *requires* that certain categories of risks be allocated in a particular fashion among insurers, or where a State *authorizes* insurers to decline to insure particular risks because the continued provision of that insurance would undermine certain regulatory goals, such as the maintenance of insurer solvency.<sup>316</sup>

In concluding that the alleged conduct would be a boycott under section 3(b) of the McCarran Act the Court noted that:

[w]e have no occasion here to decide whether the *element of state regulatory direction or authorization* of the particular practice, absent in this case, is a factor to be considered in the definition of "boycott" within the meaning of §3(b), or *whether it comes into play as part of a possible defense under the "state action" doctrine as elaborated in Parker v. Brown and its progeny.*<sup>317</sup>

And finally, the Court said, "we do not hold that all concerted activity violative of the Sherman Act comes within §3(b). Nor does our decision address *insurance practices that are compelled or specifically authorized by state regulatory policy.*"<sup>318</sup>

Three points should be noted as to this part of the *Barry* decision. First is the repeated reference to private insurer conduct authorized as well as required (compelled) by the state. Second, the explicit raising of the issue as to whether state "regulatory direction or authorization" of private conduct comes into play in the context of applying the state action doctrine. This

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315. *Id.* at 553-54 (emphasis added).

316. *Id.* at 554.

317. *Id.* at 554 n. 27 (emphasis added) (citation omitted).

318. *Id.* at 555 (emphasis added).

suggests the possibility that in the insurance area, private conduct which is authorized as well as that which is compelled, may be sufficient to invoke the state action defense. Third, this portion of the Court's opinion is *dicta*. Thus, at best we can merely speculate on the outcome of this issue.

b. *Roots of the State Action Doctrine.* *Parker* held that Congress did not intend the Sherman Act to reach the action of the states. This conclusion was premised upon two alternative rationales. First, the Court concluded that the "state in adopting and enforcing the prorate program made no contract or agreement and entered into no conspiracy in restraint of trade or to establish a monopoly."<sup>319</sup> Thus, the statutory language of the Sherman Act did not embrace the state activity.<sup>320</sup>

More importantly, the second reason underlying the Court's opinion was its concern over the impact of a contrary decision on the concept of federalism. "That apprehension was expressed as a standard of statutory construction."<sup>321</sup> "In a dual system of government in which, under the Constitution, the states are sovereign, save only as Congress may constitutionally subtract from their authority, an expressed purpose to nullify a state's control over its officers and agents is not lightly to be attributed to Congress."<sup>322</sup> This statutory construction reflected the concern that comity be shown to the states and that their role in the federal system be protected. A contrary decision in *Parker* would have denied the states their long recognized authority to deal with commercial activities of their citizens. And finally, if the Sherman Act were construed to apply to the states, state legislation could be struck down with no assurance that Congress would adequately deal with local situations when reliance on competition is inappropriate.<sup>323</sup>

A basic question left unanswered by *Parker* is whether Congress, pursuant to its commerce power, can amend the Sherman, Clayton or FTC Acts to narrow the scope of the state action doctrine or even include state action completely within the parameters of the antitrust laws. The Court in *Parker* expressly reserved this question when it declared that "[w]e may assume also, *without deciding*, that Congress could, in the exercise of its commerce power, prohibit a state from maintaining a stabilization program like the present because of its effect on interstate commerce."<sup>324</sup> Subsequent state action decisions have not addressed this issue. Thus, the question remains as to whether the state action exemption is rooted in Congressional intent, and thereby subject to change by Congress, or is it rooted in the Constitution subject to change only through judicial interpretation or constitutional

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319. 317 U.S. at 352.

320. *Antitrust Enforcement*, *supra* note 300, at 720-21.

321. *Id.* at 721.

322. 317 U.S. at 351.

323. *Antitrust Enforcement*, *supra* note 300, at 721. It has been suggested that a third rationale for the state action exemption, which was not present in *Parker*, could be based upon the traditional role of the states as definers of the public interest. *See id.* at 728-30.

324. 317 U.S. at 350 (emphasis added).



amendment.<sup>325</sup>

*National League of Cities v. Usery*<sup>326</sup> may foreshadow the answer to the constitutional issue of whether the state action immunity is constitutionally protected. In *Usery*, the question presented was whether the 1974 amendments to the Fair Labor Standards Act's minimum wage provisions to most state and local government employees was a constitutional exercise of the commerce power.<sup>327</sup> The Court held that even though wages of government employees affect interstate commerce, the application of the federal minimum wage statute to these wages transgressed an affirmative constitutional limitation on the federal commerce power.<sup>328</sup> The Court explicitly stated that "[t]his Court has never doubted that there are limits upon the power of Congress to override state sovereignty, even when exercising its otherwise plenary powers to tax or to regulate commerce [under the commerce clause]."<sup>329</sup> The Court further recognized "the essential role of the States in our federal system of government,"<sup>330</sup> and quoted with approval an early case which said "in many articles of the Constitution the necessary existence of the States and, within their proper spheres, the independent authority of the States is distinctly recognized."<sup>331</sup> Although Court decisions have upheld broad Congressional authority to preempt state regulation of the private sector, in *Usery* the Court said:

[b]ut we have reaffirmed today that the States as States stand on a quite different footing from an individual or a corporation when challenging the exercise of Congress' power to regulate commerce. . . . Congress may not exercise that power so as to force directly upon the States its choices as to how essential decisions regarding the conduct of integral governmental functions are to be made. We agree that such assertions of power, if unchecked, would indeed, as Mr. Justice Douglas cautioned in his dissent in *Wirtz*, allow "the National Government [to] devour the essentials of state sovereignty," . . . and would therefore transgress the bounds of the authority granted Congress under the Commerce Clause.<sup>332</sup>

The Court's opinion in *Usery* invoked neither a preemption analysis nor an analysis centering on whether a state statute or regulatory scheme affected

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325. Davidson & Butters, *supra* note 244, at 597.

326. 426 U.S. 833 (1976).

327. *Id.* at 841. In *United States v. Darby*, 312 U.S. 100, 125-26 (1941), the Court upheld the FLSA as applied to employees in the private sector and in *Maryland v. Wirtz*, 392 U.S. 183, 198-99 (1968), the Court upheld the FLSA as applied to employees in state hospitals, institutions and schools. *Usery* explicitly overruled *Wirtz*, 426 U.S. at 855.

328. Davidson & Butters, *supra* note 244, at 597. "Appellants' essential contention is that the 1974 amendments to the Act, while undoubtedly within the scope of the Commerce Clause, encounter a similar constitutional barrier because they are to be applied directly to the States and subdivisions of States as employers." 426 U.S. at 841.

329. 426 U.S. at 842.

330. *Id.* at 844.

331. *Id.* at 844 (quoting *Lane County v. Oregon*, 74 U.S. (7 Wall.) 71 (1869)).

332. 426 U.S. at 854-55.

interstate commerce.<sup>333</sup> But rather, *Usery* found affirmative constitutional limitations on the federal commerce power.

We have repeatedly recognized that there are attributes of sovereignty attaching to every state government which may not be impaired by Congress, not because Congress may lack an affirmative grant of legislative authority to reach the matter, but because the Constitution prohibits it from exercising the authority in that manner.<sup>334</sup>

The Court viewed the issue in a fashion similar to the approach taken in *Parker*, that of a state acting in its sovereign capacity. Furthermore, the proposition that some forms of state action are constitutionally protected against Congress' exercise of its plenary powers is not unique to the *Usery* decision<sup>335</sup> but rather finds expression in other cases including several quoted or cited in the *Usery* decision.<sup>336</sup> The question thus becomes what forms of state activity are constitutionally protected.

In the context of the *Usery* case, the Court defined the issue in terms of whether the activities are "functions essential to separate and independent existence" of the states.<sup>337</sup> The Court found that depriving states of control over the minimum wages paid to their employees not only imposes substantial costs upon states and their political subdivisions but also "displaces state policies regarding the manner in which they will structure delivery of those governmental services which their citizens require."<sup>338</sup> If Congress can withdraw from the states the ability to make fundamental employment decisions, "there would be little left of the States 'separate and independent existence.'"<sup>339</sup> Despite congressional authority under the commerce clause, the Court held that the federal imposition of minimum wage standards on the state unconstitutionally "operate to directly displace the State's freedom to structure integral operations in areas of traditional governmental func-

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333. See Davidson & Butters, *supra* note 244, at 597-98.

334. 426 U.S. at 845.

335. See Davidson & Butters, *supra* note 244 at 598-604, where the authors note that: [w]hile the Tenth Amendment has been characterized as a "truism," stating merely that 'all is retained which has not been surrendered,' . . . it is not without significance. The Amendment expressly declares the constitutional policy that Congress may not exercise power in a fashion that impairs the States' integrity or their ability to function effectively in a federal system.

Fry v. United States, 421 U.S. 542, 547 n. 7 (1975).

336. See 426 U.S. at 842-45.

337. 426 U.S. at 845. Blumstein & Calvani, *supra* note 251, at 424-28, maintain that *Usery* sets out three elements to establishing a constitutionally protected state activity by the 10th amendment: (1) an attribute of state sovereignty must be involved—i.e., a legitimate police power activity rather than simply an anticompetitive purpose, (2) the activity must be an "essential" state government function (e.g., administering public law and furnishing public services), and (3) there must be an impairment of the state function.

338. 426 U.S. at 847. For example, the increased federally impaired cost might force a reduction, restructuring or even elimination of state government services. See 426 U.S. at 846-48.

339. *Id.* at 851.

tions."<sup>340</sup> The Court found the "dispositive factor" to be a Congressional attempt to prescribe for the states what to do "in their capacities as sovereign governments. In doing so, Congress has sought to wield its power in a fashion that would impair the States' 'ability to function effectively in a federal system.'"<sup>341</sup>

Neither *Usery* nor *Parker* and its progeny establish a blanket rule that any federal commerce power statute interfering with state policy choice is unconstitutional. Rather, *Usery* establishes the rule that state activity or policy decisions directly effecting a state's ability to conduct its function as a sovereign governmental unit are constitutionally protected from federal commerce power interference. *Parker* establishes that a state acts as a sovereign, and hence is entitled to state action immunity from the Sherman Act, when it clearly articulates a policy to supplement competition and actively supervises this policy. Until *Usery*, the *Parker* state action doctrine appeared to primarily rest upon a Congressional intent-federalism foundation and was subject to Congressional change. However, it has been suggested that *Parker* as well as *Usery* is constitutionally protected against Congressional change since they both rest upon the "constitutional principle that federal commerce power cannot be exercised in a fashion that drastically impairs a state's ability to function as a sovereign in a federal system."<sup>342</sup>

But, there is question as to whether *Usery* goes as far as embracing the state action doctrine in the mantle of constitutional protection. The *Usery* holding explicitly referred to the state's freedom "to structure *integral operations* in areas of traditional governmental functions . . . ."<sup>343</sup> Wages clearly fall within these parameters. Whether state anticompetitive policy programs and supervision constitute "integral operations" is less clear. This is not to say that they don't or that *Usery* won't be extended in future cases to embrace the various *Parker* state action situations. Since the *Parker* line of case focuses upon whether the state acted as a sovereign, there appears to be a good possibility that *Usery* now or in future cases will provide, at least to some extent, constitutional recognition to *Parker*. However, it is not clear that the Court has reached that point nor is there a guaranty that the Court will.

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340. *Id.* at 852.

341. *Id.*

342. Davidson & Butters, *supra* note 244, at 604. "*Usery* gives explicit constitutional recognition to the underlying premise of *Parker* and holds that principles of federalism prohibit even Congress from using the commerce power to encroach upon state sovereignty." *Id.* at 605. See Blumstein & Calvani, *supra* note 251, at 419-31. See also note 271 *supra* as to an 11th amendment basis for *Parker v. Brown*.

343. 426 U.S. at 852 (emphasis added). For a more detailed discussion of the possible implications of *Usery* in the context of the state action doctrine see REPORT OF THE STATE REGULATION TASK FORCE OF THE FTC 98-105 (Mar. 14, 1978). [hereinafter, STATE REGULATION REPORT].

### 3. *Implications of the State Action and Preemption Doctrines in the Context of State Regulation of the Business of Insurance*

The proposal to repeal the McCarran Act antitrust immunity so as to cause the general application of the federal antitrust laws to the business of insurance, if adopted, would constitute a major change in the fundamental legal structure upon which the governance of the insurance business is based. Any such major change portends innumerable and substantial ramifications—both foreseen and unforeseen—as to the manner in which the business is regulated and conducted. The purpose of this subsection is to consider some of the ramifications of the proposed repeal with respect to the state insurance regulatory mechanism. With the application of the antitrust laws no longer barred, the question becomes to what extent the supremacy clause can be invoked to strike down various aspects of state insurance regulation. The answer, in turn, depends upon how the courts apply the state action and the preemption doctrines reviewed earlier.<sup>344</sup>

No attempt will be made in this article to exhaustively explore the potential implications of the general application of the antitrust laws to the business of insurance for the entire gamut of state insurance regulatory activity. However, a few examples will be considered to illustrate the potential alternative and unsure results stemming from Congressional adoption of this approach.

a. *Rate Regulatory Law Laws.* All states other than Illinois have some type of law governing rates charged by property and liability insurers.<sup>345</sup> These rating laws can be broken down into nine categories.<sup>346</sup>

(i) State-made rates represent the ultimate government control over insurance prices. The state agency determines and promulgates the insurance rates to which each insurer must adhere.

(ii) Under a mandatory bureau rate system, a state requires an insurer to be a member of a rating organization. The bureau rates must obtain approval from the state insurance department before they can be used. Member insurers must adhere to the approved bureau rates, although an individual company might be permitted to deviate from bureau rates if the deviation is approved by the department.

(iii) Under the prior approval rating laws, rates and supporting data must be filed with the state insurance commissioner. Rate filings do not

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344. The answer also depends upon the reactions of state legislatures and insurance regulators to the repeal of the immunity. Conceivably, there could be substantial changes in the state regulatory systems in anticipation of what the courts might determine without judicial determination ever being made. This contributes further to the unpredictability of the consequences of enacting the proposed repeal.

345. Insurance rates for life and health insurance are established independently by most insurers. Consequently, the rate making activity in these areas poses relatively much smaller risk of liability under the federal antitrust laws.

346. The following description of the rating laws is drawn from *MONITORING COMPETITION*, *supra* note 12, at 54-57.

become effective until one of two things happen. Some laws use the deemer provision. That is, the rate does not become effective until the specified waiting period expires during which period the filings are reviewed by the department. Other statutes require an affirmative approval by the commissioner before the rates may be used. The term "prior approval" is applied to both types of statutes. The rating standards provide that rates may not be excessive, inadequate nor unfairly discriminatory. The commissioner may disapprove rates which do not meet these standards either during or after the waiting period. However, filings not disapproved within the period are deemed approved. Insurers may opt to cooperate in making rates with other insurers through bureau membership or subscribership or they may file rates independently. Bureau members or subscribers may deviate from bureau rates upon application to and approval by the commissioner.

(iv) A modified prior approval law is a hybrid between the prior approval law discussed above and a file and use law discussed below. A rate revision based solely upon loss experience is effective as soon as filed with the state insurance department subject to possible subsequent disapproval. A rate revision based upon changes in rate classifications or expense relationships is subject to prior approval.

(v) and (vi) Under a file and use law, rates become effective immediately upon filing; no affirmative action by the insurance commissioner is required. File and use laws can be divided into two categories, those that require members of a rating bureau to adhere to bureau rates in the absence of an individual filing for a rate deviation and those that prohibit agreements to adhere to bureau rates. In the latter case, the bureau rates are advisory only. A member of the bureau can voluntarily use the bureau rate or simply treat the bureau rate as advisory or informational. File and use laws generally impose the same basic rate standards contained in prior approval and no file states, that rates shall not be excessive, inadequate nor unfairly discriminatory.

(vii) Use and file rating laws with bureau rates advisory are similar to category (vi) except that rates may take effect immediately. The filings need not be made until some future time.

(viii) No file rating laws with advisory bureau rates do not require the filing or approval of rates and prohibit any agreement that bureau rates must be adhered to. Rates adopted by an insurer may be put into effect immediately. The rating standards are generally similar to those in the other laws. Rating organizations are advisory only. They are specifically prohibited from requiring that any member or subscriber adhere to their rates, rating plans and forms. Both insurers and rating bureaus must maintain adequate information as to their rates. This information must be available to the commissioner. Rating and underwriting examinations are the primary means by which the commissioner maintains compliance with the law. The commissioner is authorized to take action to secure termination of any violation of the law.



(ix) One state, Illinois, requires no rate filing and provides the state no powers as to property and liability insurance rates.

Of these nine categories of insurance rating laws, the open competition laws are those in categories (vi) - (ix). The key distinguishing characteristics of the open competition rating laws are the absence of prior approval before rate changes go into effect and the prohibition against agreements to adhere to bureau rates.<sup>347</sup>

(1) *Application of Antitrust Laws to State Insurance Rating Laws.* How would state insurance rate regulation fare under a regime of antitrust law if the McCarran Act antitrust immunity was repealed? The answer would depend upon the type of rating law under consideration, the application of antitrust principles to such laws and private conduct pursuant thereto and the manner in which the courts would apply the state action and preemption doctrines. The potential conflict between the antitrust laws and the state rating laws centers primarily upon the role of the rating bureaus under the rating laws<sup>348</sup> and the interjection of state judgment in the insurance pricing mechanism through the ability to either promulgate or approve (or disapprove) rates.

Rating bureaus operate differently under the varying state rating laws ranging from the promulgation of rates to which members must adhere, to promulgating merely advisory rates, to primarily compiling statistical data.<sup>349</sup> A review elsewhere of the antitrust laws in relation to rating bureau activities<sup>350</sup> leads to the conclusion that, except for limiting bureau activities to data compilation, "[t]he concept of the rating bureau . . . is in direct conflict with the legal concepts of antitrust as propounded by the courts."<sup>351</sup> This stems from the fact that Section 1 of the Sherman Act proscribes a contract, combination or conspiracy in restraint of trade.<sup>352</sup> Those arrangements which have either the purpose or effect of stabilizing prices constitute a *per se* violation.<sup>353</sup> Thus any insurer action in concert as to insurance prices is potentially subject to antitrust liability and sanction. Consequently, if the McCarran antitrust exemption is repealed, the rating bureau activity in most situa-

347. *Id.* at 57. Furthermore, some of the open competition laws explicitly define their rating standards in terms of the presence or absence of competition. *E.g.*, CAL. INS. CODE § 1852 (West 1972); WIS. STAT. § 625.11 (1975). For a more detailed discussion of the rating laws, see MONITORING COMPETITION, *supra* note 12, at 395 *et seq.*

348. "Under the Sherman Act a combination formed for the purpose and with the effect of raising, depressing, fixing, pegging or stabilizing the price of a commodity in interstate or foreign commerce is illegal *per se*." *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 223 (1940). See also *United States v. Trenton Potteries Co.*, 273 U.S. 392, 397 (1927). Concerted pricing activity can also arise in the context of pooling and/or joint underwriting arrangements. See text accompanying notes 403-414 *infra*.

349. See MONITORING COMPETITION, *supra* note 12, at 447-49.

350. See MONITORING COMPETITION, *supra* note 12, at 449-65. See also DJ REPORT, *supra* note 14, at 167 *et seq.*

351. MONITORING COMPETITION, *supra* note 12, at 465.

352. 15 U.S.C. § 1 (1976).

353. See note 348 *supra*.

tions would be highly vulnerable to antitrust challenge. Furthermore, the member companies of the bureau would also be vulnerable.

Insurance companies which adhere to "advisory" rates of rating bureaus would have difficulty in establishing that they acted unilaterally in setting prices since mere membership in a rating bureau which promulgates insurance rates on behalf of the insurance industry would be sufficient to establish a conspiracy under Section 1 of the Sherman Act. An insurance company which is a member of a rating bureau might, by its mere membership, be held to have engaged in a price-fixing conspiracy.<sup>354</sup>

Finally, the various schemes of regulating insurance rates are subject to potential collapse to the extent the regulated companies cannot participate due to the strictures of antitrust law.

(2) *Application of the State Action Doctrine to State Insurance Rating Laws.* The clearest case for a successful invocation of the state action doctrine to bar antitrust challenge would be in conjunction with a state-made-rate type rating law. Such a law provides a clear policy to supplant competition and there can be no question that there is active state involvement in the supervision of the scheme chosen to replace competition. The meeting of these two criteria would give rise to the governmental immunity. As to the insurance companies, they are required by law to adhere to the state rates thereby meeting the compulsion-fairness tests. In this situation, the state clearly has the dominant position in decision-making as to rate levels. Consequently, under the state action doctrine, private immunity for insurers should be available as well.

The situation involving the mandatory bureau system is less clear. State law requiring insurers to be a member of a rating bureau and to adhere to bureau rates (except for individually filed deviations approved by the insurance department) would presumably provide a sufficient articulation of a state anticompetitive policy to meet the first criterion. This is especially true since permitted deviations are based upon rating standards which are not couched in terms of competition. Meeting the second criterion is less certain. If the regulator, in effect, simply delegates all authority to the rating bureau on behalf of its member companies, the test of active or meaningful supervision would not be met. On the other hand, if the insurance department actively reviews rates and demonstrates that its approval is more than mere acquiescence to bureau-initiated rates, the active supervision test would probably be met. In fact, the Fourth Circuit Court of Appeals upheld the North Carolina mandatory bureau automobile insurance rate regulatory system in *Allstate Insurance Co. v. Lanier*<sup>355</sup> on the basis that the rating bureau operated under the active supervision of the state.<sup>356</sup> Consequently, govern-

354. DIRECTOR R. MATHIAS, *supra* note 16, at 14.

355. 361 F. 2d 870 (4th Cir.), *cert. denied*, 385 U.S. 930 (1966).

356. *Id.* at 872. Insurance rating laws of all types exercise control over rating bureaus not only via their rate approval or disapproval mechanism but also through direct regulatory and

mental immunity under the state action doctrine seems to apply in the mandatory bureau system.

However, the Supreme Court cases of *Goldfarb* and *Cantor*, decided subsequent to *Allstate*, cast some doubt upon the availability of private immunity. To the extent mandatory bureau law authorizes individual insurers to deviate from the approved bureau rates, there is room for private decision-making initiative. Does this latitude sufficiently eliminate the state compulsion requirement of *Goldfarb* or render it fair under *Cantor* to hold the insurer accountable if it does not deviate since it has the opportunity to do so?<sup>357</sup> The room for insurer latitude is not overly great. In order to obtain a deviation, the insurer must demonstrate to the satisfaction of the insurance regulator that his judgment should be different in the individual insurer's situation vis-a-vis that of the bureau. The regulator still plays a dominant role in the ultimate decision as to what the rate will be. Furthermore, unlike the *Cantor* situation in which the public utility commission acquiesced in Detroit Edison rate levels with respect to the light bulb market in which there was little or no regulatory interest, in the mandatory bureau system the state is vitally

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examination authority as to bureau activities. See MONITORING COMPETITION, *supra* note 12, at 412-15.

Similarly, the Fifth Circuit held that state action immunity was available to the rates and practices of public utilities when such rates and practices are "subjected to meaningful regulation and supervision by the state to the end that they are the result of the considered judgment of the state regulatory authority. . . ." *Gas Light Co. v. Georgia Power Co.*, 440 F. 2d 1135, 1140 (5th Cir. 1971), *cert. denied*, 404 U.S. 1062 (1972). The court noted that not only did the public utility commission have the power to pass upon utility rates and practices, the commission was far from silent. It gave lengthy consideration to the practice and had full hearings. *Id.* at 1140. The court contrasted this situation to *Asheville Tobacco Bd. of Trade v. FTC*, 263 F. 2d 502 (4th Cir. 1959) in which state action immunity was not afforded because the local tobacco boards of trade created pursuant to statutory authority promulgated their own rules and regulations without regulation or supervision by the state. 440 F. 2d at 1138-39. Note that *Allstate* and *Asheville* were decided by the same court which reached opposite conclusions based upon the extent of state regulatory activity.

Most cases which have found adequate supervision involved a procedure requiring a case by case review and approval by the state agency. See STATE REGULATION REPORT, *supra* note 343 at 14. Some courts go even further and consult the record of the agency's deliberation to determine whether the approval was the result of considered judgment rather than being merely perfunctory. See *id.* at 14-15. Although it may not make sense to distinguish between case approval and a general statutory rule granting approval in all cases of a certain type, the Court has made clear that in the latter situation conduct of a certain type will not be necessarily protected by state action. See *Schwegmann Bros. v. Calvert Distillers Corp.*, 341 U.S. 384 (1951).

357. The *Cantor* majority would apparently sustain the fairness defense when a private defendant "has done nothing more than obey the command of his state sovereign," 428 U.S. at 592, or in a somewhat different formulation, when the state's participation in a decision is so dominant that it would be unfair to hold a private party responsible for his conduct in implementing it. *Id.* at 594-95. Either formulation as to a statutory prohibition such as in *Bates* would invoke the state action exemption. But, in situations involving greater private input in the regulatory process, the application of control is more troublesome. Note, *Parker v. Brown Revisited: The State Action Doctrine After Goldfarb, Cantor and Bates*, 77 COLUM. L. REV. 898, 918 (1977).

interested in the rates being charged. The insurance rate is what the regulatory structure focuses upon.

It has been suggested that before the *Cantor* "fairness" defense should be available in a rate regulatory setting, there should be a finding that the rates have been "purposefully approved, or, in other words, whether a state interest is truly at stake."<sup>358</sup> Mere state acquiescence or "neutrality" to a rate filing would not involve a state regulatory policy which should give rise to a state action exemption. But, when a substantial state regulatory interest is involved, the contrary result seems appropriate, particularly in the light of the important principle of federalism.<sup>359</sup>

However, one reading of the *Goldfarb*, *Cantor* and *Bates* cases would emphasize that in each decision the Court attached substantial significance to the presence or absence of a legislative articulation of state anticompetitive regulatory policy. If specific statutory articulation is a precondition to the finding of state action, the state action doctrine could be rendered meaningless in the context of utility, insurance and other types of rate regulation. This conclusion stems from the fact that state rate regulatory statutes tend not to establish detailed requirements but rather set forth more general standards, create a regulatory process to implement those standards, provide for judicial review, and establish a professional regulatory staff to engage in economic regulation. As a result, specific regulatory policy as to specific practices of the regulated industry is found in the record of agency action, not in the necessarily more general statute. Practical realities compel a legislature to eschew statutory detail and delegate relatively broad discretionary authority to its regulatory agencies. If the states can achieve state action immunity only by enacting complex and detailed statutes, effective regulation will be reduced.<sup>360</sup> Consequently, reason suggests that reading *Cantor* to deny state action immunity solely because of general or imprecise statutory language may be incorrect.

Nor does *Cantor* need to be read in such a manner.

Because of the unusual facts in that case, the holding can be limited to situations in which conduct sanctioned by a regulatory agency bears no conceivable relationship to the function which the state legislature purports to regulate. Only in those situations should the immunity inquiry be confined, as it was in *Cantor*, to statutory scrutiny. In cases where the utility's conduct under its tariff is not entirely unconnected to its monopoly function, even though it may have an incidental impact on competitive markets, a court should look beyond the regulatory statutes to the record of agency action. *Cantor* should not, in these circumstances, be read to allow disregard of agency action simply because there is no specific reference to particular anticompetitive practices in the regulatory statutes. As long as those practices bear some relationship to the primary

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358. *Id.* at 920.

359. *See id.* at 920, 921.

360. *See id.* at 922-24.

function which the legislature authorized the relevant agency to regulate, agency action must be recognized as a valid indicator of state policy.<sup>361</sup>

By reading *Cantor* this way in the context of insurance mandatory bureau rate regulation, since rate approval or disapproval is essentially related to the "primary function" of the state, it seems very likely that the courts would find sufficient compulsion and/or dominant state involvement in the decision-making in the mandatory bureau system to give rise to state action immunity to the private insurer activity taken pursuant to the statute.

The availability of the state action immunity becomes much less certain with respect to the prior approval laws. Such laws typically do not compel insurers to be members of a rating bureau, but if they do, the insurers must adhere to bureau rates unless they file for rate deviations and receive department approval. Both bureau rates and individual company rates are subject to insurance department prior approval (or absence of disapproval within a specified time after the rates are filed). The prior approval laws allow considerable latitude to insurers in competing with each other. Individual insurers could file rates independently, could opt to go along with bureau rates or could be independent on some lines of insurance and utilize bureau rates as to other lines.<sup>362</sup>

The model rating law developed by the NAIC in response to the McCarran Act served as the basis for most state prior approval rating laws from the late 1940's<sup>363</sup> to late 1960's at which time the movement to open competition laws got underway. The model bills

set the stage for an unparalleled growth of independent action by insurers who wished to pursue that course. During this period, price competition became keener than it had been for decades, a development made possible by the flexible albeit not perfect provision to foster competition contained in the model bills.<sup>364</sup>

This result was contemplated by the prior approval laws. The NAIC model act, while stating that its purpose is to regulate rates so that they "shall not be excessive, inadequate or unfairly discriminatory" and "to authorize and regulate cooperative activity among insurers in ratemaking," also explicitly declared that the Act does not intend "to prohibit or discourage reasonable competition" or "to prohibit or encourage . . . uniformity in insurance rates, rating systems, rating plans or practices."<sup>365</sup> In other words, the statutory expression contained in the prior approval rating laws patterned after the NAIC model demonstrated a position of neutrality on the issue of competition.

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361. *Id.* at 924-25.

362. See *MONITORING COMPETITION*, *supra* note 12, at 29-31.

363. See *id.* at 25-29.

364. *Id.* at 40.

365. NAIC Model Fire, Marine, Inland Marine, Casualty and Surety Consolidated Rate Regulatory Bill § 1, II NAIC PROCEEDINGS 654-62 (1963).



Thus, even though a strong case can be made that the active supervision test of the state action doctrine can be met (assuming the state regulator is in fact actively administering the law), there is serious doubt whether the other preconditions for state action would be met. First, the state has not clearly articulated a policy to supplant competition. Instead, the statute espoused reasonable, adequate and fair insurance rates as the basic state objectives to be achieved through the statute's regulatory provisions. The statutes are explicitly neutral on the policy of competition, but clearly that policy was deemed subordinate to those of the expressed rate standards. Second, insurers are not compelled by either statutory or regulatory agency mandate to act in concert with rating bureaus in establishing a price. There is wide latitude for private insurer decision making. Since neither the clearly articulated policy nor the compulsion-fairness tests appear to be met, state action immunity is probably unavailable to private insurers and perhaps even to the state regulator as well.

The absence of state action immunity is even more clear in the context of the open competition rating laws. These statutes typically declare that competition is a sought-after public policy.<sup>366</sup> Furthermore, several of the open competition rating laws define the standard against "excessive" rates in terms of the absence or presence of competition.<sup>367</sup> Thus, in the open competition rating law states, not only is there an absence of a clearly-articulated statutory policy against competition, but also there is frequently expressed a procompetition policy. Second, the file and use, use and file and no file rate review mechanisms suggest a lower intensity of regulatory activity and control over an insurer's rates than is the case with the state-made rates, the mandatory bureau system and the prior approval rating laws.<sup>368</sup> Third,

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366. One state statute provides that "[i]t is the express intent of this chapter to permit and encourage competition between insurers on a sound financial basis and nothing in this chapter is intended to give the Commissioner power to fix and determine a rate level by classification or otherwise. CAL. INS. CODE § 1850 (West 1972). For laws patterned after California expressions of procompetition public policy, see *MONITORING COMPETITION*, *supra* note 12, at 398-99.

Wisconsin expresses a procompetition policy in a somewhat different way. "(2) PURPOSES. The purposes of this chapter are . . . (b) To encourage, as the most effective way to produce rates that conform to the standards of para. (a), independent action by and reasonable price competition among insurers . . ." WIS. STAT. § 625.01 (1975).

A third pattern is established by the New York rating law, which includes among its stated purposes, "to promote price competition among insurers, to provide rates that are responsive to competitive market conditions . . ." N.Y. INS. LAW § 175(1) (McKinney Supp. 1979).

367. The California-type statute provides that "[n]o rate shall be held to be excessive unless . . . (2) a reasonable degree of competition does not exist in the area with respect to the classification to which such rate is applicable." CAL. INS. CODE § 1852 (West 1972).

Similarly, the Wisconsin-type statute declares that "[r]ates are presumed not to be excessive if a reasonable degree of price competition exists at the consumer level with respect to the class of business to which they apply." WIS. STAT. § 625.11(2) (1975).

368. This does not mean that the open competition laws are not regulatory laws and that the insurance department role is solely a passive one. Open competition rating laws contain rate regulatory standards which can be enforced after the rates are filed. Some open competition laws

private insurers are not compelled to charge any particular rate; they are prohibited from agreeing to adhere to bureau rates and they can initiate rate changes without prior state agency approval. In short, neither the criteria for governmental nor private immunity under the state action doctrine would seem to be satisfied by the open competition rating laws. This is even more true as to the Illinois no-rating-law situation.

At least one caveat to this analysis should be recognized. The state action cases have arisen primarily in the context of state regulatory systems designed to displace competition. Open competition insurance rating laws are rather unique among state economic regulation in that they embody a policy of fostering and maintaining competition to the degree consistent with other public policy objectives. It might be argued that a clearly articulated state policy to promote competition in balance with other major public policy objectives raises the same concerns of federalism as does a state policy to essentially displace competition. If the state establishes a mechanism to actively implement and oversee such a balanced policy and if the private persons subject to this regulation are required to operate within the parameters of this mechanism (insurance open competition rating laws), it can be argued that the state action criteria would be met.<sup>369</sup>

Because of McCarran Act antitrust immunity, the Supreme Court has had little opportunity to apply the state action doctrine in the unique insurance regulatory context. Whether the Court would be willing to extend the scope of state action to state economic regulation other than that which is designed to displace competition is at best highly speculative. Nevertheless, if the McCarran Act antitrust immunity is repealed, an effort to obtain an extension is not devoid of merit.

To summarize, repeal of the McCarran Act antitrust immunity poses uncertain ramifications for the insurance rate-making and rate regulatory systems extant today. In some states, the state action exemption might be available to protect the insurance company and/or the rating bureau acting in conformity with the state law. Presumably, this would be the case with respect to state-made rates and probably the same result would obtain as to the mandated bureau system. At the opposite end of the spectrum, the open competition laws provide little basis to successfully invoke the state action doctrine unless the Court modifies its criteria as to a clear policy to displace competition. The prior approval laws find themselves in the middle of the rating law spectrum, thereby creating greater doubt. However, the above discussion suggests that the prior approval system probably would not afford a state action immunity to federal antitrust law.

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also specifically provide for a reimposition of prior approval filing requirements if competition does not appear to be effectively functioning. *See, e.g.*, N.Y. INS. LAW § 176(2)(c) (McKinney Supp. 1979); WIS. STAT. § 625.21-625.22 (1975).

369. *But see* *George R. Whitten, Jr., Inc. v. Paddock Pool Builders, Inc.*, 424 F. 2d 25 (1st Cir.), *cert. denied*, 400 U.S. 850 (1970) (upholding a Sherman Act suit against conduct favoring one competitor over another when the state law has a procompetitive bidding policy).

(3) *Application of the Preemption Doctrine to State Insurance Rating Laws.* If the McCarran Act antitrust immunity is repealed and if the state action antitrust immunity does not apply, the viability of a particular state's insurance regulatory mechanism becomes dependent upon how the preemption doctrine applies. In this context two basic features of the rating laws will be considered: (a) the role of rating bureaus; and (b) the rate approval (or disapproval) mechanism.

(a) As noted earlier, the role of the rating bureau varies between the different states and different types of rating laws. At one end of the spectrum is the mandatory bureau concept under which insurers clearly act in concert to fix prices. This adherence to fixed prices, absent some protection afforded by state law, undoubtedly would constitute a *per se* violation of the antitrust laws.<sup>370</sup> Although the prior approval, non-mandatory bureau laws provide more latitude for insurers to compete and insurers are not compelled to belong to a rate making group, rating bureau members are subject to the requirement to adhere to the rates established in concert (subject to possible individual deviations). Under antitrust law the fact that competition exists in an industry in no way immunizes concerted activity to fix prices. Absent some immunity derived from state law, the requirement to adhere to rates would condemn bureau activities if the antitrust laws were applied. Similar results would accrue in those file and use states which have the adherence requirement despite the more flexible approval mechanism.

The situation is less clear in open competition states. Although bureau rates are sanctioned, agreements to adhere to such rates are prohibited. Bureau members and subscribers are free to use or reject filed bureau rates as they see fit. Although price-fixing agreements are a *per se* violation of antitrust law, there must be a demonstration that an agreement exists. In the absence of an explicit agreement, the question becomes to what extent the court will infer or imply an agreement or conspiracy from the surrounding circumstances. Although the fact that individual insurers charge identical prices ("conscious parallelism") by itself is not deemed sufficient to establish a conspiracy to fix prices, this along with other factors may imply such a conspiracy.<sup>371</sup> A factor like insurer involvement through a rating bureau in developing the prices would most likely be more than enough to infer an

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370. See text accompanying notes 349-354 *supra*.

371. The crucial question is whether respondent's conduct toward petitioner stemmed from independent decision or from an agreement, tacit or express. To be sure, business behavior is admissible circumstantial evidence from which the fact finder may infer agreement. But this Court has never held that proof of parallel business behavior conclusively establishes agreement or, phrased differently, that such behavior itself constitutes a Sherman Act offense. Circumstantial evidence of consciously parallel behavior may have made heavy inroads into the traditional judicial attitude toward conspiracy; but "conscious parallelism" has not yet read conspiracy out of the Sherman Act entirely.

Theater Enterprises, Inc. v. Paramount Film Distributing Co., 346 U.S. 537, 540-41 (1954). See also MONITORING COMPETITION, *supra* note 12, at 160-64.

implied conspiracy and render rating bureau and individual company activity a violation of antitrust laws.

In 1971, a major insurance rating bureau announced a new policy as to its procedures to be used in open competition states with respect to automobile and homeowner insurance.<sup>372</sup> Under this policy, rather than filing a bureau rate on behalf of its members with the state insurance department, the bureau would distribute advisory rates directly to individual companies along with enough detail to allow the individual insurers to review the advisory indications in conjunction with their own loss and expense experience. The individual insurers can then make an independent judgment as to what its own rates should be. Furthermore, the insurer would make its own individual filings with the department.<sup>373</sup>

Under antitrust law, however, even the bureau "advisory" rate procedure is highly suspect. The antitrust cases involving trade associations proscribe the use of "suggested" rates.<sup>374</sup> The argument can be made that the insurance rating bureau "advisory" rates are different than the trade association cases "suggested" rates in that the former are intended as a starting point for individual insurer independent action while the latter were intended for members to gravitate towards the same price. This argument has been rejected in at least one case, however, involving an association of car dealers distributing a fixed price to its members as a device to permit larger allowances on trade discounts. The court of appeals held that:

[t]he competition between the Plymouth dealers and the fact that the dealers used the fixed uniform list price in most instances, only as a starting point, is of no consequence. It was an agreed starting point; it had been agreed upon between competitors; it was in some instances in the record respected and followed; it had to do with, and had its effect upon price.

The fact that there existed competition of other kinds between the various Plymouth dealers, or that they cut prices in bidding against each other, is irrelevant.<sup>375</sup>

The similarity between the insurance rating bureau "advisory" rates and the uniform list prices in the car dealer case is apparent. Thus, it is unlikely that the advisory rate role of insurance rating bureaus would be able to withstand challenge under a general application of the antitrust laws.<sup>376</sup>

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372. Statement by Insurance Services Office Relative in Its Policy Procedure in Open Competition Rate Regulatory States (1971).

373. Carl B. Black, ISO—Competitive Rating Procedure, Statement to the NAIC Zone IV Meeting in Springfield, Ill. (Oct. 2, 1973).

374. *American Column & Lumber Co. v. United States*, 257 U.S. 377, 398-99 (1921) (feature found most objectionable by the Court was the reporting of market conditions and production information with "significant suggestions as to both future prices and production"). For a review of the trade association cases, see *MONITORING COMPETITION*, *supra* note 12, at 453-62.

375. *Plymouth Dealers' Ass'n v. United States*, 279 F. 2d 128, 132 (9th Cir. 1960).

376. A major rating bureau's own statement of policy recognized that advisory rates could

As a bureau reduces its activities relevant to the making of rates, its vulnerability to antitrust liability lessens. If the bureau simply collects, compiles and disseminates past loss and expense data, it would apparently be functioning within the permissible ambit of antitrust law. The Supreme Court has expressed that antitrust public policy favors the exchange of cost and price data in a competitive environment:

the public interest is served by the gathering and dissemination, in the widest possible manner, of information with respect to the production and distribution, cost and prices in actual sales, of market commodities, because the making available of such information tends to stabilize trade and industry, to produce fairer price levels, and to avoid the waste which inevitably attends the unintelligent conduct of economic enterprise.<sup>377</sup>

But, when a rating bureau, managed and controlled by competing insurers, deals with future pricing data, such as the projection of loss and expenses and the development of trended (prospective) rates, the bureau would likely run afoul of the antitrust laws.<sup>378</sup> In short, whenever an industry-controlled organization goes beyond collecting, compiling and disseminating past loss and expense data, such activity in all likelihood could be successfully challenged under a general application of the antitrust laws.<sup>379</sup>

With this backdrop of the likely illegality of a wide range of bureau ratemaking activities under the antitrust laws, assuming the unavailability of state action immunity, the question becomes whether the state rating law protects such activity under the preemption doctrine. As summarized earlier, the Supreme Court has established two general tests as to whether a federal statute preempts state law, the Congressional intent test and the conflict test.<sup>380</sup> Applying these tests to the insurance rating bureau situation yields somewhat uncertain conclusions.

Under the intent test, the Court starts with the assumption that "the historic police powers of the States were not to be suppressed by the Federal Act unless that was the clear and manifest purpose of Congress."<sup>381</sup> The antitrust laws, the Sherman, Clayton and FTC Acts, contain no explicit statutory language pertaining to state insurance regulatory laws in general

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encourage uniform rates if insurers routinely adopted them without modification. See note 372 *supra*.

377. *Maple Flooring Mfgs. Ass'n v. United States*, 268 U.S. 563, 582-83 (1925).

378. DJ REPORT, *supra* note 14, at 169.

379. There is not even an absolute assurance that collection of past data is immune to antitrust liability since, in the context of developing an insurance price, such activity may tend to stabilize prices. See *id.* at 170.

380. See text accompanying notes 226-236 *supra*.

381. *Jones v. Rath Packing Co.*, 430 U.S. 519 (1977) (quoting *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947)). Since the states have traditionally regulated the business of insurance since the mid-1800's and since the Court has upheld state insurance regulation on the basis that the business of insurance is "clothed with a public interest," *German Alliance Ins. Co. v. Lewis*, 233 U.S. 389, 415 (1914), it seems clear that such regulation falls within the parameters of this assumption.



nor the insurance rating laws in particular. This is not surprising, however, since at the time the antitrust laws were enacted, insurance was not deemed to be commerce.<sup>382</sup> Consequently, insurance remained beyond the scope of the commerce power until the *South-Eastern Underwriters* case in 1944. For the same reason, it would be difficult to infer a "clear and manifest" purpose to preempt the state insurance laws by looking at the legislative history of the antitrust laws.<sup>383</sup> This conclusion is buttressed by the fact that immediately after the Court determined insurance was commerce, Congress promptly provided the business of insurance with an exemption from antitrust coverage by enacting the McCarran Act.

An additional potential source of finding a Congressional intent to preempt would be a statute repealing the McCarran Act antitrust immunity. Since Congress has not yet done so, however, any appraisal of this possibility would merely be speculative. Furthermore, in this section of the article, it is assumed that repeal of the McCarran antitrust immunity would not be accompanied by any specific intent to limit state insurance regulatory activity. Congressional repeal of the McCarran antitrust immunity without Congressional limitation on state regulation of insurance would not appear to meet the congressional intent criteria of the preemption doctrine.

The second test for preemption is whether state law conflicts with federal law, whether state law stands "as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."<sup>384</sup> Conflict clearly arises when federal antitrust law prohibits what state law mandates.<sup>385</sup> Under this test, in the absence of a state action immunity, there is little doubt that state law authorizing rating bureau activity and requiring insurer adherence to bureau rates under either the mandatory bureau system, prior approval or file and use rating approaches would be preempted. This activity is price fixing *per se* under the antitrust laws. Any state requirement of adherence is in direct conflict with the antitrust prohibition.

Under the open competition laws, rating bureau member insurers are authorized to act in concert to establish rates and to adhere to such rates. It might be argued that there is no conflict between antitrust law and the open competition statute since this type of state law prohibits agreements to adhere and there can be no violation of the Sherman Act in the absence of an agreement in restraint of trade. The gravamen of this argument is twofold. First, under the antitrust laws the federal courts are not compelled to rely on what a state determines to constitute an agreement. Rather, in the concerted action context of bureau activities, the courts are likely to find an

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382. Divining the Congressional intent as to the antitrust laws is quite difficult since they were enacted in an era when the perception of the federal power under the commerce clause was much more restricted than today's perception. See Blumstein & Calvani, *supra* note 251, at 401.

383. See *id.* at 402.

384. *Jones v. Rath Packing Co.*, 430 U.S. 519, 526 (1977) (quoting *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941)).

385. *Id.*

implied agreement regardless of what the rating law provides. Second, the Supreme Court has made clear that "a state does not give immunity to those who violate the Sherman Act by authorizing them to violate it, or by declaring that their action is lawful."<sup>386</sup> Thus, in the open competition rating law context, the application of antitrust law would appear to prohibit rating bureau and insurer activity which the state law authorizes but does not require. Although such state interference with the federal scheme is less blatant than in the required adherence situation, the conflict between the state and federal schemes is more than ample to invoke the preemption doctrine. This, in turn, eliminates state law protection for private bureau ratemaking activities which are proscribed by antitrust law.

(b) The second fundamental feature of state insurance rating laws is the establishment of some type of rate approval or disapproval mechanism. Rate approval, although intertwined with the manner in which rating bureaus function, has an existence independent from that of the rating bureau provisions of the law. Even with the elimination of bureau ratemaking and rate filing activity, individual insurers must comply with the statute's rating standards and filing requirements. To the extent the state action doctrine does not apply, a legitimate question for separate inquiry is whether the applicability of the antitrust laws to insurance would preempt the state rate regulatory requirements which are unrelated to or separable from those provisions relating to bureau ratemaking.

The primary purpose of the antitrust laws is to foster or maintain competition. Although there is no single or absolute definition of competition, competition embraces the notion that the price and supply of goods or services are determined by the interaction of buyers and sellers acting independently of each other. The interjection of government into the determination of prices interferes with the interaction of competing buyers and sellers. Thus, in a general sense, government rate regulation conflicts with the functioning of competition in the market place. But, does this interference in the market place give rise to preemption of state rate regulation under the preemption doctrine?

For the same reasons considered in connection with rating bureaus, the "clear and manifest purpose of Congress" test for preemption has little applicability in the insurance rate approval area.<sup>387</sup> Furthermore, for several reasons, the conflict test under the preemption doctrine does not appear to warrant the conclusion that the rate approval mechanisms would be preempted.

First, the mere act by a state agency to approve or disapprove an insurance rate does not result in a violation of Section 1 of the Sherman Act, since such a violation requires a demonstration that there is an agreement, combination or a conspiracy to restrain trade.<sup>388</sup> Second, in *Exxon Corp. v. Governor*

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386. *Parker v. Brown*, 317 U.S. 341, 351 (1943).

387. See text accompanying notes 381-83, *supra*.

388. Theoretically, one could postulate a situation in which the regulatory approval mech-

of *Maryland*,<sup>389</sup> the Supreme Court recently reiterated that the "teaching of this Court's decisions . . . enjoin seeking out conflicts between state and federal regulation where none clearly exists"<sup>390</sup> and that "hypothetical conflict is not sufficient to warrant pre-emption."<sup>391</sup> In view of the nebulous linkage between the rate approval mechanism for individual company rates and an adverse impact on the degree of competition, the likelihood that the Court would preempt state law in this area on the basis of conflict appears relatively small. This is particularly true with respect to the open competition states to the extent the rating standards applied are couched in terms of the presence or absence of competition or the impact of the rate upon competition.

Third, even if the rate approval mechanisms could be shown to significantly and adversely affect competition, *Exxon* made clear that, although state economic regulation might have an adverse impact on competition, this fact is insufficient to find a preemption of state law. The Court noted that

[t]his is merely another way of stating that the Maryland statute will have an anticompetitive effect. In this sense, there is a conflict between the statute and the central policy of the Sherman Act—our "charter of economic liberty." Nevertheless, this sort of conflict cannot itself constitute a sufficient reason for invalidating the Maryland statute. For if an adverse effect on competition were, in and of itself, enough to render a state statute invalid, the States' power to engage in economic regulation would be effectively destroyed. We are, therefore, satisfied that neither the broad implications of the Sherman Act nor the Robinson-Patman Act can fairly be construed as a congressional decision to preempt the power of the Maryland Legislature to enact this law.<sup>392</sup>

Fourth, under prior approval and open competition rate approval mechanisms, the states do not require or authorize that which the antitrust laws prohibit. For these reasons, the prior approval and especially the open competition rate approval mechanisms do not satisfy the conflict test so as to cause preemption.<sup>393</sup>

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anism constituted sham regulation and is, in fact, a means through which competitors fix rates. For example, a regulator in agreement with competing insurers could approve a rate only at an agreed-upon level. However, there is no suggestion that this occurs in the real world. To the contrary, wide variations in insurance rates are the rule rather than the exception other than in situations where uniformity is called for by law. For the purposes of this discussion, it is assumed that the regulator is not a participant in any agreement or conspiracy with one or more regulated companies.

389. 437 U.S. 117 (1978).

390. *Id.* at 130.

391. *Id.* at 131.

392. *Id.* at 133-34.

393. This discussion is irrelevant to the approval mechanism under a mandatory bureau rate law since the preemption of the law's authorization of rating bureau activity renders the rest of the law meaningless. Nor is the discussion relevant to state-made rates which have no approval mechanism for insurer filings. Since state-made rates eliminate price competition, there is a clear conflict between the implementation of such law and the basic policy objective

In summary, the interaction between the repeal of the McCarran antitrust immunity with no specific congressional limitation on state insurance rating laws, the state action doctrine and the preemption doctrine pose uncertain implications for the insurance rate regulatory system. However, a state-made-rate system would appear to enjoy the immunity of the state action doctrine. Although less certain, it is nevertheless quite likely that the mandatory bureau system, if actively supervised by the state, would also successfully invoke state action protection against antitrust challenge. Although an argument can be made that state action embraces the prior approval and perhaps open competition laws, the opposite conclusion is more likely. In the absence of state action, protection of private bureau ratemaking activity would be preempted, but the rate approval mechanisms in both open competition and prior approval states, as applied to individual insurer rates, would appear to possess continued validity. In other words, simply repealing the McCarran antitrust immunity would probably leave the state rate regulatory system intact with the exception of most rating bureau activity in the prior approval and open competition states.

The uncertainty of the reaction of the insurance industry, state insurance regulators and state legislatures to repeal of McCarran antitrust immunity further clouds the ultimate implications of such Congressional action. If states determine that bureau ratemaking activity is essential to achieving public policy goals in their states, the states may enact the more stringent, less competitive state-made-rate or mandatory bureau systems to replace their prior approval or open competition laws to invoke the state action doctrine. This would work against the pro-competition purpose of proponents of repeal. It would undo the balance between competition and other public policy objectives under the prior approval and open competition laws. Finally, it would force the states to implement a more rigid anticompetitive regulatory system.

A second alternative would be for the state government to take over many of the bureau ratemaking activities short of actually setting mandated rates. The "state bureau" could collect, compile and disseminate loss and expense data and even provide advisory rates to each company. This approach, however, promises increased uniformity and decreased competition, since the establishment of advisory rates by government would inevitably have an impact on the state regulator's approval or disapproval of individual insurer rates that are different from those developed by the government agency. To some extent, this effect may be lessened if the state agency developing the advisory rates is independent of the agency authorized to approve or disapprove the actual rates of the individual insurer.

A third alternative would be assumption of the bureau ratemaking activities by an independent organization or organizations. Insurers would be pro-

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of the antitrust laws. But, in light of the *Exxon* case, it is unclear whether such a state law would be preempted. This question may never come before the Court because the state action exemption is probably available to the state-made rate and mandatory bureau rating laws. See text accompanying notes 355-61 *supra*.

hibited from participating in the management of the organization.<sup>394</sup> However, this would result in insurer management losing control of important management functions. Furthermore, there is no certainty that this approach would be free from antitrust challenges if not actual antitrust liability.

The fourth alternative would be for each insurer to attempt to perform each bureau ratemaking function for itself. This could deprive the public of significant economies of scale,<sup>395</sup> adversely affect the ability of smaller insurers to compete, hamper the ability of new competitors to enter the market,<sup>396</sup> and possibly reduce the availability of coverage in various lines of insurance.<sup>397</sup>

Any major change in the fundamental legal structure within an industry function is replete with uncertainty. The insurance industry is no exception. The repeal of the McCarran antitrust exemption would leave the status of the rate regulatory system uncertain.<sup>398</sup> The type and extent of the reaction to this uncertainty are not clear. The earlier discussion suggests that the impact of repeal on the level of competition would be minimal.<sup>399</sup> Thus, the potential price for change is very high and the expectable benefit minimal, if not negative.

b. *Regulation of Voluntary Insurance Pooling Arrangements.* One fundamental public policy goal of state insurance regulation is the availability of insurance coverage to insurance buyers needing coverage. If a potential insured cannot obtain coverage, other policy objectives such as reasonable price, fair treatment and reliable (financially sound) insurers able to meet their obligations have little meaning to him.<sup>400</sup> State insurance regulation seeks to achieve widespread availability through a variety of techniques including the authorization of various types of voluntary pooling or joint underwriting arrangements and, when necessary, mandatory residual market mechanisms. The voluntary arrangements are the subject to this subsection and the mandatory approach will be considered in the following subsection.

As noted earlier, the insurance industry has a variety of voluntary inter-company risk sharing arrangements often referred to as pools.<sup>401</sup> Typically such pools of insurers are created to make coverage available to insureds (1)

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394. Such an approach is advocated in DJ REPORT, *supra* note 14, at 177-78.

395. See text immediately preceding paragraph accompanying note 143 *supra*.

396. See text accompanying note 143 *supra*.

397. See text accompanying note 144 *supra*.

398. In a separate opinion appended to the National Commission Report, Commissioner McClory noted that the Commission's repeal of the McCarran antitrust exemption would trade that exemption "for an uncertain exemption based on a hastily constructed re-draft of the ever evolving State action doctrine. . . . I am not persuaded that the majority acted correctly in voting to exchange the relative certainty of McCarran-Ferguson for another exemption whose breadth is unclear and whose impact has not been sufficiently explored." NATIONAL COMMISSION REPORT, *supra* note 13, at 404.

399. See text accompanying notes 52-101, *supra*.

400. MONITORING COMPETITION, *supra* note 12, at 98.

401. See text immediately following note 146, *supra*.



seeking extraordinarily large amounts of coverage; (2) whose operations require specialized insurance services which cannot be provided economically by individual companies; (3) whose operations are especially hazardous or (4) who are unacceptable to individual insurers. By combining resources, the voluntary risk sharing arrangements provide capacity and permit a spread of the risk which an insurer would be unwilling to write on a single company basis. They may also offer specialized services or facilities to a limited market on a less costly basis than could an individual insurer. The voluntary pools assume a variety of forms ranging from a temporary *ad hoc* joining together of individual insurers (and/or reinsurers) to provide coverage to one risk to a permanent pool staffed to underwrite and issue policies, provide inspection and claim services, and function like an individual insurer.<sup>402</sup>

If the McCarran antitrust immunity were repealed, the antitrust exposure of an insurer participating in some type of voluntary pool would be tested under the antitrust rules applicable to joint ventures.<sup>403</sup> In essence, under antitrust law, a joint venture is an arrangement whereby two or more independent entities combine a segment of their resources to create a single or joint cooperative enterprise to provide a service or product. Parties to the joint venture contribute money, effort, skills, knowledge and/or property to the enterprise and share in the risks and the profits.<sup>404</sup> Joint ventures derive their economic justification by enabling the participants to achieve economies of scale and to share risks which would not be assumed by a participant on an individual basis.<sup>405</sup> Because of their economic worth, joint ventures are said not to be inherently illegal under the antitrust laws so long as the purpose and effect is not to unreasonably restrain trade.<sup>406</sup>

The antitrust issues raised by a joint venture are threefold. First, does the creation of the joint venture substantially eliminate competition?<sup>407</sup> Where the effect of a joint venture is to foreclose actual or potential competition among its participants or other existing or potential competition, the joint ventures will be closely scrutinized under antitrust law.<sup>408</sup> On the other hand, where the joint venture is essential to the conduct of business so that the participants either could not or would not offer the product or service individually, there is no restraint on competition since the participants are neither actual or potential competitors.<sup>409</sup> Second, even if a joint venture

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402. The Department of Justice report describes in some detail various types of pooling arrangements which it labels as "placements," "reinsurance arrangements," "joint underwriting" and "pooling arrangements." DJ REPORT, *supra* note 14, 201-21.

403. For a review of the federal antitrust law on joint ventures, *see id.* at 119-45.

404. *Id.* at 119.

405. DIRECTOR R. MATHIAS, *supra* note 16, at 17.

406. DJ REPORT, *supra* note 14, at 121.

407. *See id.* at 122-29.

408. *See United States v. Penn-Olin Chemical Co.*, 378 U.S. 158, 167-74 (1964).

409. *United States v. Morgan*, 118 F. Supp. 621, 689, 690 (S.D.N.Y. 1953); *United States v. Pan American World Airways, Inc.*, 193 F. Supp. 18, 27-31. (S.D.N.Y. 1961), *rev'd on other grounds*, 371 U.S. 296 (1963).

serves a legitimate business purpose and does not substantially lessen competition, are there any unreasonable collateral restraints? That is:

[w]here challenged conduct is subservient or ancillary to a transaction which is itself legitimate, the decision is not determined by a *per se* rule. The doctrine of ancillary restraints is to be applied. It permits, as reasonable, a restraint which (1) is reasonably necessary to the legitimate primary purpose of the arrangement, and of no broader scope than reasonably necessary; (2) does not unreasonably affect competition in the marketplace; and (3) is not imposed by a party or parties with monopoly power.<sup>410</sup>

Third, is the joint venture an essential facility to which all competitors are entitled access on reasonable and nondiscriminatory terms?<sup>411</sup>

The Department of Justice views the insurance *ad hoc* joint underwriting and joint reinsurance pooling arrangements for a fixed duration as *ad hoc* joint ventures under the antitrust laws for the purpose of providing coverage to large risks. Generally, the participants adhere to the terms negotiated by the lead underwriter. Such insurance risk-sharing arrangements are necessary to provide adequate underwriting capacity. This, coupled with several other factors suggesting that such arrangements are favorably structured for competition, is thought to be enough to permit the continuation of such activities which "are necessary to the conduct of the business and reasonably structured."<sup>412</sup> Similarly, as to the permanent type of insurance voluntary pooling arrangements, the Department of Justice concludes that such arrangements are "either necessary to the conduct of the business (and reasonably structured) or providing significant economies of operation without substantially lessening actual or potential competition, would be lawful joint venture arrangements under the federal antitrust laws."<sup>413</sup>

For the purpose of this article, it can be assumed that at least some insurer voluntary pooling arrangement could survive antitrust challenge if the McCarran antitrust immunity were repealed. However, this does not answer the question to what extent the insurance regulatory objective of availability of coverage will be thwarted by the application of antitrust law to the voluntary insurance pools.

Insurance company management, insurance brokers and any other involved parties would be confronted with difficult antitrust questions having uncertain answers whenever they undertake either an *ad hoc* joint venture or participate in a more permanent pool. For example, will the provision of coverage through the joint venture have a substantial adverse impact on competition and thereby violate the antitrust laws? The Supreme Court in *United States v. Penn Olin Chemical Co.* enumerated the criteria for determining the probability that a joint venture will substantially lessen competi-

410. *United States v. Columbia Pictures Corp.*, 189 F. Supp. 153, 178 (S.D.N.Y. 1960).

411. See DJ REPORT, *supra* note 13, at 131-33.

412. *Id.* at 226-29.

413. *Id.* at 237.

tion.<sup>414</sup> These include (1) the number and power of competitors in the relevant market; (2) the background of their growth; (3) the power of the joint venturers; (4) the relationship of their lines of commerce; (5) the competition existing between them and the power of each in dealing with the competition of the other; (6) the setting in which the joint venture was created; (7) the reasons and necessities for its existence; (8) the joint venturer's line of commerce and the relationship thereof to that of its parents; (9) the potential power of the joint venture in the relevant market; (10) an appraisal of what the competition would have been in the relevant market if one of the joint venturers had entered it alone; (11) the effect of such entry on the other joint venturer's potential competition and (12) other factors indicative of potential risks to competition in the relevant market.

These are not easy antitrust or economic issues. Often it takes a court years to resolve such questions in a given case. To require an insurer to reach conclusions on these criteria each time it enters into an *ad hoc* voluntary pooling arrangement to provide coverage to a particular risk, or whenever it participates in an on-going permanent pooling operation, cannot help but have an inhibiting influence on insurers' willingness to provide needed coverage. This is particularly true in view of the vulnerability to not only civil actions by the antitrust enforcement agencies but also criminal and private party treble damage actions.<sup>415</sup> There would be no dearth of opportunity for government and private parties to second guess an insurer's decision whether his joint venture conduct would substantially lessen competition. Furthermore, the other joint venture antitrust issues as to ancillary restraints and availability of essential facilities enlarge the insurer's potential vulnerability.

Some may question whether the permitted scope of voluntary risk-sharing arrangements under the antitrust laws is as broad as suggested in the Department of Justice analysis. But, even if it is assumed that this analysis is correct, the scope of such activity is less than that permitted under state insurance regulation. Furthermore, if the antitrust laws were applied, the combination of insurers' uncertainty as to the legal parameters within which they could safely operate, the severe penalties if they are wrong and the practical and costly problems in arriving at an informed conclusion promises a substantial shrinking of insurer willingness to make needed coverage available. The shrinkage is further exacerbated if the actual permissible voluntary pooling activity is narrower than the Department of Justice report suggests. Such a result works in direct conflict with the public policy goal of maximizing availability of coverage needed by the insurance-buying public.

Before finalizing such a conclusion, however, it is necessary to consider whether either the state action or preemption doctrine would alter the application of the antitrust laws to the voluntary pooling arrangements. The various states generally regulate voluntary insurance pools. Typically, these

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414. 378 U.S. 158, 177 (1964).

415. See text accompanying notes 164-70 *supra*.

pools are authorized by statute to engage in joint underwriting or joint reinsurance. States require insurance pools to file certain materials with the insurance commissioner, to comply with the general rating law standards and to obtain approval (or absence of disapproval) under the state's rate approval procedures. Generally, joint underwriters may act in concert with each other as to establishing rates; preparing insurance policies, underwriting rules and surveys; conducting inspections and investigations; furnishing loss and expense statistics and conducting research. Furthermore, insurers engaged in joint underwriting or joint reinsurance are prohibited from engaging in unfair or unreasonable practices and are subject to the commissioner's authority to make reasonable rules and regulations necessary to carry out the purposes of the rating law.<sup>416</sup>

The availability of the state action exemption for this insurance regulatory scheme is unlikely. Although insurers may act in concert, there is no clear articulation of a policy to displace competition. In fact, the regulation is likely to be pursuant to a prior approval or open competition rating law which expresses either a position of neutrality on competition or a procompetitive policy position.<sup>417</sup> The test of active state supervision would probably be met by virtue of the pooling arrangement being subject to the rating law provisions. However, the insurers are not compelled by state law to participate in the voluntary pooling arrangements. Therefore, they do not meet the compulsion-fairness test necessary to invoke private immunity under the state action doctrine.

Nor does the application of the preemption doctrine afford any comfort. To the extent antitrust law prohibits voluntary pooling, state law authorizing such activity directly conflicts with federal law. Under the conflict test of the preemption doctrine, the state law must give way and state efforts to achieve insurance availability through voluntary insurance pools suffer correspondingly.

c. *Residual Market Mechanism Under State Insurance Regulation.* In addition to the voluntary pooling arrangements which arise primarily to meet the needs of commercial buyers of insurance, a variety of residual market mechanisms have been developed to assure the availability of insurance to individuals who have been precluded from the voluntary insurance market. Such mechanisms include assigned risk plans for automobile insurance, FAIR plans for property insurance and plans for medical malpractice insurance. Consideration of the automobile assigned risk plans, described earlier,<sup>418</sup> serves to illustrate the potential impact of the repeal of the McCarran anti-trust immunity on state residual market programs.

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416. DIRECTOR R. MATHIAS, *supra* note 16, at 16. See also NAIC Model Consolidated Casualty, Surety, Fire, Marine and Inland Marine Rate Regulatory Bill § 11, II NAIC PROCEEDINGS 655, 680 (1963). Most state insurance rate regulatory laws are at least substantially patterned after the NAIC model act(s).

417. See text accompanying notes 365-366 *supra*.

418. See text accompanying note 148 *supra*.

To the extent that state law provides no antitrust immunity protection to assigned risk plan activity, insurers participating in this type of plan would be vulnerable to antitrust challenge. In administering the plan, insurers act in concert in developing the rates for the assigned risks and the policy forms used. Concerted action to fix prices is a *per se* antitrust violation. Furthermore, assigning risks could be considered as an allocation or division of markets which is also a *per se* violation.<sup>419</sup>

The preemption doctrine affords little protection to this residual market scheme. Clearly the state law sanctioning concerted activity directly conflicts with antitrust prohibition of such activity.

If a residual market mechanism mandates insurers to participate, at first blush it would appear that the state action exemption would be available to protect insurers in their implementation of the program. A closer look, however, raises some doubts. The state statute may say nothing about mandating uniform rates for assigned risk coverages. Even though the regulatory agency may approve the plan's proposed rates, a court may find no clear articulation of state policy to displace competition as to rates.<sup>420</sup> If such a policy has to be established by explicit statutory language, rather than by agency action pursuant to statutory authority, the first test for state action would not be met. Even if this criterion is met, there remains an equally serious question: does the state require insurers to charge the same rates for assigned risks? Does the fact that the commissioner has approval power over the rates compel insurers to charge the same rates or does the individual insurer retain sufficient private decision-making initiative so as to make it fair, pursuant to *Cantor*, to hold it accountable for acting in concert with other insurers in submitting proposed assigned risk rates to the commissioner for use by all insurers? The answers to these questions can vary according to the particular state statute under consideration<sup>421</sup> and the actual role played by the regulatory agency in the decision-making process.

Presumably, if a particular state residual market mechanism lacks sufficient explicit statutory articulation of a policy to displace competition or sufficient insurer compulsion, the state legislature could remedy such defects. Until this is done, however, insurers acting in concert under such statutes may be vulnerable to antitrust liability in the absence of protection under the state action doctrine.

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419. *Northern Pacific Ry. Co. v. United States*, 356 U.S. 1, 5 (1958).

420. There is often no specific reference to a legislative policy to displace competition in insurance statutes establishing residual market plans. See CAL. INS. LAW § 11620 (West 1972) (standards couched in terms of a "reasonable plan" and "equitable apportionment."); WIS. INS. LAWS § 619.01(1) (1975).

421. For example, the California law requires the plan which is submitted for commissioner approval to contain provisions showing the basis upon which premium charges shall be made. CAL. INS. LAW § 11624(e) (West 1972). Does this require uniform charges? Furthermore, does the fact that insurers are not required to submit any plan, leaving the development of the plan up to the commissioner, provide insurers sufficient decision-making freedom so as to be unable to invoke the state action exemption?



One final observation should be made on the implications of repealing the McCarran Act antitrust immunity for the state insurance policy of maximizing the availability of insurance coverage. Neither the preemption doctrine nor the state action doctrine protects voluntary insurance pools from antitrust challenge. This promises to significantly reduce the availability of coverage through voluntary means. To fill the gap, states could mandate availability residual market programs in a manner to invoke the state action exemption. However, mandated programs tend to be uniform and rigid. Thus, in terms of fostering competition through the general application of antitrust law, the cure may prove worse than the disease. That is, to the extent there are anticompetitive consequences of voluntary pools under state insurance regulation, the adverse consequences may be smaller than the anticompetitive consequences resulting from forcing the states to expand mandated residual market mechanisms to assure availability of coverages.

*B. Repeal of McCarran Antitrust Immunity Plus Congressional Limitations on State Insurance Rating Laws*

The discussion in Section A considered the implications of repealing the McCarran antitrust immunity with no additional explicit congressional limitation on the ability of the states to regulate insurance. Subject to carving out some specific areas for antitrust immunity and to recommending further study of insurance regulation, the National Commission essentially recommended this approach.<sup>422</sup> Others, however, go further and recommend that limitations be placed upon the authority of the state to regulate insurance rates. The insurance portion of the report of the Economic Advisory Panel to the National Commission concluded that

[t]he repeal of the McCarran-Ferguson Act alone will have little if any effect on the extent of price competition in this [insurance] industry. If the goal is a more competitive market for property/casualty insurance, removing the ability of the states to regulate rates, rate classifications, etc. would be a much more potent instrument.<sup>423</sup>

Although the National Commission recommendations did not extend to such limitations, the Commission did urge the states to "place maximum reliance on competition in pursuing their regulatory objectives"<sup>424</sup> and expressed the belief that "narrowly targeted antidiscrimination, disclosure and similar statutes are preferable to such anticompetitive economic regulation as state rate-setting."<sup>425</sup> These manifestations of a body of opinion perceiving an anticompetitive influence of state rating laws strongly suggest the possibility that efforts will be made to convince Congress to place limits on state authority

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422. See text accompanying note 33 *supra*.

423. Joskow, *supra* note 101, at 9.

424. NATIONAL COMMISSION REPORT, *supra* note 13, at 25.

425. *Id.*

to regulate insurance rates as well as to repeal the McCarran antitrust immunity.

The clearest example would be an outright explicit prohibition of state authority over insurance rates, classifications, and territories as well as a removal of the antitrust immunity for cooperative ratemaking activities. Such a restriction on state authority might extend to all types of insurance or it might be limited to specific lines.<sup>426</sup> However, as to those types of coverage immunized from state controls, insurers would be free to establish their insurance rates within the parameters of antitrust constraints.

### 1. *Potential Regulatory Vacuum and Federal Rate Regulation*

The potential implications of repealing the McCarran antitrust immunity and prohibiting the states from exercising rate regulatory authority are clear. The federal antitrust laws attempt to deter anticompetitive conduct and to foster conditions conducive to competition. At the same time, however, the antitrust laws are no guarantor that effective competition will occur or will continue to occur. Many American industries are subject to the antitrust laws. It has been said that several of these industries are not very competitive, because of conditions which antitrust enforcement cannot or will not relieve. Where antitrust law is unsuccessful in effectuating vigorous competition, and no other agency has jurisdiction, a regulatory vacuum is created, rendering the public vulnerable to abuse.<sup>427</sup> The general application of the federal antitrust laws could produce this very result in the insurance industry.

Particularly significant in this context is the fact that knowledgeable consumers who "shop" among competing coverages constitute a key element in an effective competitive market. Few today would contend that the typical insurance buyer is adequately informed as to comparative insurance prices, quality and services. While various regulatory efforts (such as experiments with different types of shopper's guides) have improved the situation, much remains to be done. Preclusion of the imposition of rate controls, or the threat thereof, as a deterrent to abusive insurer conduct, would place the insurer in a potentially and temptingly exploitive position.

As a consequence, despite the avowed purpose that the proposed application of the antitrust laws would increase competition and reduce the need for rate regulation, federal rate regulation promises to be the ultimate result. This is most likely to occur in one of two ways.

- (1) The general application of the federal antitrust laws would be

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426. See text accompanying note 29 *supra*.

427. One commentator noted that "this call for economic Darwinism assumes that there is, in fact, competition in all insurance markets and in all lines of insurance. Many state insurance regulators across the country sincerely doubt that to be the case." Richard Mathias, Illinois Insurance Director, A critique of the Report of the National Commission on Antitrust Policies and Procedures, Remarks before the Annual Meeting of Consumer Federation of America, Washington, D.C., (Feb. 8, 1979).

achieved through some modification or repeal of the McCarran Act. However, no legislative effort to do so would likely retain its original form. There has long existed an articulate influence, on and within government, pressing for increased economic controls for a broad range of goods and services. Furthermore, not all members of Congress have the same degree of faith in the antitrust laws which the Department of Justice and the National Commission reports reflect. Thus, it is likely that any bill enacted by Congress will contain some type of federal rate regulatory authority, especially if all state rate regulatory authority is precluded. The resulting creation of institutionalized federal machinery will increase federal insurance regulation and set the stage for even more.

(2) Even if Congress initially determined to rely on the antitrust laws as the regulator of insurance rates, increased federal regulation would follow. A most likely scenario revolves around increasing insurance rates. Most knowledgeable observers of the property and liability insurance business believe that the application of the federal antitrust laws will do little to reduce rates. A state insurance regulator will rarely refuse to allow an insurer to reduce its rates if it so chooses. On the other hand, removal of state authority to regulate rates would lead to even greater rate increases because of insurer concern over the mounting inflationary impact. Congressional reaction to sharply rising insurance prices is predictable. Imposition of federal rate controls can be expected to follow substantial insurance rate increases.

This is not mere speculation. For example, on February 1, 1977, the New York prior approval law for no-fault automobile insurance rates expired while the legislature debated what the appropriate time period for extension would be. Upon expiration, there was open rating. Immediately, several insurers raised their automobile rates in New York by averages of eighteen percent to twenty-nine percent.<sup>428</sup> Unlike the situation which would prevail if only the antitrust laws applied, under the open competition law the insurance commissioner has the authority to review rate increases after the fact to determine whether they meet the standard of reasonableness. The important point of this example is the indication that those insurers who may support preempting state regulatory authority in favor of the antitrust laws may be doing so not with the view of increasing competition and lowering rates but rather with the view that they want to be free to substantially increase rates.

Few, if any, members of Congress want to be held responsible for enacting legislation which is perceived by the public as enabling insurers to increase rates. Consequently, a series of inevitable and substantial rate increases above and beyond the current pattern, coupled with a Congressional prohibition against state controls, could very well lead to demands for federal rate regulatory controls to fill the federally-created void embodied in the various antitrust proposals.

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428. Harnett, *Slamming Door on Auto Rate Increases Made During Hiatus Time*, Ins. Advocate, Feb. 26, 1977, at 5.

## 2. *Potential Limitation on the Power of Congress to Remove State Regulatory Authority*

Previous discussion suggests that the state action doctrine may sustain some forms of state insurance rate regulation if the McCarran Act antitrust immunity were repealed.<sup>429</sup> However, if Congress, either as a part of its repeal of the McCarran antitrust exemption or in the future, through statutory language, explicitly declares that all state rating laws are prohibited and antitrust laws should apply exclusively, the validity of any state rate regulatory effort is subject to severe doubt. If the state action doctrine is founded on Congressional intent,<sup>430</sup> the states would clearly be ousted from this regulatory sphere.

On the other hand, *Usery* suggests the possibility that state action is constitutionally protected,<sup>431</sup> in which case the courts, rather than Congress, will define the extent to which various insurance regulatory systems are protected. This protection could be limited to state-made rates and/or mandating bureau rate systems,<sup>432</sup> or possibly could extend throughout the spectrum of rating laws including prior approval and perhaps even open competition laws.<sup>433</sup> If state action extends as far as the latter two and if it is constitutionally protected, Congressional efforts to change the current regulatory pattern will founder. If, as is more likely, constitutionally-protected state action extends to only the more rigid forms of rate controls, Congressional efforts to apply antitrust law to the insurance industry and to remove state rate regulation may be counter-productive to its basic purpose of promoting competition in the insurance business. Such an effort would confront the states with the choice of either no rating law or a constitutionally-protected rigid rating law. Each state would then have to determine not only which approach would best balance its competing public policy objectives, but also which approach would be most politically feasible.

In brief, repealing the McCarran antitrust immunity, coupled with a specific Congressional prohibition against state insurance rating laws, promises severe alternative implications. If state action is constitutionally protected, the states may be forced to impose a rigid anticompetitive rate regulatory regime which is counterproductive to the basic purpose of modifying the McCarran Act. On the other hand, if state response is not constitutionally protected or if the states elect not to respond, the future of federal rate regulation of insurance seems assured. This too is counterproductive to the avowed purpose of modifying the McCarran Act.

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429. See text accompanying notes 355-369 *supra*.

430. See text accompanying notes 319-322 *supra*.

431. See text accompanying notes 324-343 *supra*.

432. See text accompanying notes 355-361 *supra*.

433. See text accompanying note 369 *supra*.

### C. Federal Standards for State Insurance Rating Laws

The proponents of general application of the antitrust laws to the business of insurance have raised a variety of concerns as to the functioning of the current system. Nevertheless, the major thrust of their criticism focuses upon the operation of the state insurance rating laws which are perceived to sanction concerted action to fix prices through rating bureau activities.<sup>434</sup> Repeal of the McCarran antitrust immunity is seen as a major remedy by subjecting such concerted activity to the prohibitive principles of antitrust. In addition, some suggest explicitly prohibiting state rate approval or disapproval interference as to insurer prices established on an individual company basis.<sup>435</sup>

At the same time, however, even among the proponents of applying antitrust law, there are major elements recognizing potential problems with total abolition of state insurance rate regulatory authority. The testimony by a staff member of the FTC before the National Commission stated:

[w]e are not yet prepared, however, to say that the benefits of state rate regulation are always and inevitably outweighed by the limitations which it imposes on full and open price competition. Nor are we ready to say that the consumer of insurance will always be adequately protected by the antitrust laws and should willingly trade the multifaceted protection given by state insurance regulators from unreasonable and unfair prices for the federal antitrust umbrella.

We are not convinced that unregulated price competition will in all cases best serve the needs of the consumers of these virtually essential lines of insurance; nor are we certain that unregulated competition is wholly compatible with the goal of full availability of essential insurance at reasonable prices and without unfair discrimination. Unlike several other regulated industries, the insurance industry's price deregulation would not clearly result in any substantial reduction in rates. Experience in the open competition states indicates that rates have not escalated as a result of less regulation, but there is apparently no effective cartel to be broken, and so rates have not tended to drop. In addition, the lack of a national consensus on the social policies to be served by insurance makes a unidimensional federal insistence on rate deregulation inappropriate. Since insurers now have considerable freedom to price their product, in both "open competition" and "prior approval" jurisdictions, there appears to

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434. See text accompanying notes 422-426 *supra*. Noteworthy, is the fact that, although the National Commission had concerns over concerted activity as to pooling arrangements, it recognized the necessity for such activity and recommended affirmation of the lawfulness of essential collective activities under the antitrust laws. NATIONAL COMMISSION REPORT, *supra* note 13, at 225. Similarly, the Department of Justice recognizes the legitimacy of joint placements and pooling and argues, in effect, that legitimate activities would be permissible under the antitrust laws. Only on the fringe, nonessential anticompetitive joint arrangements are of antitrust concern. DJ REPORT, *supra* note 14, at 237-38.

435. See text accompanying notes 29, 423 *supra*.



be no urgent need for a federal mandate of deregulation in the name of independent pricing.<sup>436</sup>

Similarly, the National Commission was unprepared to recommend abolition of state rate regulation but instead recommended a study of the appropriate regulatory response to the problems of equity and discrimination in insurance rates and the relationship between rate regulation and the availability and affordability of insurance.<sup>437</sup>

The reluctance to push for total abolition of state rate regulatory authority reflects two major undercurrents. First, there is a recognition of the need to balance a variety of conflicting public objectives such as competition, equity, availability and affordability. Although the antitrust proponents desire that this balance be struck in a manner having the least anticompetitive impact possible, a convincing case has not been made that antitrust law alone can achieve an acceptable balance. Second, sole reliance on the antitrust laws provides no public protection when competition is weak or nonexistent as to a given line of insurance in a particular state. The potential regulatory vacuum<sup>438</sup> is the Achilles heel of the total rate regulatory abolitionist approach.<sup>439</sup> Because of the major concerns for appropriately balancing competing policy objectives and the potential regulatory vacuum in the absence of workable competition, Congress might conceivably determine to continue state rate regulatory authority subject to certain federal standards.

If Congress ultimately elects the federal standards approach, the probable foundation of the standards seems apparent from the clear preferences expressed by the antitrust proponents. For example, the National Commission concluded that the "regulatory mechanisms existing in many states unduly restrict independent pricing and that true open competition laws are the preferable means of achieving available, reasonably priced insurance for a majority of consumers."<sup>440</sup> Similarly the Department of Justice report stated: "[t]he relatively favorable performance of the insurance companies under the highly competitive system suggests that it provides a more effective mechanism for accomplishing one of the basic insurance goals—generally available coverage at a price reasonably related to cost."<sup>441</sup> Because of the

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436. A. Foer, *supra* note 28, at 13-14.

437. See NATIONAL COMMISSION REPORT, *supra* note 13, at 225.

438. See text accompanying notes 427-428 *supra*.

439. Professor Joskow, in the Economic Advisory Panel Report to the National Commission, not only recommended restricting the ability of the states to regulate rates, he also suggested authorizing the "states to petition the Justice Department to reimpose rate regulation for lines of insurance which are not workably competitive." Joskow, *supra* note 101, at 18-19. Such recommendations implicitly recognize the potential regulatory vacuum problem.

440. NATIONAL COMMISSION REPORT, *supra* note 13, at 243.

441. DJ REPORT, *supra* note 14, at 341. As a basis for its finding that the antitrust laws should apply to the insurance industry, the Department of Justice relied heavily upon a comparison of experiences between an open competition and two prior approval states. See *id.* at 36 *et seq.* It should be noted, however, that even if it is assumed *arguendo* that the Department comparative economic analysis supports a finding that industry performance is superior under

perceived success of open competition rating laws in terms of achieving the beneficial results of competition, an FTC representative on the National Commission, during the Commission's hearings, suggested the possibility that the Commission endorse the open competition rating law movement by the states.<sup>442</sup> Another member of the Commission, presumably for similar reasons, raised the possibility of continuing the McCarran antitrust exemption for those states having open competition laws and eliminating the immunity for those that do not.<sup>443</sup> Thus, if Congress determines to enact federal standards for state insurance rating laws, the open competition rating law approach appears to be the leading candidate to serve as a prototype.

Although prediction as to specific possible federal standards is hazardous at best, the general contours might be discerned from the concerns raised during the course of the National Commission deliberations. Based on these deliberations, the federal standards might contain the following basic elements. First, the rating standards would probably be couched in terms of competition. For example, if competition is found to be workable in a given line of insurance in a given state, by definition rates would not be excessive. Only if workable competition is absent would the traditional test of reasonable rates be applicable.<sup>444</sup> Second, a rating standard might specifically prohibit what the Department of Justice describes as "invidious" discrimination.<sup>445</sup> Third, prior approval rate mechanisms would probably be prohibited, but subsequent disapproval of rates would probably be permitted. However, there may be a provision for reimposition of prior approval as to those lines of insurance in the state which are not found to be workably competitive. Fourth, the scope of permissible collective activity through rating bureaus would be specifically delineated, probably confined to the collection, compilation and dissemination of certain types of data and information. Fifth, insurers would most likely be expressly prohibited from entering any agreements to adhere to the use of any rates, rating systems, underwriting rules or policy forms except in the context of regulated residual market plans.

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open competition rating laws, it does not follow that antitrust laws should apply and that even the open competition laws should be prohibited. Nevertheless, some antitrust proponents, including the Department of Justice, make this unwarranted quantum leap.

442. National Commission Hearings, *supra* note 26, at 87.

443. *Id.* at 84, (July 27, 1978).

444. See *MONITORING COMPETITION*, *supra* note 12, 401-02, 436-37. For discussion of the rating standard of inadequate rates, see *id.* at 402-03, 437-39.

445. *DJ REPORT*, *supra* note 14, at 347. The report includes in this category insurer refusal to service individuals and charging disproportionately higher rates because of race (territorial redlining), age or sex. *Id.* Currently there is a wide ranging debate within the insurance industry at the state level and at the federal level as to what constitutes appropriate rating and territorial classifications. See Report of the NAIC Rates and Rating Procedures Task Force, I NAIC PROCEEDINGS 910 (1979). Entering into this debate is beyond the scope of the Article. If and when a consensus emerges, the consensus is likely to be what is engrafted as a part of any federal standards. For a discussion of the current standards of unfair discrimination under state insurance rating laws, see *MONITORING COMPETITION*, *supra* note 12, at 403-04, 430-34, 439-40.

Finally, additional specific antitrust-type prohibitions conceivably could be made a part of a set of federal standards.<sup>446</sup>

A federal standards approach could be implemented in different ways. One technique, suggested by one member of the Commission, would be to condition the continuance of the McCarran Act antitrust exemption on state enactment of an open competition rating law, on the theory that this would cause sufficient pressure for the states to move in this direction.<sup>447</sup> A stronger approach from the federal perspective, although not necessarily a more appropriate one, would be to repeal the McCarran antitrust immunity and expressly prohibit state insurance rate regulation except for state regulation in conformity with the federal standards for an open competition rating law. Private activity, undertaken pursuant to such rate regulation in conformity with federal standards, should be specifically authorized in this type of legislative plan.

Among the major alternative approaches to modify and/or repeal the McCarran Act antitrust immunity, the federal standards-open competition rating law approach possesses some significant advantages. First, it would eliminate much of the uncertainty, which would occur if the McCarran antitrust immunity were simply repealed, as to the validity of state rate regulation and private insurer activity pursuant thereto. Second, it avoids the potential regulatory vacuum which is the Achilles heel of prohibiting all rate regulation and relying solely on the antitrust laws. Third, a mechanism is retained to coordinate the resolution of competing public policy objectives. Fourth, at the same time, however, competition would become the primary regulator of insurance rates where competition is, in fact, effective or workable. Fifth, within the parameters of federal imposition of competition as the primary standard, this approach does the least violence to the fundamental concept of federalism by leaving the regulation of the insurance industry to the states. Not only is this sound policy, but it is less likely to engender judicial invocation of constitutional limits on Congressional power. Sixth, with the option of enacting open competition laws available, states are less likely to respond to the repeal of the McCarran antitrust immunity by enacting very stringent rate regulation and reduced flexibility for competition in an effort to obtain protection afforded by the state action doctrine. Seventh, this approach relies on the proven success of open competition laws rather than on the antitrust laws, whose standards and enforcement are often inconsistent with the economic concept of competition.

Although the federal standards-open competition rating law approach warrants the highest marks among the various means to amend or repeal the McCarran Act, this does not support the conclusion that the McCarran Act

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446. See COLO. REV. STAT. § 10-4-514 (1973); N.Y. INS. LAW § 177(1) (McKinney 1966). The NAIC currently has an exposure draft of a model open competition rating law under deliberation, which reflects some of the same concerns expressed at the federal level. See Report of the NAIC Competition Subcommittee, June 5, 1979, II NAIC PROCEEDINGS 269 (1979).

447. National Commission Hearings, *supra* note 26, at 84 (July 27, 1978).

should be repealed or modified. The various reasons militating against the general application of antitrust law to the business of insurance still hold true,<sup>448</sup> although perhaps to a lesser degree in some respects under the federal standards approach. The imposition of federal standards would limit the degree of state choice as to how best to organize the economic activity within its borders. This limitation would apply regardless of how well the current system is working for a particular state. Furthermore, once the McCarran Act is amended, precedent would be established for greater ease of future direct Congressional involvement into the state insurance regulatory process.

D. *Impact of the Repeal or Amendment of the McCarran Antitrust Immunity on the Issue of State Versus Federal Regulation of Insurance*

Altering the McCarran Act so as to apply the antitrust laws to the insurance business cannot be isolated from the fundamental issue of state versus federal regulation of insurance. Substantial increase in federal regulatory activity will result from an actual or perceived potential regulatory vacuum stemming from amending the McCarran Act and from the removal of the McCarran Act's bar to FTC regulatory activity. This, in turn, raises the fundamental issue of state versus federal regulation of insurance. To each of these points we now turn.

1. *Regulatory Vacuum and Other Sources Leading to Federal Insurance Regulation*

Efforts to apply antitrust law to the insurance business in one way or another are likely to result in substantial federal insurance regulation. Because of the basic distrust of competition possessed by some members of Congress and the opportunities to amend original proposals in the legislative process, any movement to modify the McCarran Act, especially if done in a manner so as to remove state authority over rates, very conceivably will be encumbered by some type of federal rate regulatory control or at least oversight.<sup>449</sup> Those members of Congress favoring economic controls can be expected to attempt to fill a perceived regulatory vacuum. However, even if such efforts are initially thwarted in Congress and the McCarran Act antitrust immunity is repealed without provision for federal rate regulatory oversight, the ever increasing insurance rates due to inflationary pressures, the public adverse reaction thereto and the normal political desire to avoid public blame for increased rates ultimately promise Congressional action to fill a perceived regulatory void.<sup>450</sup> This likelihood is most clearly present when repeal of the McCarran antitrust immunity is coupled with an explicit prohibition of state rate regulatory authority. To the extent that a simple repeal of the McCarran antitrust immunity precludes the states from effectively

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448. See text immediately following text accompanying note 141 *supra*.

449. See text preceding text accompanying note 428 *supra*.

450. See text immediately preceding text accompanying note 428.

containing rates (due to the preemption doctrine) the regulatory vacuum potential is also present. The federal standards approach engenders the likelihood of direct federal regulatory oversight if Congress elects to vest authority in a federal agency to determine whether state rating laws comply with the federal standards rather than leaving such responsibility to the courts.

Furthermore, even if federal rate regulation were not to occur, amending the McCarran Act to apply antitrust law to the insurance business would still necessarily cause a substantial increase in federal regulatory involvement. Despite the Department of Justice staff interpretations of the antitrust law as it would apply in the insurance context,<sup>451</sup> most would agree (including the National Commission)<sup>452</sup> that various areas of joint activity and pooling arrangements would have to be carved as exemptions from any application of the antitrust laws to assure availability of a variety of coverages, residual market mechanisms, guaranty funds and the like. Determining the scope of what should be permissible concerted activity is such a continuous problem as conditions and markets change so as to defy a one-time sound legislative solution. Furthermore, it is primarily a regulatory rather than an antitrust problem. Wrestling with it on an ongoing basis would deeply enmesh the federal antitrust enforcement agencies into the insurance regulatory process.

No purpose would be served by an exhaustive catalog of the entire range of possible scenarios relating to the federal regulatory consequences of amending or repealing the McCarran antitrust immunity. For the purposes of this article, it is enough to recognize the high probability of such consequences occurring. In turn, this leads to the necessity of considering the state versus federal regulation issue in an evaluation of the merits of a McCarran Act change.

## 2. *Removal of the Bar to FTC Regulatory Activity*

The repeal of the McCarran Act antitrust immunity, in addition to the situations suggested above, would immediately and directly increase federal insurance regulatory activity. Currently the Sherman, Clayton and FTC Acts apply to the business of insurance except to the extent such business is regulated by state law.<sup>453</sup> By virtue of this provision, for the most part, Congress authorized the states to oust both the Department of Justice and the FTC from insurance regulation. Repeal of this provision in a manner so that the Acts apply to the business of insurance would remove the bar to FTC jurisdiction over the insurance industry.

The FTC is not only an antitrust enforcement agency, it also is a major regulatory agency with authority to enforce the FTC Act. The Act bans unfair methods of competition and unfair or deceptive acts or practices.<sup>454</sup> The FTC

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451. See DJ REPORT, *supra* note 14, at 146-286.

452. NATIONAL COMMISSION REPORT, *supra* note 13, at 225.

453. 15 U.S.C. § 1012(b) (1976).

454. 15 U.S.C. § 45 (1976).



also enforces the Clayton Act,<sup>455</sup> which bans activities ranging from price discrimination to mergers.<sup>456</sup> The FTC is organized around its two major areas of activity, the Bureau of Competition and the Bureau of Consumer Protection. Members of the FTC staff not only have made it amply clear that the governance of insurance markets should not be left solely to competition,<sup>457</sup> but also that the FTC contemplates active involvement in such regulation.<sup>458</sup>

The scope of FTC regulatory interest in insurance is far from narrow. An internal FTC staff task force on insurance has designated as high priority areas such topics as medicare supplement insurance, insurance mergers, industrial life insurance investigation, economic analysis of insurance discrimination, territorial insurance rating and privacy.<sup>459</sup> Medium priority items include technical assistance to the states, insurer role in attempts to contain insurance costs, fiduciary liability for insurance agents, subsidy schemes and residual market mechanisms, and dread disease policies.<sup>460</sup> Lower priority activity includes automobile claim handling, homeowners insurance and reinsurance.<sup>461</sup> Major ongoing or recently completed FTC activities include development of a system of life insurance cost disclosure,<sup>462</sup> report on industrial life insurance<sup>463</sup> and a study of the economics of insurance discrimination including an examination of the competitive market, types of fair and unfair discriminatory practices and possible regulatory alternatives.<sup>464</sup>

This regulatory activity of the FTC is not unique to the insurance area: "the Commission is currently embarking upon an aggressive campaign to prohibit, through a series of trade regulation rules, anticompetitive conduct that has little, if any, economic justification, but that nevertheless either is condoned, encouraged, or actually administered by state governments."<sup>465</sup>

455. 15 U.S.C. § 21(a) (1976).

456. See 15 U.S.C. §§ 13, 14, 18, 19 (1976).

457. A. Foer, *supra* note 28, at 2; Reich, *supra* note 176, at 4-5.

458. Indeed, some government intervention in the form of antitrust enforcement, may be necessary to ensure that competition itself is healthy and robust. So the public policy question becomes: who will guide the "invisible hand" of the market when it slips or goes astray—the federal government, the states, or both? Who has the comparative advantage to remedy which set of problems?

Reich, *supra* note 176, at 5. See also *id.* at 9-10. A report of an FTC Staff Insurance Task Force speaks in terms of "a renewed FTC commitment to obtaining effective regulation of the insurance industry." FTC OFFICE OF POLICY PLANNING, INSURANCE POLICY SESSION 30 (1978) (edited version).

459. Reich, *supra* note 176, at 10.

460. *Id.* at 11.

461. *Id.* at 12.

462. *Id.* at 32. STAFF OF THE FTC, LIFE INSURANCE COST DISCLOSURE (1979).

463. E. LaPorte, FTC OFFICE OF POLICY PLANNING, LIFE INSURANCE SOLD TO THE POOR: INDUSTRIAL AND OTHER DEBIT INSURANCE (1979).

464. FTC Contract for Economic Analysis of Insurance Discrimination (Jan. 1979).

465. Davidson & Butters, *supra* note 244, at 577. Further suggestion of the FTC mounting attack on state activity is the FTC staff report exploring

the legal limits on the FTC's authority to act in areas involving state regulation. Specifically, it discusses the Commission's authority to restrict (either by adjudication

This campaign has embraced such areas as state regulation of legal services, state milk price regulation, restriction on health maintenance organizations, state regulation of Blue Shield Plans, state regulation of accountants, eyeglass advertising restrictions and real estate brokerage regulation.<sup>466</sup> These attacks on state-sanctioned conduct, combined with the publicly expressed areas of FTC interest in insurance, lead to the conclusion that in addition to enforcing the antitrust laws, the FTC intends to become a major if not dominant force in insurance regulation.

Section 5 of the FTC Act establishes the basic prohibition against unfair methods of competition and unfair or deceptive acts or practices.<sup>467</sup> To define and enforce the Act, the Commission possesses both adjudicatory<sup>468</sup> and rule-making authority.<sup>469</sup> In the absence of the McCarran antitrust immunity, the question becomes whether FTC activity taken pursuant to such authority preempts state insurance regulatory activity.

If the Commission finds in an adjudicatory proceeding that the respondent has engaged in an unfair trade practice, the Commission may issue a cease and desist order against recurrence of the illegal practice. In doing so, the issue is raised as to whether an FTC finding that state law or private conduct taken pursuant to state law is an unfair practice would preempt state law. Similarly, can the Commission, as part of a reasonable remedy to prevent some unfair trade practice, prohibit the enforcement of state law?<sup>470</sup> If the state laws or private conduct do not qualify as "state action" under the *Parker* doctrine, presumably FTC cease and desist orders and remedial measures could preempt state action under the supremacy clause.<sup>471</sup> Whether preemption would, in fact, occur depends upon the normal application of the principles of the preemption doctrine.

With respect to the Commission's rulemaking authority, the District of Columbia Court of Appeals in *National Petroleum Refiners Association v.*

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or by rule-making) private conduct which is regulated by state law, and the Commission's authority to challenge actions and regulations of the states themselves (and their officers, agencies and subdivisions).

STATE REGULATION REPORT, *supra* note 343, at 1.

466. Davidson & Butters, *supra* note 244, at n.10.

467. 15 U.S.C.A. § 45(a)(1) (Supp. 1979).

468. 15 U.S.C.A. § 45(b) (Supp. 1979).

469. 15 U.S.C.A. § 46(g) (Supp. 1979).

470. STATE REGULATION REPORT, *supra* note 343, at 38-39. An FTC order requiring prior approval of a corporate acquisition or merger could be construed to preempt a state approval mechanism of the same transaction. *Id.* at 39.

471. *Id.* at 40. There are cases sustaining Commission orders prohibiting conduct authorized by state law but not actively supervised: *Peerless Products, Inc. v. FTC*, 284 F.2d 825, 827 (7th Cir. 1960); *Asheville Tobacco Bd. v. FTC*, 263 F.2d 502, 509-10 (4th Cir. 1959); *Chamber of Commerce v. FTC*, 13 F.2d 673, 684 (8th Cir. 1926); or without a state policy decision that was inconsistent with a federal statute, *Spiegel, Inc. v. FTC*, 540 F.2d 287, 292 (7th Cir. 1976); *Royal Oil Corp. v. FTC*, 262 F.2d 741, 743 (4th Cir. 1959). Only *Asheville*, however, mentioned *Parker* and is the only one decided on the basis of the state action doctrine.

FTC<sup>472</sup> held that the FTC has the power to promulgate substantive rules. Since it was unclear to the court whether Congress intended the FTC to have substantive rulemaking power, it is similarly unclear whether Congress intended such rules to be able to preempt state law.<sup>473</sup> The FTC has maintained that a violation of its substantive rules violates the FTC Act and that the rules have the force and effect of law and consequently have the capability of preempting state law under the supremacy clause.<sup>474</sup> The Court has indicated in several instances that rules of other administrative agencies can preempt state law.<sup>475</sup> Whatever the previous debate, however, Congress alleviated much of the doubt by passing the Magnuson-Moss amendments in 1975 which confirmed the FTC's substantive rulemaking authority as to unfair or deceptive practices.<sup>476</sup> The rules are enforced through the Commission's adjudicatory proceedings. The legislative history makes clear that Congress intends these rules to possess preemptive capabilities,<sup>477</sup> presumably in accord with the normal preemption doctrine principles.

The more difficult legal question is whether FTC adjudicatory activity and/or substantive rulemaking can preempt state law and/or private conduct which qualifies as "state action." Some commentators suggest that since *Parker* and its progeny were decided under the Sherman Act, the Court's reasoning does not apply to and limit the reach of the FTC Act.<sup>478</sup> A variety of rationales have been put forth to distinguish the FTC and Sherman Act situations with respect to the Commission's adjudicatory authority. For example, although the legislative history of the FTC Act (like that of the Sherman Act) failed to mention state regulation, in the FTC Act (unlike the Sherman Act) Congress authorized the Commission to determine what constituted an unfair trade practice, which includes determining whether state laws or private conduct is unfair. Enforcement under the FTC Act was entrusted to a specialized agency which acts as an arm of Congress.<sup>479</sup> The contrary argument is that a basic principle of statutory construction provides "unless Congress conveys its purpose clearly, it will not be deemed to have significantly changed the federal-state balance."<sup>480</sup> A second policy argument to infer that state action does not restrict FTC adjudication preempting capacity rests upon the fact that remedies can be entirely prospective,

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472. 482 F.2d 672, 698 (D.C. Cir. 1973), *cert. denied*, 415 U.S. 951 (1974).

473. Comment, *supra* note 253, at 310.

474. *Id.* at 305, 310; *contra id.* at 310-11.

475. *See id.* at n. 262.

476. 15 U.S.C.A. § 57(a) (Supp. 1979).

477. *See* Comment, *supra* note 253, at 311-12; STATE REGULATION REPORT, *supra* note 343, at 52 *et seq.* The preemption issue, however, is not completely resolved. Comment, *supra* note 253, at 312-13.

478. *See* Note, *The State Action Exemption and Antitrust Enforcement Under the Federal Trade Commission Act*, 89 HARV. L. REV. 715 (1976).

479. STATE REGULATION REPORT, *supra* note 343, at 45-46.

480. *United States v. Bass*, 404 U.S. 336, 349 (1971). *See* *FTC v. Bunte Bros. Inc.*, 312 U.S. 349, 354-55 (1941).

thereby avoiding subjecting states to civil liability without advance notice. Similarly, private parties acting pursuant to state law would not be penalized for obeying state law prior to the determination of its illegality.<sup>481</sup> Arguments to the contrary include the contentions that FTC enforcement would still replace state policy decisions as to the regulation of its economy and that such preemption normally will not be inferred in the absence of clear Congressional intent.<sup>482</sup> The key to *Parker* is its recognition of the right of a state to regulate, not just to be free from monetary damages.<sup>483</sup> In short, although it can be argued that the preemptive force of FTC actions pursuant to its adjudicatory authority extends even to areas covered by the state action doctrine, the absence of such legislative intent and the general rule that such intent will not be inferred lightly strongly suggest that the Commission's powers in this area are no greater under the FTC Act than under the Sherman Act.

The arguments supporting broader rulemaking preemptive capacity, however, may be stronger. A rulemaking procedure has been said to be more suitable than an adjudicative proceeding to cause preemption since it enables the Commission to hear all interested parties, not just the respondents, and to draft an industry-wide solution rather than proceeding on a case-by-case basis. Consequently, preemptive authority, so it is argued, is more likely to have been intended by Congress.<sup>484</sup> Furthermore, it can be argued from the legislative history of the Improvements Act that Congress intended the rulemaking authorized by that Act to have preemptive force even in areas otherwise qualifying as state action, thereby supplying the expression of intent which is missing in the adjudicatory situation.<sup>485</sup> A contrary argument, however, is that

while the Commission is clearly an expert arbiter of federal trade regulation policy, and although its judgments may well be superior to those of the various states, the clear implication of *Parker* is that federalism preserves the freedom of the states to supplant the national policy of unrestrained competition with state regulation, absent a clear congressional statement to the contrary. Viewed in this light, the conclusion is inescapable that the policy underlying *Parker* applies with equal vigor to the FTC Act.<sup>486</sup>

In short, the Commission's preemptive powers in areas subject to state regulation are at least as broad under the FTC Act as under the Sherman Act. Whether the Commission's cease and desist orders, remedies and rulemaking can, under the FTC Act, preempt state law or private conduct which qualifies

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481. STATE REGULATION REPORT, *supra* note 343, at 48.

482. *Id.* at 49.

483. Davidson & Butters, *supra* note 244, at 587.

484. STATE REGULATION REPORT, *supra* note 343, at 50-51.

485. *See id.* at 66-67. However, there may be limitations other than state action on the Commission's authority. *See id.* at 67-72.

486. Davidson & Butters, *supra* note 244, at 588.

as state action in the context of the Sherman Act is an unresolved issue both because of the uncertainty as to Congressional intent and because of the possibility that state action is constitutionally rooted. If the latter is true, state action would be constitutionally protected against FTC activity regardless of the ultimate determination of Congressional intent.<sup>487</sup>

Even if the state action doctrine does impose some limits on the FTC regulatory activity, the preemptive capacity of the FTC under its broad general standard and its adjudicating and rule-making powers is still very extensive. The FTC staff has indicated that, particularly in the consumer protection area, the state action doctrine limits "may not restrict the Commission very much."<sup>488</sup> Removal of the McCarran Act antitrust immunity bar to FTC insurance regulatory activity will invite direct FTC involvement. The scope of the FTC enunciated insurance regulatory interests evidences that the FTC will eagerly respond to the invitation. Armed with the sweeping legal powers to define unfair trade practices and the ability to preempt state laws and private conduct pursuant thereto, FTC activity not only will result in widespread dual regulation of insurance with the states,<sup>489</sup> but also in dominant federal regulation.<sup>490</sup> Such regulation, in the long run, may or may not be more competitively oriented than that under the evolving state insurance regulatory system.<sup>491</sup> In any event, it raises the fundamental issue of state versus federal regulation of insurance.

### 3. *The Inherent Advantages of State Insurance Regulation*

The National Commission's report focuses upon the McCarran Act as if it is solely an antitrust immunity statute. This misimpression obscures the broader and more fundamental issue of federalism. When Congress enacted the McCarran Act, it sought to resolve the allocation of governmental power and authority over insurance between the federal and state governments. Congress concluded that the public would be better served if regulatory authority over the business of insurance were vested in the states.<sup>492</sup> Repeal or substantial amendment of the McCarran Act to reduce or eliminate antitrust immunity for the business of insurance is inherently intertwined with the fundamental issue of state versus federal insurance regulation. The potential

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487. See text accompanying notes 326-343, *supra*.

488. STATE REGULATION REPORT, *supra* note 343, at 41.

489. Duality can arise from an application of the preemption doctrine which finds no preemption and from the protection of state activity by the state action doctrine.

490. The National Commission Report ignored this fundamental implication of its recommendations despite a separate opinion filed by Commissioner McClory emphasizing this very point. See NATIONAL COMMISSION REPORT, *supra* note 13, at 404-05.

491. Professor Joskow, as a member of the Economic Advisory Panel to the National Commission, expressed concerns over the prospect of the FTC becoming deeply involved in insurance ratemaking through control over insurance rate classification. Joskow, *supra* note 101, at 17. He also urged that "some way could be found to restrict the FTC's role in direct 'economic' regulation to behavior that would ordinarily be illegal under the Sherman Act. . . ." *Id.* at 19.

492. See 15 U.S.C. § 1011 (1976).



regulatory vacuum situation and the removal of the McCarran Act bar to FTC activity makes this abundantly clear. Despite this basic fact, however, the National Commission's report fails to address the merits of this issue head on but instead blithely goes forward to recommend the repeal of the antitrust immunity before further study of insurance regulation. Nevertheless, a brief review of the inherent advantages of state insurance regulation is essential to a proper evaluation of the implications of amending the McCarran Act.

The advantages of state regulation of insurance include (a) the implementation of the concept of federalism; (b) the utilization of an existing system of regulation; (c) the benefits of pluralism, experimentation and vitality; (d) governmental accountability stemming from the threat of a federal alternative; (e) keeping regulation closer to the people and (f) preserving limitations on omnipotence.

a. *Federalism.* Professor Spencer Kimball, in addressing the issue of state versus federal regulation stated that

there is importance to our whole society, altogether transcending and overriding industry interests, of some fundamental political values urging state level regulation. The very basis of our federal system is at issue. Decentralization and dispersion of political power is in itself an important value in a democratic society. Concentrations of power are bad per se, and it is irrelevant whether the concentrations are in government, in labor, or in business. In any case they are in people. For present purposes, however, I am only concerned with powerful government. Undue concentration of power in Washington is unwise from any point of view. Any problems that can be dealt with adequately at the state level *should* be handled there in preference to Washington.<sup>493</sup>

The dispersion of political and economic authority and power between state and federal governments serves the public interest. This concept of federalism has been a traditional constitutional principle rooted in sound public policy.

History of both federal and state governments has demonstrated that government cannot always be relied upon to perform in the public interest. An important guardian of such interest is the dispersion of power between the state and federal government enabling each to exercise a discipline over the other . . . . Undisciplined power tends to become unresponsive at best and corrupt at worst. Effective implementation of the concept of federalism is fundamental to the exercise of such discipline. This concept requires a dispersion in ultimate decision-making power and responsibility and not merely superimposing a federal government regulatory agency on top of that of the states.<sup>494</sup>

The inevitable shift in regulatory locus stemming from significantly repealing

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493. S. KIMBALL & H. DENENBERG, *INSURANCE, GOVERNMENT AND SOCIAL POLICY* 416 (1969).

494. Statement of the NAIC on National Health Insurance before the House Committee on Ways and Means, 1 NAIC PROCEEDINGS 696, 702 (1972).

or modifying the McCarran Act would directly contradict the fundamental concept of federalism in general and ignore the advantages inherent in state insurance regulation in particular.

b. *Existence of State Insurance Regulation.* The state insurance regulatory system not only already exists, but also has been long in place. The system utilizes over fifty offices (at least one in each state and multiple offices in several states), employs over 5100 persons with combined budgets in excess of \$100 million.<sup>495</sup>

As a general proposition, it is more effective and less expensive to improve upon and add to existing institutions than to start new ones, especially with respect to institutions, such as the state insurance regulatory mechanism, which have demonstrated a willingness and facility to evolve to meet changing conditions and public demands. Assumption of regulatory power by the federal government could sweep away much of the experience and expertise existing in state insurance departments. Such a shift would cast doubt for years as to many of the rules under which the business has been accustomed to function. From the customers' perspective, the known local points for applying citizen pressure would be removed, dispersed or obscured.

Furthermore, there is no assurance that the resulting quality of federal regulation will justify the dislocations incident to the change in locus of regulatory authority. The history of many federal agencies does not give rise to overconfidence. Few things are so unsure as predicting the full range of consequences of a major change in a complex system. Consequently, the fact that the state insurance regulatory mechanism already exists, in itself, is a powerful argument for its continuance.<sup>496</sup>

c. *Pluralism, Experimentation and Vitality.* A third set of advantages of state regulation pertains to pluralism and diversity within the system. Conditions and problems can and do differ substantially from state to state; for example, structures of the industry in a state, degree of market availability for a given line of insurance and the like. A state regulator is better able to react to local conditions than a federal regulator who must function under one set of rules applicable to all states. The state regulatory system is far more flexible in handling diverse situations.

Furthermore, the state pluralistic regulatory system

involves regulatory agencies of limited size. It seems clear that the economies of scale taper off as size increases beyond some point while problems of bureaucracy become proportionately worse.

The field of government regulation is imperfectly understood. This lends support to utilizing a number of agencies rather than just one. Such a system is conducive to experimentation and will confine the impact of an

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495. Statement of the NAIC on the Federal Insurance Act of 1977, S. 1710, I NAIC PROCEEDINGS 830, 850 (1978); INSURANCE INDUSTRY COMMITTEE OF OHIO, STATE INSURANCE DEPARTMENT STATISTICAL DATA 1 (1979).

496. Statement of the NAIC on S. 1710, *supra* note 495, at 850.

experiment until it has been tested. The dispersion of decisional responsibility and power tends to restrict the gravity of the impact of mistakes or miscalculation to a limited area and segment of the population. On the other hand, a dramatic and effective innovation by a particular state is apt to be adopted elsewhere after a period of time and testing.<sup>497</sup>

Federal regulation by its very nature cannot permit this type of experimentation except at the risk of bad regulation resulting in nationwide adverse consequences.

Pluralism also affords a more fertile environment for greater vitality than does a single national agency. The scope for top creative leadership is greater in a system having several tops. The work of one or more vigorous agencies is contagious. It tends to be imitated, competed with and used as a standard in other states. The problem of keeping regulatory agencies, whether state or federal, imbued with the sense of vitality, capable of self-renewal and change is now and, certainly in the future, a graver public concern than an occasional awkwardness of a multi-state regulatory system.<sup>498</sup>

d. *Accountability Through the Threat of a Federal Alternative.* An extremely important, unique and infrequently recognized advantage of state regulation is the threat of a national alternative which always hangs over it. State insurance regulatory agencies are subject to review, investigation and embarrassment by Congress, which has the power to abolish the system if it so chooses. Such Congressional oversight stimulates the states to a better performance.

On the other hand, if a national regulatory agency becomes involved, it is unlikely that it would be as skeptically watched or credibly menaced. Congressional oversight of federal regulatory agencies has not been demonstratively better than state legislative oversight of state agencies. In other words, Congressional oversight of federal agencies has yielded fewer public benefits and more adverse side effects than Congressional oversight of state insurance regulation.<sup>499</sup>

It has been said concerning independent federal regulatory commissions that: "[w]hile commissions exercise broad discretion in regulatory matters, the devices and institutions available for maintaining their political accountability are unsatisfactory. Consequently, their wide scope of discretion is not controlled by firm lines of responsibility."<sup>500</sup> In contrast, state insurance commissioners are appointed by the governor (who is directly accountable to the

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497. *Id.* Unlike the Brooke bill dual charter approach (S. 1710) which may result in interregulator competition for laxity in order to attract insurers to their system, competition between state regulators improves regulation since insurers cannot opt for a different regulation and still remain in the state.

498. *Id.*

499. *Id.*

500. M. BERNSTEIN, *REGULATING BUSINESS BY INDEPENDENT COMMISSION* 295 (1955).

electorate) or are elected directly by the electorate in eleven states,<sup>501</sup> and are thus directly accountable. Furthermore, if the McCarran Act is left intact, the system of accountability of state agencies to Congress would be retained so long as federal assumption of insurance regulatory authority remains solely as a threat rather than becoming a reality.

e. *Regulation Closer to the People.* Although cliché, it is nevertheless true that the states are closer to the people than is the federal government. An individual member of the public possesses more readily available means to seek redress, to obtain answers to his inquiries and to apply pressure at the state level. For example, an insurance commissioner and his higher level staff are more accessible than comparable members of the President's cabinet or chairmen of independent agencies, such as the Board of Governors of the Federal Reserve System or the FTC. Furthermore, there are over fifty state insurance commissioners, as contrasted to one cabinet secretary (or federal agency chairman), to whom resort can be had. When ultimate responsibility is vested in Washington, the response tends to be more sluggish and less attuned to the individual's needs and demands.<sup>502</sup>

f. *Limitations on Omnipotence.* A large federal agency vested with comprehensive authority and responsibility to regulate the insurance industry would wield substantial power over this nation's economy. This is particularly true since Congress, to a greater degree than most state legislatures, tends to establish broad standards and delegate wide discretionary power to federal regulatory agencies.<sup>503</sup> Except for sporadic Congressional oversight, the exercise of regulatory power by federal agencies, within broad parameters, remains virtually unchecked. At least under the state regulatory system, an insurer can opt out of doing business in a state. It cannot opt out of the entire nation.<sup>504</sup>

Furthermore, if the federal regulatory function is vested in the same agency responsible for providing federal insurance and reinsurance, the power of the agency becomes awesome.<sup>505</sup> On the one hand, if the federal agency

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501. The insurance commissioner is elected in Delaware, Florida, Georgia, Kansas, Louisiana, Mississippi, Montana, North Carolina, North Dakota, Oklahoma and Washington. COUNCIL OF STATE GOVERNMENTS, *THE BOOK OF THE STATES 1978-1979*, at 126-27 (1978).

502. Statement of the NAIC on S. 1710, *supra* note 495, at 851.

503. For further discussion, see Hanson, *supra* note 22, at 621.

504. [T]he business has always feared the imbalanced or fundamentally hostile, or politically demagogic commissioner. Again, the risk that the business might be exposed to one or a few of this type among fifty is overwhelmingly different from the risk that one such may achieve a position of total power for even a brief period. Address by Richard S.L. Roddis, INSURANCE BROKERS SOCIETY OF NORTH CALIFORNIA, *THE GRASS IS ALWAYS GREENER—REFLECTIONS ON STATE VERSUS FEDERAL REGULATION* at 15 (June 14, 1966).

505. Such a prospect is far from being inconceivable. Under the dual chartering approach contained in the Brooke bill, the newly created federal regulatory agency would also assume control of the federal insurance (crime and flood) and reinsurance (riot) programs currently under the Federal Insurance Administrator, S. 1710, 95th Cong., 1st Sess. § 101(f)(1) (1977). More recently, Congressman LaFalce introduced a bill which would create a federal insurance commission which would not only establish a new federal regulatory authority but also would

seeks to expand its insurance operations, it could, either intentionally or inadvertently, regulate the insurance industry into ineffective performance so as to create the necessary legislative climate for such a change. On the other hand, the ever-present threat of a federal insurance alternative to the private industry would afford the federal regulator with awesome regulatory leverage. In short, a federal agency possessing either sole or predominant regulatory authority over an entire industry on a nationwide basis would assume attributes of a virtually omnipotent overseer, even more so if such regulator also possessed the power to provide federal insurance coverage. Such a federal agency runs counter to the emerging consensus of the appropriateness of the reduction of, or at least the imposition of limitations on, the federal regulatory role in our society.

g. *Perceived Disadvantages of State Insurance Regulation.* Typically, three arguments are advanced in support of insurance regulation at the federal rather than the state level: uniformity, quality of personnel and the weakest link theory.

(1) *Uniformity.* Lack of uniformity in regulation is often cited as a substantial weakness of regulation on a by-state basis. Several observations cast doubt on this conclusion.

First, uniformity is a questionable goal. The insurance industry has numerous logical ties to the geographic, economic and political environment in each of the states. For example, risk analysis, coverage and rating are related to local conditions and demands. Marketing methods, company size, structure and orientation have evolved from and exist within state and regional circumstances. Although in some matters uniformity is helpful since several insurers conduct their operations on a nationwide basis, this is not the case in many other areas. Diversity is a positive factor when local conditions vary or experimentation is desirable. Lack of uniformity is inherent in a large, complex nationwide economy. Uniformity *per se* is a highly overrated virtue.<sup>506</sup>

Second, even if uniformity were desirable, federal regulation would not necessarily produce it.<sup>507</sup> Uniformity, or the lack thereof, is more a function of how the laws are administered than of the literal statutory language. In regulating a complex, diverse and continental industry, a federal agency is confronted with a basic dilemma. At one extreme, emphasis on the interest of maintaining uniformity would result in centralized controls in Washington. Those who deal with the system, whether members of the public or of the industry, would have to wend their way through a maze to the focus of decisional power, if they can get there at all. Flexibility is lost, rigidity sets in and varied consumer needs go unmet. On the other hand, in the interest of adapting to regional and local differences, decentralization of responsibil-

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transfer the control of such federal insurance programs to this new regulatory authority. H.R. 1866, § 501, 96th Cong., 1st Sess. (1979).

506. S. KIMBALL & H. DENENBERG, *supra* note 493, at 421.

507. *See id.* at 420.



ity may be emphasized at the sacrifice of the "ideal of uniformity."<sup>508</sup> When this occurs, a major alleged advantage of federal regulation evaporates.

Third, there is little likelihood that federal insurance regulation would be concentrated in one agency capable of producing the uniformity envisioned by the federal proponents. Today, even with the McCarran Act bar to federal regulation, a multitude of federal agencies have sought to either directly affect insurance regulation or have worked around its periphery. In addition to the Department of Justice and the FTC, these agencies include, for example, the Department of Transportation (automobile no fault insurance, oil pollution insurance, high occupancy vehicle insurance); the Securities and Exchange Commission (variable life insurance, participating life insurance, certain annuities, insurance company loss reserves and insolvencies); the Department of Commerce (products liability, municipal self fire insurance); the Department of Health, Education and Welfare (national health insurance, medical malpractice); the Federal Emergency Management Administration (assumption of the Department of Housing and Urban Development's [HUD] responsibilities as to federal flood and crime insurance and federal riot reinsurance, with the corresponding oversight over state FAIR plans providing property coverage residual market mechanisms); Office of Consumer Affairs; the HUD and Civil Rights Commission interest in insurance practices alleged to violate existing or future protection of civil rights and others.<sup>509</sup> If the McCarran Act limitation on federal regulation of the business of insurance were removed, a host of existing, as well as new, agencies would become directly involved in insurance regulation. This, in turn, belies any notion that federal regulation possesses the capacity to achieve uniformity even if uniformity were a desirable objective.

Fourth, in situations where substantial uniformity is needed, such uniformity has often been achieved in insurance regulation through inter-state cooperation (for example, the annual statement, examinations and the development and enactment of various model laws and regulations). The existence of the National Association of Insurance Commissioners has proven to be a valuable facility in achieving cooperation as an impetus for action and as a means to achieve uniformity in appropriate situations.

In brief, if a high degree of uniformity is an appropriate goal, a federal regulatory agency can only achieve it at the sacrifice of more important values. However, the capacity of the federal government to achieve uniformity is highly questionable due to the competing and conflicting interests of

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508. Basil J. Mezines, Executive Director of the FTC, stated that in response to critics of that organization's performance the FTC underwent an internal reorganization. Among other things, the FTC's regional offices were given greater autonomy and authority and that the increase in complaint actions in 1971 was due in part to the efforts of these offices under their expanded authority. Mezines, *FTC Official Views Industry Self Regulation*, 25 PERSONAL FINANCE LAW QUARTERLY REPORT 123 (1971).

509. See Intragency Council on Accident Compensation and Insurance, Partial Inventory of Current Federal Accident Compensation and Insurance Initiatives and Programs (Jan. 31, 1979) (unpublished memorandum).

multiple federal agencies. On the other hand, uniformity to the extent required can be and has been achieved through the state insurance regulatory system.

(2) *Quality of Regulatory Personnel.* Some argue that a federal regulatory agency can attract better talent. Professor Kimball responded to this point by noting:

[i]t is less clear that it is true when one compares the national civil service with the civil service in the largest and most populous states. Increasingly, able people prefer to stay where they grow up rather than migrate to the banks of the Potomac to live in the much less relaxed atmosphere of the nation's capital. The always dubious attractions of Washington look less glamorous now than recently. Moreover, the quality advantage is only marginally true. One needs only to compare the quality of the best and the worst national agencies to realize that there is no clear and sharp contrast in quality between national and state regulation.

Again, whatever the situation may be now, there is no assurance that over the long pull the attractions of the national civil service will ensure quality regulation there. The attraction of the metropolis in the first half of this century has become less today.<sup>510</sup>

There is an absence of evidence that this trend has reversed.

Furthermore, in recent years, in our inflationary economy, which is the basis of many insurance regulatory problems, insurance has become a more visible and political issue. Consequently, persons with the power to appoint insurance regulatory officials (like governors) are under greater pressure to attract a higher level of competence. Thus, the quality of personnel argument is not only subject to serious doubt now, but it is even more dubious in the future.

(3) *The Weakest Link Theory.* An oft expressed notion is that state regulation should stand or fall according to the quality of regulation of the weakest state. Such an argument has been described as "pure fallacy."<sup>511</sup> Insurers writing a significant amount of business are licensed to do business in several states, each of which exercises regulatory control. As a result, if the regulation in several states is effective, virtually all of the business is subject thereto. In practical effect, the stronger states do much to make up for those few who may exercise weaker regulation. Furthermore, there exists regulatory competition between states which provides leverage for better quality regulation, a kind of leverage absent in Washington.<sup>512</sup>

State insurance regulation is not an end in itself. Its justification rests upon the protection afforded the insurance-consuming public consistent with other goals of public policy. The state insurance regulatory mechanism is not perfect. However, the history of federal regulatory agencies reveals a lack of

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510. S. KIMBALL & H. DENENBERG, *supra* note 493, at 418.

511. *Id.* at 419.

512. *Id.* at 419-20.

perfection at that level as well. The case for state regulation is a strong one. The system already exists. It is capable of experimentation, change and vitality. It tends to be more responsive since it is closer to the people and because of the ever present threat of federal alternative. But even more important, state regulation is more consistent with the fundamental precepts of a viable federal form of government which disperses regulatory power. On the merits, the creation of an institutional insurance regulatory structure at the federal level is not only unnecessary, but it also poses adverse and long range consequences not only for the insurance industry but more importantly for the public interest its purpose is to serve.

## V. SUMMARY AND CONCLUSION

For the most part, the conduct of the insurance industry and state regulation thereof have evolved separately from the development of the federal antitrust laws for differing reasons at different times. First, both insurance and insurance regulation predated the enactment of antitrust legislation by several decades. Second, until 1944, insurance was not considered to be commerce and therefore was beyond the scope of Congressional power and antitrust law jurisdiction. Third, after the Supreme Court brought the business of insurance within the embrace of interstate commerce, Congress established by enacting the McCarran Act the public policy that insurance should continue to be regulated at the state level and that for the most part, the antitrust laws should not apply to the business of insurance to the extent the business is regulated by the states. Thus, with the exception of some peripheral areas<sup>513</sup> and some efforts to narrow the scope of the McCarran antitrust immunity through judicial interpretation,<sup>514</sup> the basic insurance mechanism and its regulation have functioned outside the antitrust orbit.

The latter half of the 1970's witnessed increasing industry, government and public interest in deregulating various segments of this nation's economy. Deregulation would be coupled with an expanded reliance upon competition, subject to antitrust oversight, as the primary regulator of our economic markets. The impact of these winds of change on the insurance industry were first comprehensively explored in the 1974 NAIC staff study on competition in the property and liability insurance business.<sup>515</sup> Three years later, the Department of Justice report<sup>516</sup> openly advocated bringing the insurance industry within the embrace of the antitrust laws. The 1979 National Commission report<sup>517</sup> recommended repeal of the McCarran Act antitrust immunity for insurance. The resolution of whether and, if so, how this should be done ultimately rests with Congress. But whatever the specific approach consid-

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513. MONITORING COMPETITION, *supra* note 12, at 217-48.

514. See generally cases cited note 12 *supra*.

515. MONITORING COMPETITION, *supra* note 12.

516. DJ REPORT, *supra* note 14, at 341.

517. NATIONAL COMMISSION REPORT, *supra* note 13, at 225.

ered, the fundamental issue is whether the public interest will better be served by a broad application of the federal antitrust laws to the business of insurance.

The United States Supreme Court has declared that the antitrust laws are premised on the concept that "competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress. . . ."<sup>518</sup> This, in turn, emphasizes that a fundamental goal of national policy is *not* the application of the federal antitrust laws *per se*, but rather the fundamental national policy is the preservation and fostering of competition. Consequently, those advocating substituting primary reliance on federal antitrust law for the long-standing national policy of primary reliance on state insurance regulation have the threshold burden of establishing that the antitrust laws will substantially improve competition in the business of insurance. If this threshold burden is met, the antitrust proponents then have the burden of demonstrating that the benefits of improved competition outweigh the adverse implications for the insurance-consuming public in the insurance regulatory context. Not only have the proponents failed to meet both burdens, but also the opposite conclusions are warranted.

(1) General Application of Antitrust Law Would Not Substantially Enhance Competition.

Several reasons support this conclusion, including the following:

(a) The business of insurance is highly competitive under the current state regulatory system. The combination of the competitive structure and performance of the insurance industry, the manner in which various state insurance rating laws function, including increasing sanctioning of and emphasis on competition, and the state insurance regulatory activity through the NAIC to preserve and foster competition, evidence the competitiveness of the insurance markets. As a result, the application of the federal antitrust laws to the business of insurance, at maximum, would have only minimal impact on furthering competition.

(b) Antitrust law possesses substantial defects as to both substantive standards and manner of enforcement. Consequently, the application of the antitrust laws often makes little economic sense and often negatively affects competition.

(c) The state insurance regulatory mechanism possesses inherent advantages both in substantive standards and enforcement with respect to preserving and fostering competition in the insurance business. These include the flexibility to draw upon those antitrust concepts appropriate to insurance competition and avoid those which are not. To the extent the repeal of the McCarran antitrust immunity results in either a preemption or a deterrence

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518. *Northern Pacific Ry. Co. v. United States*, 356 U.S. 1, 4 (1958).

of such state activity, an inferior pro-competitive program is substituted for a stronger one. Furthermore, amendment of the McCarran Act may induce or compel the states to revert to more rigid anti-competitive regulatory approaches (for example, state rate setting or mandatory bureau rates, state management of data collection, wide-ranging mandatory residual market mechanisms or even state insurance) so as to invoke the state action doctrine.

In short, the implementation of the public policy objective of fostering and preserving competition in the business of insurance is not significantly dependent on nor well served by the general application of the antitrust laws, since competition is already quite vigorous, antitrust law is severely flawed and application of antitrust law would adversely effect implementation of competitive policy at the potentially more effective state level. Thus, the burden of meeting the threshold criterion (that antitrust laws, applied to the insurance industry, would substantially improve competition in the insurance business) has not been met.

(2) General Application of Antitrust Law Would Adversely Effect the Insurance Buying Public.

Several reasons support this conclusion, including the following:

(a) **Lessened Benefits Accruing from Competition.** The general application of antitrust law to insurance with the corresponding limitations on state insurance regulatory activity—whether due to express Congressional declaration, the interplay of state action and preemption doctrines or state policy decisions to let antitrust law assume primary responsibility—would lessen the likelihood that the full benefits of competition would accrue to the insurance-consuming public.

(b) **Adverse Impact on Coordinated Activity.** Several types of coordinated activity among insurers, which are important not only to the functioning of the insurance mechanism, but also to achieving important insurance regulatory objectives, would be severely limited or precluded by general application of the antitrust laws. First, application of the antitrust laws would detract from the industry's overall ability to compile and disseminate data relevant to establishing rates on useful and economic bases. In turn, this would lessen the ability of many insurers to develop appropriate rates, which is essential to fair treatment of policyholders and availability of coverage. This would also undermine two conditions of effective competition, the existence of numerous competitors and the ease of entry into the market. Second, voluntary joint underwriting and pooling arrangements would be jeopardized under antitrust law. The combination of insurers' uncertainty as to the legal parameters within which they could safely operate on a coordinated basis, the severe penalties if they are wrong in their judgment and the practical and costly problem of arriving at an informed judgment promises substantial shrinking of insurer willingness to make available needed coverage which cannot be prudently provided by a single insurer. This, in turn, could severely harm businesses, or even bring them to a standstill, because of the inability



to purchase needed protection. Third, state insurance regulation attempts to assure the availability of essential coverage to persons unable to obtain it in the voluntary market by establishing residual market mechanisms such as assigned risk plans (automobile insurance), FAIR plans (property insurance), joint underwriting associations (medical malpractice) and others. Any time insurers coordinate their activities as to providing coverage or establishing rates, their activities would be vulnerable to antitrust liability. To the extent these plans are mandated, the state action doctrine might afford some protection, but the extent of the protection is subject to some doubt. Fourth, application of the antitrust laws could reduce the flexibility of the states in addressing the fundamental problem of assuring reliability of the insurance institution in meeting its obligations by limiting the use of the guaranty fund association mechanism.

(c) *Adverse Impact on Spreading the Risk of Loss.* Unrestrained competition under the antitrust laws could cause the insurance institution to fail in performing one of its most fundamental functions (spreading the risk of loss) by precluding the state insurance regulator from monitoring and balancing the constant tension between insurer efforts to compete for profitable business (through refining risk classifications and careful underwriting), the need to spread the risk of loss and the political reaction to the public's notion of fairness.

(d) *Adverse Impact on Coordinating Competing Public Policies.* Even if it were assumed that general application of antitrust law to insurance would enhance competition, total reliance on competition is not in the public interest. There are several other major public policy objectives, such as availability, affordability, reliability and fairness which compete not only with each other but also with the objective of competition. Achieving a reasonable balance requires a rational means of coordination. Litigation to apply unclear and often defective antitrust standards by private as well as government parties on a case-by-case basis is an inadequate system to reconcile the appropriate role of antitrust principles and regulation. The suggestion of carving out specific narrow exceptions to the removal of antitrust immunity offers, at best, a poor response to the need. In contrast, the state regulatory system, with its increasing promotion of and reliance upon competition, within the balanced framework of other insurance regulatory goals, offers the most promising means to achieve such rational coordination on behalf of the insurance-consuming public.

(e) *Adverse Impact as to State Versus Federal Regulation of Insurance.* Whether intentionally or inadvertently, pushing efforts to repeal the McCarran antitrust immunity ultimately promises the establishment of a substantial federal insurance regulatory role due to the creation of a potential insurance rate regulatory vacuum and the removal of the bar to dominant and even preemptive FTC regulatory activity. The substitution of federal for state insurance regulation not only deprives the insurance-consuming public of the advantages inherent in state regulation of insurance, but it also undermines

the avowed pro-competition objective underlying the amendment of the McCarran Act.

Congress can elect from a variety of alternatives to amend the McCarran Act to apply the antitrust laws to the business of insurance. The implications of three alternatives have been explored in this Article. The federal standards for open competition rating laws possess several significant advantages over repealing the McCarran antitrust immunity and coupling repeal with specific limitations on state regulatory authority. These advantages accrue in the areas of promoting competition, achieving other insurance regulatory goals and maintaining insurance regulation at the state level. However, if reliance on competition is the primary answer to exercising control over rates and other aspects of insurance markets, the states have it within their power to implement this approach without antitrust law and to do so in a manner that dovetails with other aspects of insurance regulation. Through NAIC and individual state activity, there is movement in this direction. Furthermore, if primary reliance on competition does not work for a given line of insurance in a given state, the state rating laws provide machinery to obtain the exercise of appropriate control without the upheaval of changing the whole system.

In conclusion, if the McCarran Act is amended to apply the federal antitrust laws to the business of insurance, with the corresponding explicit statutory or preemptive doctrine limitations on state regulatory authority, the competitive objectives of national policy will be dealt a serious blow. Additionally, the ability of the insurance mechanism and its regulation to serve the needs of the insurance-consuming public will be seriously impaired.

