STATE REGULATION OF "THE BUSINESS OF INSURANCE"—McCARRAN'S SHATTERED SHIELD

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I. INTRODUCTION

At the present time it is virtually an article of faith in insurance circles that the regulation of insurance has been, and must continue to be, by the states and for the states. It was not always so. In post Civil War America and through the first decade of the twentieth century, the leading insurance executives of the day were in favor of federalization of insurance supervision, federalization of insurance taxation and federal chartering of insurance companies. At that time all concerned were conscious of the fact, now largely forgotten, that the case of *Paul v. Virginia*[1] was a test case instituted by insurance interests in a then unsuccessful attempt to effect a judicial declaration that the Commerce Clause prohibited state regulation and taxation of the business of insurance, while permitting exclusively federal regulation and taxation of the business of insurance.[2]

Prominent among the advocates of continued state regulation was the redoubtable Louis D. Brandeis, in 1905 an active member of the Boston Bar. Then, as ever, Brandeis championed, not non-regulation, but stern and effective regulation by the regulatory authority enjoying practical vitality, adequate financing, and uncommon concern for the welfare of policyholders and the public. In the first decade of this century, however, the locus of effective regulation of insurance was in the states. Thus the scathing Brandeis indictment of a pending bill to federalize insurance regulation:

> The sole effect of a Federal law would be . . . to free the companies from the careful scrutiny of the commissioners of some of the States. It seeks to rob the State even of the right to protect its own citizens from the legalized robbery to which present insurance measures subject the citizens, for by the terms of the bill a Federal license would secure the right to do business within the borders of the State, regardless of the State prohibitions, free from the State's protective regulations.[3]

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1 75 U.S. (8 Wall.) 168 (1869).

2 Johnson, *The Direct and Indirect Effect of Federal Programs and Regulations on Insurance Operations and Markets*, in INSURANCE, GOVERNMENT AND SOCIAL POLICY: STUDIES IN INSURANCE REGULATION 365 (S. Kimball and H. Denenberg ed. 1969).

3 Quoted in n.17 of the dissenting opinion of Justice Jackson, United States v. South-Eastern Underwriters Ass'n., 322 U.S. 533 (1944).

Self-annointed reformers of the current era may be actuated by a sincere belief that sinister forces are at work. In this view, we should be persuaded that the insurance industry's near unanimous current advocacy of continued state regulation of insurance stems largely from a desire to continue relatively innocuous and fragmented state regulation of what is now perceived to be a national enterprise.

Sincere and sympathetic advocates of a continued role for state regulation of insurance, moved more by the motives of a Brandeis, may nevertheless well question at the current time whether state regulation of insurance is either effective or desirable. At the least they must be cognizant of the fact that a new generation of Supreme Court decisions interpreting the McCarran Act effects a division of regulatory labor between the states and various federal agencies which is probably unlike the division thought to have been effected by the Act and the Congress which gave it birth. Where candor reigns supreme, even the draftsmen of a modern general business corporation act concede that state regulation has its distinct limits:

> The modern corporation's business is frequently national or international in scope; its state of incorporation is largely incidental. Recognizing this fact, and seeking to attract corporations to establish their domiciles within their borders, most states in recent decades have been increasingly flexible and permissive in revising their corporation laws.
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> Pursuing this policy perhaps further than any other state, the Commission believes it is following sound public policy for New Jersey. It is clear that the major protections to investors, creditors, employees, customers, and the general public have come, and must continue to come, from Federal legislation and not from state corporation acts. Whether it be anti-trust or securities regulation, wage and hour or social security laws; bankruptcy or corporate reorganization statutes; or even controls over personnel practices provided in the Internal Revenue Code, or controls over the methods of marketing and advertising of products, provided both by statutes and administrative agencies, the means of assuring such protections must be provided by the Federal Government. Any attempt to provide such regulations in the public interest legislation would only drive corporations out of the state to more hospitable jurisdictions.[4]

This Article will suggest a division of authority to tax and duty to regulate, which, while not entirely consistent with received tradition in the insurance industry, is believed to be not at all inconsistent with the leading cases, and which is thought to be mandated by the more recent and better considered Supreme Court decisions bearing on the meaning of the words of art "the business of insurance" as used in the McCarran Act. It is, it will be suggesetd, the securities law cases impinging on insurance which presage a shifting emphasis in interpretation. This developing interpretation could shatter the shield with which the McCarran Act sought to envelop state taxation and regulation of insurance companies.

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[4] REPORT OF THE NEW JERSEY CORPORATION LAW REVISION COMMISSION ix (1968).

II. State Taxation and State Regulation

A. *The Rejection of Dual Regulation*

It is paradoxical and perhaps unfortunate that earlier generations should have seen the choice between state and federal regulation of insurance as clear-cut. The choice need not have been, one may now suggest, a choice between mutually exclusive alternatives. The duality of existing federal-state banking regulation was not seized upon as a model for duality of insurance regulation. This may have been unfortunate. It is further paradoxical, and, to this generation of commentators, perverse, that *Paul v. Virginia* should have been interpreted as meaning that the power to tax the activities of insurance companies was inseparable from the power to effect meaningful commercial regulation thereof. Much belatedly, and to most observers' surprise (which surprise was unjustified), the decision of the United States Supreme Court in *United States v. South-Eastern Underwriters Association*[5] makes it reasonably clear that decisions such as *Paul v. Virginia* need not have been given any broader import than sustaining the proposition that the separate and sovereign states of the federal union were free to tax the operations of insurance companies even though their activities were in commerce and were subject to general federal commercial statutory regulation, to wit, the Sherman Antitrust Act. The authority of the separate states to tax insurance companies could have been sustained, consistent with acceptance of the proposition that the federal government was free to charter insurance companies in some instances, and regulate particular aspects of insurance company activity in all instances.

B. *The Tax Impact of the Commerce Clause*

1. *State Power to Tax Interstate Commerce*

At least since *Minnesota v. Blasius*,[6] it has been clear that decisions dealing with congressional regulation of interstate commerce present different problems than are presented by the state tax cases under the Commerce Clause. The cases routinely upholding federal regulatory power do not at all negate state taxing power. Neither does a holding that a state may tax aspects of interstate commerce at all imply that the state has paramount power, or any power, to regulate, at least in the presence of exercised federal authority to regulate. The leading authority on state taxation takes great pains to emphasize that, in the context of commerce clause limitations on state taxation, "the Court narrowed the area of what constitutes an interstate business or transaction."[7] This development coincided with the demonstrable tendency of the Court, in the context of validation of congressional regulation of commerce, to grossly expand the area which was regarded as interstate commerce.

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[5] 322 U.S. 533 (1944).
[6] 290 U.S. 1 (1933).
[7] J. Hellerstein, State and Local Taxation 166 (3d ed. 1969).

A fair summary of the traditional wisdom respecting the imposition of state taxes on interstate business would highlight the following points:

(1) Burden or not, interstate commerce must ordinarily pay its fair share of state taxes.[8]
(2) A state may not lay an excise tax on the "privilege" of engaging in interstate commerce, but may (if the tax is fairly apportioned) tax income derived from exercise of that "privilege."[9]
(3) A state may not directly regulate interstate commerce by means of taxation.[10]
(4) A state may not levy a tax which provides a direct advantage to local business.[11]
(5) A state may not levy a tax which discriminates directly against interstate commerce—leaving similar local commerce untaxed or undertaxed—by subjecting interstate commerce to the burden of multiple taxation.[12]

An overriding qualification should be noted. A fair apportionment will make virtually any tax sought to be imposed by a state one which (if minimal due process nexus requirements are met) is not an impermissible direct or multiple tax in spite of a certain quantum of burden on interstate commerce.

The unsettled questions are, broadly speaking, two: (1) Whether a state, choosing to burden local intrastate commerce significantly, may, in the same measure, burden interstate commerce, and (2) whether the forbidden discriminatory multiple state taxation exists when there is potential for many separate states to levy cumulatively discriminatory taxes, or whether only the actual existence of a discriminatory tax burden will trigger Commerce Clause invalidity.

2. *The Stone-Rutledge Multiple Taxation Doctrine*

It is significant that the architects of the presently prevailing understanding and rationalization of state taxation of interstate commerce are Justices Stone and Rutledge, the authors, respectively, of the dissenting opinion in *South-Eastern Underwriters*, and the majority opinion in *Prudential Insurance Co. v. Benjamin*.[13] It was Mr. Justice Stone who swept away the traditional view that under the Commerce Clause interstate commerce may not be taxed at all. He simply did not share the view, held with some passion by Frankfurter, that the Commerce Clause created an area of trade free of state taxation. Continued deference to the Frankfurter position, on rare occasions, made it prudent, as Hellerstein notes, to affirm (for tax purposes) that the peculiar area of exclusively interstate commerce was very small indeed.[14] Frankfurter,

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[8] Western Live Stock v. Bureau of Revenue, 303 U.S. 250 (1938).
[9] McGoldrick v. Berwind-White Coal Mining Co., 309 U.S. 33, 48 (1940); Joseph v. Carter & Weekes Stevedoring Co., 330 U.S. 422, 442 (1947).
[10] Freeman v. Hewit, 329 U.S. 249 (1946).
[11] Voight v. Wright, 141 U.S. 62 (1891).
[12] Gwin, White & Prince v. Henneford, 305 U.S. 434 (1939).
[13] 328 U.S. 408 (1946). *See* text at note 22, *infra*.
[14] *Supra* note 7.

in a rare, late, and only momentary triumph over the Stone-Rutledge view, passionately declaimed that a state cannot "justify what amounts to a levy upon the very process of commerce across State lines by pointing to a similar hobble on its local trade."[15] Stone and Rutledge created, rather, the multiple taxation doctrine, under which state taxes would be invalidated on Commerce Clause grounds only if the Court thought that they subjected interstate commerce to a risk of multiple taxation not borne by local commerce. The result was that interstate businesses were no longer immune from taxation merely because the levy was imposed on interstate commerce or on the receipts from such commerce.

The Stone-Rutledge mainstream doctrine emphasized that potentially multiple, *i.e.*, cumulative, state taxes would offend against Commerce Clause limitations, while Mr. Justice Black, the author of the Court's decision in *South-Eastern Underwriters*, has consistently espoused the view that the Commerce Clause would be offended only when and if potentially multiple and cumulative state taxes were actually imposed.[16] In broadest terms, Black always has argued for extreme freedom for states to tax interstate business as they may wish, subject to correction only if it were demonstrated that actual multiple burdens have been imposed.

3. *Carte Blanche for State Taxation?*

Very recently Mr. Justice Black's view may have prevailed—only to risk Congressional reversal. Long before the Commerce Clause was routinely used to attack multiple discriminatory state taxation of interstate commerce, the 14th amendment Privilege and Immunities Clause was used to void a Nevada tax burdening movement between states.[17] *Crandall v. Nevada*,[18] surprisingly, was held, last April 19, not to bar imposition of non-discriminatory airport boarding taxes.[19] This is fair apportionment with a vengeance. So long as this view, or even a near approximation of it, prevails generally, there is no reason to fear that characterization of the insurance business as business in interstate commerce deprives the states of any power to tax.

C. *State Licensing of Insurance Companies and Insurance Agents*

The prominent case of *Robertson v. California*[20] is often miscited for the proposition that the McCarran Act holds that States may regulate any aspect of insurance agent and insurance company licensing, however discriminatory against the foreign insurance company, or however directly burdensome of interstate commerce. In point of fact, McCarran Act issues are pointedly not

15 Freeman v. Hewit, 329 U.S. 249, 254 (1946).
16 J. Hellerstein, State and Local Taxation 169-70 (3d ed. 1969).
17 Crandall v. Nevada, 73 U.S. (6 Wall.) 35 (1867).
18 *Id.*
19 Evansville-Vanderburgh Airport Authority Dist. v. Delta Airlines, Inc., 405 U.S. 707 (1972).
20 328 U.S. 440 (1946).

made the basis of decision in the *Robertson* case. The opinion, by Mr. Justice Rutledge, concludes as follows:

> Our determination has been made without specific reliance upon the McCarran Act for two reasons. One is that this was not necessary. The other arises from the facts that this is a criminal proceeding, the appellant's acts held to violate the California statutes were committed in August following rendition of the *South-Eastern* decision in June of 1944, and the McCarran Act was not approved until March 9, 1945. . . . And to avoid any semblance of retroactive effect in a criminal matter, we have refrained from explicit reliance upon the Act in this case. It does not detract from our decision on other grounds that the McCarran Act, if applied, would dictate the same result.[21]

It is indeed indicated that the McCarran Act, had it been applied, which it was not, would have dictated the same result; but the precise holding of the *Robertson* case was that a state, where no contrary congressional regulation of the matter has been undertaken, and where no federal pre-emption is indicated, has the power, in the exercise of traditional police powers, to protect her own residents by prohibiting inadequately secured insurance companies, even to the point of excluding a business being carried on in interstate commerce. The decision of the Court, in the concurrently delivered decision in *Prudential Ins. Co. v. Benjamin*,[22] is characterized by its author as a "not unexpected sequel to *U.S. v. South-Eastern Underwriters Assn.*"; but the case has risen to the top because the teaching of *South-Eastern Underwriters* with respect to the existence of state power to tax insurance companies has been misapprehended. The South Carolina premium income tax, imposed alone on the South Carolina premium income of foreign insurers, is accorded the review it received only because it was a manifestly discriminatory levy. Were the South Carolina tax on premium income applied alike to domestic and foreign insurers it is doubtful that the case would have merited any extended review or discussion.

Mere citation of myriad authority in the Commerce Clause tax field would have sufficed to indicate that, of course, states may tax interstate commerce on a non-discriminatory basis. As it is, the Supreme Court of the United States upholds the judgment of the Supreme Court of South Carolina sustaining the premium income tax on a basis other than the one relied upon below. The South Carolina Supreme Court had held that the continued exaction of the tax was not in violation of the Commerce Clause, presumably on the spurious reasoning that domestic insurers pay other taxes, *e.g.*, property taxes, which foreign insurers do not in fact have occasion to pay if they have no property in South Carolina. Mr. Justice Rutledge's opinion categorically declines to deal with this question (perhaps because the proper result was too easily predictable—and not consistent with the McCarran Act). Instead, the ground of decision in

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21 *Id.* at 461-62.
22 328 U.S. 408 (1946).

the Supreme Court is made to be the proposition that Congress, having plenary power to regulate interstate commerce, including insurance, may choose to adopt, and did adopt, a policy of permitting states to impose, peculiarly in respect of insurance, manifestly discriminatory taxes. The state's power to tax insurance companies was not significantly impinged upon by the decision in *South-Eastern Underwriters.* The net effect of the McCarran Act was the very peculiar validation of what might otherwise have been an unconstitutionally discriminatory levy.

III. McCarran Act Problems

The significant problems which the McCarran Act has engendered are not, one-time protestations to the contrary notwithstanding, to be found in the area of taxation. The significant problems are two in number. First: questions relating to the power of the federal government to enforce the antitrust laws in respect of insurance. Second: questions relating to the applicability of otherwise general federal regulation in respect of such matters as mail fraud and securities regulation to the business which insurance companies do. It was with the first of these questions which the *South-Eastern* decision dealt. The other set of questions was not directly confronted by the draftsmen of the McCarran Act—and the answers which the courts have increasingly given in this area, it is suggested, have done much to undermine the whole edifice, to call into question even some propositions which we once thought settled in favor of exclusive state regulation, and against federal intervention.

A. *Antitrust*

1. *The South-Eastern Underwriters Decision*

The beginning sentence of the *South-Eastern Underwriters* opinion, it is suggested, is more significant than it may seem at first blush. "For seventy-five years this court has held, whenever the question has been presented, that the Commerce Clause of the Constitution does not deprive the individual states of power to regulate and tax specific activities of foreign insurance companies which sell policies within their territories."[23]

Paul v. Virginia, it must seem in retrospect, said far more than it needed to say when it was indicated that the issuance of a contract of insurance was not a transaction of commerce and that an insurance policy was not an article of commerce. The misstep in *Paul v. Virginia,* it is suggested, was to equate power to regulate with power to tax, and to accept the proposition that, as between the nation and the state, only one authority could both tax and regulate.

It was not fully recognized that the *South-Eastern Underwriters* decision potentially destroyed the monolithic approach to insurance regulation. A careful reading of Mr. Justice Black's opinion for the Court would suggest, with the wisdom of hindsight, that the power of the federal establishment was not un-

[23] 322 U.S. 533, 534 (1944).

duly asserted, and that the holding was simply and only that Congress had undoubted authority to regulate the insurance business in all its aspects, if Congress chose to do so, and, more specifically, that in enacting the Sherman Anti-trust Act, purporting to regulate all of commerce (save to the extent that Congress itself should later specifically create exemptions from its overall application) the interstate aspects of the business of insurance companies had been regulated also. Very carefully left untouched were the powers of state to tax and to regulate in exercise of a continuing and undoubted state police power. Though this author would take the view that the dissenting opinion of Mr. Chief Justice Stone in *South-Eastern Underwriters*[24] was unduly alarmist on the extent to which application of the Sherman Act would invalidate existing state legislation, the Stone dissent is remarkably seminal in its recognition of a potential dichotomy in insurance regulation. Stone's dissent, little noted, lays the groundwork for a distinction between "the business of insurance" and certain other rather extensive activities of insurance companies which could be subjected to federal regulation at the will of Congress (possibly even without overruling the precise holding of *Paul v. Virginia*).

Mr. Chief Justice Stone's distinction may perhaps be analogized to state law regulation of conveyancing in real property law. It would today not be doubted that—though the Congress of the United States may shape in practice real estate transactions to the character it desires, by its exercise of an undoubted power to regulate certain financial aspects of real estate transactions—the law of real property, of titles, of conveyancing, is still mainly private state law, rather than statutory law enacted by the Congress of the United States. Mr. Chief Justice Stone, it is suggested, may have had in mind a similar distinction between "the business of insurance" and the business of insurance companies. That is, the business of insurance itself was the act of forming a contract of insurance. That which Mr. Chief Justice Stone justifiably sought to do was to preserve as the exclusive province of state law the whole body of contract law relating to the formation, validation and interpretation of contracts of insurance. So much was, and remains, state law, and would, only at very grave peril to the body politic and the corpus juris, be obliterated and made nugatory by a declaration no more profound than that insurance was commerce between the states. The Stone dissent in *South-Eastern Underwriters* does seem to suggest, on careful reading, that numerous activities of insurance companies collateral to, and following upon execution of a contract of insurance, are in interstate commerce and could be appropriately regulated by federal statutes directed to the questions thereby presented.

2. *Rate Making*

This analysis is, concededly, not fully dispositive of the precise question before the Court in *South-Eastern Underwriters*. Granting that a multitude,

[24] *Id.* at 562 (dissenting opinion).

perhaps most, of the activities of insurers could be regarded in any event as subject to existing or possible federal regulation, we would yet have no satisfactory formula for determining whether or not the activities of rate bureaus fell within the interdiction of the Sherman Act's Section 1 prohibiting "contracts, combinations or conspiracies in restraint of trade." The Stone dissent makes no persuasive argument for inclusion of collusive rate making in the purely contractual non-commerce aspects of insurance company activity.

Perhaps nearly all of the then-sitting justices could have agreed that on the record presented by the case, the collusive activities of the South-Eastern Underwriters Association could not have passed muster under the Sherman Act, while agreeing that the precise act of forming an insurance contract remains non-commerce and subject to state law exclusively. The assurances of this cannot be great, and are moot in any event.

Granting, arguendo, that the case for concerted collection of insurance statistics is overwhelming, and that the Sherman Act, if read to prohibit that activity, would have to be countermanded by federal statutory enactment—near unanimous agreement can probably nevertheless be obtained for the proposition that predatory collusion in execution of insurance company functions deserves no protection and is to receive none. The McCarran Act, itself, let us recall, expressly leaves subject to the Sherman Act, "any agreement to boycott, coerce, or intimidate"[25] and the House Committee Report makes it reasonably clear that it was not contemplated that states could or should make compulsory membership in any rating bureau or the charging of uniform rates.[26]

3. *Advertising—The National Casualty and Travelers Health Decisions*

The draftsmen of the New Jersey Business Corporation Act could candidly admit in 1968 that state control over interstate marketing and advertising, presumably including interstate marketing and advertising of insurance, is a task which is frankly beyond the ken of state regulation.[27] Section 2(b) of the McCarran Act provides, however, that 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. In the late 1950's the F.T.C. undertook to regulate what it believed to be the misleading advertising propagated by mail-order insurers. The problem is still with us, honest observers will admit. The F.T.C., in *F.T.C. v. National Casualty Company*,[28] was dealt with harshly by the Supreme Court. Not only did the Court indicate that the F.T.C. could not regulate advertising if the state to which the advertising was directed was regulating such advertising; it declared

[25] McCarran Act § 3(b), 15 U.S.C. § 1013(b) (1970).
[26] H.R. REP. No. 143, 79th Cong., 1st Sess. (1945).
[27] *Supra* note 3.
[28] 357 U.S. 560 (1958).

also that the mere existence of a state statutory prohibition on false advertising, if not mere pretense, was regulation within the meaning of Section 2(b) of the McCarran Act. Though this decision seemingly gave *carte blanche* to state regulators (or non-regulators) of insurance advertising, the opinion is subject to some limitations, which should be noted for the entree which they gave to subsequent qualification.

The advertising schemes under review in *National Casualty* involved the activity of agents working in the states to which advertising was directed. It was asserted and assumed, with citation to *Robertson v. California*, that the state in which the advertising was received, had, under traditional police powers, very adequate means to regulate, *i.e.*, prohibit, such advertising within its boundaries. The precise act of dissemination of such advertising was taken to be a wholly intrastate act subject to regulation by the authorities of the states whose citizens were the recipients thereof. The presence of soliciting agents in the several object states was cruicial to the decision. The *National Casualty* decision was a short, *per curiam* opinion strongly supported by the vast majority of state Attorney Generals, which contained no careful consideration—indeed, no consideration at all—of the definition of "the business of insurance." The sword cuts both ways. The decision may be taken to indicate that the Supreme Court was here approving of a very broad conception of the meaning of "the business of insurance" as being very nearly synonymous with anything and everything which an insurance company might take a mind to do.

Less than two years later, in *F.T.C. v. Travelers Health Association,*[29] the Supreme Court, in a longer, more carefully considered opinion, which had to reckon with *S.E.C. v. Variable Annuity Life Insurance Company*[30] as a precedent, held (over the vehement protest of the dissenters that the Supreme Court was involved, first in *VALIC*, now in the instant case, in the progressive emasculation of the McCarran Act) that Section 2(b) of the McCarran Act ousted the F.T.C. from jurisdiction over misleading mail order insurance company advertising only in the circumstance in which the regulatory authorities of the state to which the advertising was directed in fact engaged in regulation thereof. The mere fact that the insurance company's domiciliary state purported to, or did in fact, regulate the company's advertising availed nothing. Now, attaching great significance to a state's inability to effect extraterritorial application of its laws, the majority opinion in *Travelers Health* observed that in the *National Casualty* case the court expressed no view as to "the intent of Congress with regard to interstate insurance practices which the States cannot for constitutional reasons *regulate effectively*."[31] This decision begins to give rise to the nagging suspicion that, subsequent to *VALIC* and *Travelers Health*, the Court does indeed have effective regulation, as opposed to mere legislation, in mind.

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29 362 U.S. 293 (1960).
30 359 U.S. 65 (1959).
31 F.T.C. v. National Cas. Co., 357 U.S. 560, 564 (1958) (emphasis added).

4. *Mergers*

Subsequent decisions seem to sustain this reading of *Travelers Health* in the area of challenged insurance company mergers, the traditional baliwick of the Antitrust Division.[32] Subsequent decisions in the area of rate making, a traditional area of state activity, seem still to remain faithful to *National Casualty*,[33] including the dubious proposition that mere state legislation is enough to repel the writ of antitrust.

It may be suggested that it is only history, as embodied in *Robertson*, with its emphasis on state police power, which sustains state regulation of advertising and rate making; but that history dictates another approach to the question of jurisdiction over insurance company mergers, in either the antitrust or securities law arenas. However much the antitrust-merger question is in doubt (and it is in doubt, precisely because the McCarran Act did address itself expressly to the relationship between antitrust law and state regulation of insurance), the securities law-merger question is no longer in doubt. A clear and resounding answer, sharply denigrating the role, and reducing the meaning, of the McCarran Act has been given.

B. *Securities Regulation—The National Securities and VALIC Decisions*

1. *The Securities Act and The Insurance Industry*

At the present, however, it is not the dichotomy between contracting and other activities, nor yet the dichotomy between predatory and non-predatory concerted behavior which engages our attention. It is instead a distinction which was in the *South-Eastern Underwriters* opinion only in embryo. The new and presently existing dichotomy, laid bare by the *National Securities*[34] case, is the distinction between "the business of insurance" and the insurance business—the whole scope of activities conducted by insurance companies. "The business of insurance" is not the insurance business. The McCarran Act, contrary to widespread impression, never did insulate state law regulation of insurance company activities not included within the narrow scope of "the business of insurance" from exisiting federal statutory control. It required, however, the aggressive activity of the United States Securities and Exchange Commission to make this clear.

The S.E.C., and members of its staff, were early, persistent, and successful advocates of the proposition that at least certain very important aspects of the

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[32] United States v. Chicago Title & Trust Co., 242 F. Supp. 56 (N.D. Ill. 1965); Maryland Cas. Co. v. American Gen. Ins. Co., 232 F. Supp. 620 (D.C. Cir. 1964).

[33] Ohio AFL-CIO v. Insurance Rating Bd., 451 F.2d 1178 (6th Cir. 1971); North Little Rock Transp. Co. v. Casualty Reciprocal Exch., 181 F.2d 174 (8th Cir. 1950); Lynch v. Insurance Rating Bd., Civil No. 5205 (M.D. Tenn. 1968); Allstate Ins. Co. v. Lanier, 242 F. Supp. 73 (E.D.N.C. 1965), *aff'd*, 361 F.2d 870 (4th Cir. 1966), *cert. denied*, 385 U.S. 930 (1966); California League of Independent Ins. Producers v. Aetna Cas. Ins. Co., 175 F. Supp. 857 (N.D. Cal. 1959).

[34] S.E.C. v. National Sec., Inc., 393 U.S. 453 (1969).

business of insurance companies took place in interstate commerce, and were not exempt from exisiting federal regulatory statutes which did not particularly specify that the regulation was, in McCarran Act terms, regulation of "the business of insurance."[35] The focus of the legislative hearings leading to enactment of the McCarran Act was, of course, applicability of the Sherman Act to collusive rate making, and the impact of an expanded constitutional definition of commerce on state privilege to tax interstate business. The relation between the McCarran Act, on the one hand, and the federal antitrust laws, on the other, has been well explored. It is the vital and expanding federal securities law, however, which has undermined substantial portions of McCarran Act lore and legend, and threatens to send nearly the entire edifice crashing into the S.E.C. sea.

2. *The Structure of the Securities Act of 1933*

This is best understood against an analysis of the Securities Act of 1933, which reveals its all-encompassing character. Both within the original contemplation of the draftsmen, and the course of expansive interpretation, the Securities Act's definition of "security" has produced some results which may be surprising to the insurance bar. The mere fact that something is primarily a chattel, or primarily realty, or primarily a franchise, has not prevented characterization of exceedingly diverse properties, interests, instruments, and expectations as "securities" within the meaning of the Securities Act.[36] As this relates to the typical stock life insurance company, particularly, it can logically be asserted that such diverse interests and instruments created by an insurance company as common equity shares, short-term commercial paper, promissory notes, insurance contracts, variable annuities, fixed annuities, and variable life insurance policies are all "securities."

It was never intended that the registration requirements of Section 5 of the Securities Act[37] should apply to certain of these securities. But it is reasonably clear that only the most ardent proponent of state regulation of insurance would seriously advocate that the McCarran Act restoration of state-law hegemony over "the business of insurance" would result, *pro tanto*, in an exemption of life insurance equity securities from the perfectly generalized and neutral registration and prospectus delivery requirements of Section 5 of the Securities Act. It would seem that it has been tacitly agreed from the beginning that the relevant federal regulatory agency, notwithstanding the *Paul v. Virginia* decision, and, further, notwithstanding the McCarran Act, always did

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35 *See, e.g.*, Timberg, *Insurance and Interstate Commerce*, 50 YALE L.J. 959 (1941).

36 S.E.C. v. W.J. Howey Co., 328 U.S. 293 (1946) (orange groves); S.E.C. v. Glenn W. Turner Enterprises, Inc., CCH Fed. Sec. L. Rep. 93,606 (D. Ore. Aug. 30, 1972) (pyramid sales plans); Johnson v. Espey, CCH Fed. Sec. L. Rep. 93,376 (D. N.Y. Feb. 14, 1972) (discretionary commodity trading accounts); S.E.C. v. Lake Havasu Estates, CCH Fed. Sec. L. Rep. 93,348 (D. Minn. Jan. 11, 1972) (land purchase contracts); Chaney v. United States Title Ins. Co., 292 F. Supp. 376 (D. Utah 1968) (uniform land purchase contract).

37 15 U.S.C. § 77e (1964).

have jurisdiction to enforce the disclosure requirements of the 1933 Act as against insurance companies issuing equity securities. To the extent that insurance companies registered their issues of equity securities with the S.E.C. between 1933 and the date of the *South-Eastern Underwriters* decision, it was tacitly recognized that the presumed constitutional exclusion of insurance from commerce extended only to certain limited activities of insurance companies, and by no means to the marketing of equity securities in interstate commerce. The Congress, notwithstanding the mandate of *Paul v. Virginia*, could and did apply to an aspect of the business of insurance companies the generalized doctrine embodied in the 1933 Act—that all issuers of securities, including insurance companies, should comply with this federal regulatory statute. The *South-Eastern Underwriters* decision, accordingly, it is suggested, added nothing to the scope and reach of S.E.C. control of the business of insurance companies.

Did enactment of the McCarran Act change this? Only on the thesis that the McCarran Act was to be taken exceedingly literally wherein it provided that: "No Act of Congress shall be construed to invalidate, impair or supercede any law enacted by any state for the purpose of regulating the business of insurance . . . unless such act specifically relates to the business of insurance,"[38] could it be thought that the McCarran Act had implicitly repealed or modified the Securities Act of 1933. If, as commonly thought, "the business of insurance" is co-extensive with the insurance business, it would, however, literally seem that Section 2(b) of the McCarran Act would have suspended the applicability of the Securities Act to offerings of the equity or debt securities of insurance companies, to say nothing of suspending applicability of the Securities Act to an insurance company's issuance of fixed or variable annuities or variable life insurance products.

In this regard the curious negative implication of Section 3(a)(8) of the Securities Act[39] becomes doubly important. If it had been assumed that insurance policies and annuity contracts of the sort known and written in 1933 were not securities, the proper course for the draftsmen of Section 3(a) to have followed would have been simply to leave them unmentioned. Specification of insurance policies and annuity contracts in Section 3(a)(8) as a type of security for which an exemption from the registration and prospectus delivery requirements of Section 5 was available causes the logical inference that, being securities exempt from the registration provisions, insurance policies and annuities contracts were, nevertheless, like the several types of securities enumerated in other exemptive subsections of Section 3(a), subject to the very nearly all-pervasive antifraud provisions of Sections 12(2)[40] and 17.[41] The argument that exemption from registration constitutes exemption from the other pro-

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38 McCarran Act § 2(b), 15 U.S.C. § 1012(b) (1964).
39 15 U.S.C. § 77c(a)(8) (1964).
40 15 U.S.C. § 77*l*(2) (1964).
41 15 U.S.C. § 77q (1964).

visions of the act, *i.e.*, exemption from the antifraud provisions, will not wash. The draftsmen of the 1933 Act well knew that securities enumerated in the various exemptive subsections of Section 3(a) were subject to the antifraud provisions, as is evidenced by the further curious exemption, contained in Section 3(a)(2),[42] of government and bank securities from the otherwise applicable express civil liability for fraudulent sale created by Section 12(2). From this civil liability bank securities were specifically and uniquely exempted. Insurance company securities were not. A similar analysis of the relevant provisions of the Securities Exhange Act of 1934 would ordinarily make the selling of insurance policies and fixed annuity contracts subject to the Draconian remedies subsequently provided by judicial law-making in the cause of creating implied remedies under Section 10(b) of the Exchange Act,[43] and the notorious Rule 10b-5[44] promulgated thereunder.

The position of a leading commentator on the statute has been that the unfortunate Section 3(a)(8) was simply a work of supererogation.[45] The inclusion of insurance policies and annuity contracts in Section 3(a)(8) of the 1933 Act may raise the inference that, by so mentioning some aspects of the business of insurance companies in the Securities Act, the Act falls within the category, in McCarran Act Section 2(b) terms, of an Act of Congress which "specifically relates to the business of insurance." The insurance industry would thus be twice cursed by a supererogatory phrase. The excess of caution manifest in its creation would have, on this argument, the dual effect of subjecting the marketing of life insurance to the antifraud provisions of the securities law, and equally important, the removal of some large portion of the business of insurance companies from McCarran Act insulation. For historic life insurance products, the Loss supererogation thesis seems most plausible. The supererogation thesis would seemingly establish also, however, that the Securities Act of 1933 is not an Act of Congress which "specifically relates to the business of insurance." Apart from Section 3(a)(8), which we can agree to treat as a superfluity which isn't there, the Securities Act contains no substantial reference to insurance.

It is thus possible logically to assert, in consequence, that the McCarran Act does properly insulate the business of insurance companies from application and enforcement of the Securities Act. At least to the extent that state blue sky laws contain within their general provisions a requirement relating to disclosure or providing for prior administrative approval of issuance or sale of equity or debt securities by insurance companies acting within their boundaries, such state blue sky laws would literally fall within the insulating language of Section 2(b) of the McCarran Act, for, manifestly, we are dealing with a law of some state enacted for the purpose of, or at least with the effect of, regulat-

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42 15 U.S.C. § 77c(a)(2) (1964).
43 15 U.S.C. § 78j(b) (1964).
44 17 C.F.R. § 240.10b-5 (1970).
45 1 Loss, Securities Regulation 497 (2d ed. 1961).

ing some aspect of an insurance company's business, *viz.*, the issuance of equity and debt securities.

In the knowledge of the author, however, no responsible insurance industry spokesman has espoused the view that existence or enactment of a state blue sky law applicable to the issuance or sale of an insurance company's orthodox equity or debt securities, effects, by operation of McCarran Act Section 2(b), an ousting of the federal Securities Act from applicability in the premises. The insurance fraternity appears, rather, to have vaguely understood, or at least acquiesced in the proposition, that "the business of insurance," in McCarran Act terms, never did reach so far as to encompass all aspects of the insurance business.

The explanation for the applicability of the Securities Act to insurance company issuance of securities is not that the states have failed to regulate such aspects of an insurance company's business (whether effectively or only nominally), but, rather, that the McCarran Act simply does not operate in the premises, *because an insurance company's issuance of securities*, however central to its existence, *is no part of "the business of insurance."*

3. *The VALIC Decision*

This is, of course, a virtual concession that "the business of insurance" as used in the McCarran Act is a word of art, a reference to something far narrower than the totality of an insurance company's business, a reference to some more isolated and identifiable relation between insurer and insured. Such was the position taken by the Supreme Court of the United States on every occasion when the relation of the securities laws to the business of insurance companies came before it. As Loss puts it, "The Supreme Court's ruling [in *VALIC*] that variable annuities were securities within the 1933 Act is necessarily a holding that the McCarran-Ferguson Act does not bar the application of that statute to the issuance of securities of insurance companies."[46]

Loss does not comment, however, on the possible rationale for the holding. Is it that the McCarran Act has not insulated this activity of insurance companies from federal control because the states' regulation, though existent on paper, is insufficiently effective? Were this so the federal courts, *National Casualty* to the contrary notwithstanding, would be engaged in testing the effectiveness of all types of state regulation of insurance—and they would be applying a very high benchmark, for by no means is state enforcement of their blue sky laws a mere sham or pretense, or even an only episodically energized activity.

The rationale of *VALIC*, as it relates to the McCarran Act, is more plausibly that "the business of insurance" has reference only to relations between the insurer and the insured—and possibly that it has reference only to that core con-

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[46] 4 Loss, Securities Regulation 2516 (2d ed. 1961).

tractual relation which was not, under *Paul v. Virginia*, in interstate commerce, and which still may not be.

The *VALIC* case is, it is suggested, the seminal case defining the Court's current position with respect to the scope and meaning of "the business of insurance" within the meaning of Section 2(b) of the McCarran Act. It remained for the *National Securities* case to sharply and cleanly declare that "the business of insurance" was by no means congruent with the business which insurance companies do, and to articulate the now controlling rationale that the McCarran Act comes into play only where the crux of the matter is the relationship between insurer and insured—between the insurance company and the policyholder as creditor and beneficiary of fixed value contracts.

Some fairly surprising suggestions with respect to the meaning of the *VALIC* case are here offered, with the challenge to the reader to examine closely the text of the decision to determine to one's own satisfaction how revolutionary the case may be. A "security" within the meaning of the various statutes administered in part by the S.E.C., we have seen,[47] can encompass some very surprising animals, yes animals.[48] More to the point, for insurance company executives, is the fact that it has recently been declared that the statutory term "evidence of indebtedness"[49] (which is one species of "security") "is not limited to a promissory note or other simple acknowledgment of a debt owing and is held to include all contractual obligations to pay in the future for consideration presently received."[50]

This may be new ground, to be explored gingerly. It may also resurrect an old question about the inclusion of ordinary life insurance policies and fixed annuity contracts within the meaning of "security." The *VALIC* opinion contains no suggestion that even traditional fixed annuity contracts or ordinary life insurance policies are excluded from the definition of "security." They are, by operation of Section 3(a)(8) of the Securities Act of 1933, specifically exempted from the registration and prospectus delivery requirements of Section 5—but that of itself imports no exemption whatsoever from the ubiquitous antifraud provisions, which are enforceable by the public prosecutor and the private litigant, in criminal courts, in civil suits, and in equity.

As for the application of the McCarran Act? Consider: The Variable Annuity Life Insurance Company was presumably a bona fide life insurance company, subject to state insurance regulation, presumably the beneficiary of that language in Section 2(b) of the McCarran Act which declares that "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

47 *Supra* note 36.
48 Continental Marketing Corp. v. S.E.C., 387 F.2d 466 (10th Cir. 1967).
49 Securities Act of 1933 § 2(1), 15 U.S.C. § 77b(1) (1964). *See also* Securities Exchange Act of 1934 § 3(a)(10), 15 U.S.C. § 78c(a)(10) (1964).
50 United States v. Austin, BNA Sec. Reg. & L. Rep. No. 162 (10th Cir. June 26, 1972).

. . . unless such Act specifically relates to the business of insurance."[51] It is difficult to believe that the Securities Act of 1933 could be said to "specifically relate to the business of insurance." It is equally difficult to believe that state-granted permission to market variable annuity contracts was not being "invalidated, impaired, or superseded," on an ordinary view of things, by the S.E.C.'s requirement that variable annuities, as a species of security not precisely comprehended within the Section 3(a)(8) exemption from registration requirements, must be registered before being offered to the public.

There is an easy answer to the conundrum, and *VALIC* implicitly gives it. No issuer of securities, including insurance companies, is ever exempt from the registration requirements of the Securities Act except on that Act's own terms, assuming potential availability of some exemption from registration therein enumerated. The McCarran Act is of no assistance for the reason that when an insurance company issues securities it is engaged in the business of issuing securities, not in "the business of insurance." "The business of insurance" has a narrow meaning, not a broad one. It includes very little. It certainly does not include the whole of the business which an insurance company might do. It may not even include advertising. In terms of the application of "federal corporation law" (created by the secutities laws), it does not include mergers, consolidations, or other organic changes, whether or not the selfsame merger or other organic change was the subject of state insurance regulation. But to recite this is to tell the story of *National Securities* rather than the history of *VALIC*.

Mr. Justice Brennan's concurring opinion in *VALIC* is the more careful and thoughtful analysis. It is also far reaching in its implications. After reciting the truism that the emphasis in federal securities regulation under the Securities Act is really quite permissive in theory, imposing a mere truth-telling requirement, Brennan continues:

> The emphasis is on disclosure; the philosophy of the Act is that full disclosure of the details of the enterprise in which the investor is to put his money should be made so that he can intelligently appraise the risks involved.
>
> The regulation of life insurance and annuities by the States proceeded, and still proceeds, on entirely different principles. It seems as paternalistic as the Securities Act of 1933 was keyed to free, informed choice. Prescribed contract clauses are ordained legislatively or administratively. Solvency and the adequacy of reserves to meet the company's obligations are supervised by the establishment of permissible categories of investments and through official examination . . . .
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> In fact, one of the basic premises of state regulation would appear to be that . . . the investor . . . *not* become a direct sharer in the company's investment experience; that his investment in the policy or contract be sufficiently protected to prevent this. But . . . where the coin of the company's obligation is not money . . . the his-

[51] *Supra* note 38.

> toric functions of state insurance regulation become meaningless . . . beyond controlling corporate solvency and the adequacy of reserves, and maintaining observance of the legal list of investments, the state plans of regulation do not go in regulating investment policy.[52]

What is it that state regulation of insurance is meant to do? It is suggested that Mr. Justice Brennan's enumeration is very nearly exhaustive. State regulators prescribe contract clauses, test for and seek to maintain insurers' solvency, seek to guarantee the adequacy of reserves (in large measure by requiring that premiums be high enough, and that debilitating competition in this area *not* occur), specify the permissible categories of insurance company investments, and effect periodic official examinations.

Perforce, without being clearly labeled as such, this is a description of the boundaries of "the business of insurance." "The business of insurance" does not comprehend the business of issuing securities—even when a regulated insurance company's entire business is the issuance of variable annuities, *i.e.*, securities. The argument can prove too much. If ordinary life insurance policies and fixed annuities are securities, have not the securities laws swallowed up the whole of state insurance regulation? It would now commonly be conceded that the whole Section 3(a)(8) exemption is a work of excess caution, a work of supererogation. It would seem to be recognized today that the traditional life insurance policies and fixed annuities known to the trade in 1933 are properly exempt from application of any portion of the Securities Exchange Act of 1933 for a reason better than the one given in the text of the Act or its legislative history. They are not securities, were not meant to be included, and should have been specifically exempted, not from the requirements of Section 5 by a Section 3(a) exemption, but, rather, from the Section 2(1) definition of security by express negation in that definitional section. Both variable annuities and variable life products present different, close, and complex problems, for which we have, at best, some tentative ground rules, an examination of which is beyond the scope of this Article.

The opinion of the Court by Mr. Justice Douglas in *VALIC* either betrays a momentary lapse in articulation of the structure of the Securities Act (an unlikely supposition) or gives a possible suggestion that he, for the Court, is prepared to make very decisive inroads in the *National Casualty* rule that mere legislation is regulation enough. He says:

> Respondents are regulated under the insurance laws of the District of Columbia and several other States. It is argued that that fact brings into play the provisions of the McCarran-Ferguson Act. . . .
>
> While the term "security" as defined in the Securities Act is broad enough to include any "annuity" contract, and the term "investment company" as defined in the Investment Company Act would embrace an "insurance company," the scheme of the exemptions lifts *pro tanto* the requirements of those two Federal Acts to

[52] S.E.C. v. Variable Annuity Life Ins. Co., 359 U.S. 65, 77-78 (1959).

> the extent that respondents are actually regulated by the States as insurance companies, *if indeed they are such*. The question common to the exemption provisions of the Securities Act and the Investment Company Act and to § 2(b) of the McCarran-Ferguson Act is whether respondents are issuing contracts of insurance.[53]

If by "scheme of exemptions" Mr. Justice Douglas means only the Securities Act and Investment Company Act exemptions, a slight misstatement follows. Exemption from registration under the Securities Act does not lift the antifraud requirements *pro tanto*, or at all, and it has never been suggested or believed, even after this opinion, that it does. If, however, Mr. Justice Douglas had in mind the "scheme of exemptions" including Section 2(b) of the McCarran Act, a plausible, though strained, interpretation emerges. If the issuer is an insurance company (which is doubted), and if that insurance company is *actually regulated* (in respect of the whole scope of its relations with purchasers of its variable annuities, including state law disclosure and registration requirements which substantially duplicate the administrative protection afforded the investor by the existence and activity of the S.E.C.), and if the investor has the benefit of state-law civil recovery provisions which substantially duplicate the express civil remedy provisions of Sections 11 and 12(1) and 12(2) of the Securities Act of 1933, and if state law substantially duplicates the oversight, and imposes the constraints on management which the Investment Company Act imposes on the managers of pooled equity capital, then, we could grant, the "scheme of exemptions" lifts *pro tanto* the requirements of those two Federal Acts. They don't, and we can't. Is that the end? May Mr. Justice Douglas be suggesting that he, for the Court, is here declaring that the *National Casualty* equation of legislation with regulation is no longer good? To obtain McCarran Act exemption from application of federal antitrust law, must we now have *actual* regulation?

Lower federal courts have had occasion, episodically, to confront a purported McCarran Act exemption from the Securities Act frontally. In *S.E.C. v. American Founders Life Insurance Company*[54] the court expressly declared, the precise issue having been raised, that the offer and sale of insurance company stock was not "the business of insurance" within the scope of the McCarran Act. When raised with particularity, and faced, the federal courts have consistently rejected the proposition that "the business of insurance" is to have any broad meaning at all.

4. *The National Securities Decision*

The decision which laid this entire matter to rest, at least as it relates to the application of the tremendously expansive federal securities laws to insurance company corporate finance is the decision of the Supreme Court of the United States in *S.E.C. v. National Securities, Inc.*[55] This decision, reversing the 9th

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[53] *Id.* at 67-68.
[54] Civil No. 6021 (D. Colo. May 7, 1958).
[55] 393 U.S. 453 (1969).

Circuit Court of Appeals[56] on the question of the impact of the McCarran Act, categorically gives us our new guideline. "The business of insurance" is in no event broader than those aspects of the business of insurance companies which focus on the relation between insurer and insured.

Different tests may conceivably characterize the quality of an Act of Congress which can break through the McCarran Act protective barrier and a law enacted by a state creating such protective barrier. The former must be one which "specifically relates to the business of insurance." The latter must be one which is "enacted . . . for the purpose of regulating the business of insurance." The *National Securities* case gives more guidance on the latter than the former.

National Securities is not a case which focuses primarily on the question whether or not the application of the pre-existing Securities Act with reference to insurance can be deemed specific. It focuses on the question whether an Arizona insurance regulatory statute purportedly inclusive of considerations of shareholder welfare has been invalidated, impaired or superseded by a federal statute.

Only by a distinctly non-literal reading of Section 2(b) of the McCarran Act can the Court's result be reached. The Arizona statute does undoubtedly regulate the merger aspects of the business of insurance companies, and does so in terms of both policyholder and shareholder welfare. It specifically directs that mergers of insurance companies shall not be approved unless non-prejudicial, in the eyes of Arizona authorities, to shareholders of a stock life insurance company.[57] If the same standards be applied here as have been applied in testing whether or not rate bureau regulation by a state amounted to regulation of the business of insurance by a state, the answer would have to be given that this Arizona statute regulates something about the business of these insurance companies, and that an Act of Congress, by the decision in *National Securities*, has been permitted to invalidate, impair or supersede the same.

It is suggested, however, that the crux of the matter is not whether the Securities Act specifically relates to the business of insurance, and can thus, consistent with Section 2(b) of the McCarran Act, "invalidate, impair, or supersede" a state statute regulating insurance, but, rather, whether any aspects of the relation between insurance company and shareholder are comprehended within "the business of insurance." It is suggested that the reasonable reading of this case is that insurance company relations with shareholders, and questions of insurance company corporate finance, reorganization, combination, merger, and in growing measure, fiduciary responsibility, are simply not comprehended within the meaning of "the business of insurance."

5. *State Insurance Regulators as Surrogate Enforcers of Federal Securities Law*

In its comprehensive report, the Special Study anticipated by six years the

[56] S.E.C. v. National Sec., Inc., 387 F.2d 25 (9th Cir. 1967).
[57] ARIZ. REV. STAT. § 20-731 (Supp. 1972).

Supreme Court's rationale and decision in the *National Securities* case, and extended that rationale to include a recommendation,[58] subsequently adopted with material modification,[59] that insurance companies should not effectively be exempt from the provisions of Sections 13, 14, and 16 of the Exchange Act once the Securities Acts Amendments of 1964 made Exchange Act registration mandatory for all sizeable issuers regardless whether their securities were traded on exchanges or over-the-counter. More exactly, in response to intensive industry lobbying, insurance companies were technically exempted from coverage of Exchange Act Sections 13, 14, and 16, but only on condition that states would subject their domiciliary insurance companies to a regimen of reporting, proxy regulation, and insider liability for short-swing trading which substantially duplicated, as a matter of state law, the demands and burdens which otherwise would have been imposed by the Securities Acts Amendments of 1964.[60]

6. *Federal Supremacy—Despite McCarran*

It was not seriously suggested, to the knowledge of the author, that the McCarran Act, automatically and of its own force, would make a generalized application of Exchange Act strictures to OTC-traded issuers inapplicable to insurance companies. The precise question with which we deal could probably not have arisen in litigation centered on the Securities Acts Amendments of 1964, given that that legislation did deal specifically with insurance companies and thus breached the McCarran Act protective wall by the originally contemplated permissible means.

One point is worth making however, and recalling repeatedly. The McCarran Act does not reverse the *South-Eastern Underwriters* decision. Now that insurance is interstate commerce, the Congress can usurp state prerogatives relating to regulation of insurance at any time, and can do it while leaving the McCarran Act intact, by simply reciting that the regulatory legislation in question does deal with commerce in general—and with insurance. A perpetually efficacious charter for state rule the McCarran Act is not—by its own terms. Wherever the S.E.C. and its law have impinged on insurance companies the battle has been joined: usually the S.E.C. has won,[61] occasionally it has compromised; but never has the now shattered shield bearing the McCarran crest served to protect an expansive meaning for "the business of insurance." The Report of the Special Study properly understood that the *VALIC* decision of 1957 had already laid to rest whatever apprehension one might have had that

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58 H.R. Doc. No. 85, 88th Cong., 1st Sess. 40 (1963).

59 Securities Exchange Act of 1934, § 12(g)(2)(G), 15 U.S.C. § 78*l*(g)(2)(G) (Supp. V, 1970) *amending* Securities Exchange Act of 1934, § 12(g), 15 U.S.C. § 78*l* (1964).

60 5 Loss, Securities Regulation 2741-60 (2d ed. 1961).

61 S.E.C. v. United Benefit Life Ins. Co., 387 U.S. 202 (1967); S.E.C. v. Variable Annuity Life Ins. Co., 359 U.S. 65 (1959); S.E.C. v. American Founders Life Ins. Co., Civil No. 6021 (D. Colo. May 7, 1958).

the McCarran Act effected insulation of insurance companies from the regulatory provisions of the federal securities law.[62]

The conclusion—the overall teaching—of the *VALIC* and *National Securities* decisions is clear. The McCarran Act presents no obstacle whatsoever to the application of existing federal statutes to any aspect of the business of insurance companies other than the relation between insurer and insured. A suggested extrapolation from that conclusion, which remains yet to be explored in any detail in litigated cases, is that the phrase "the business of insurance" in Section 2(b) of the McCarran Act extends insulative protection from generally applicable federal law to nothing more than the core relationship of insured to insurer, the pure contract relation which the Stone dissent in *South-Eastern Underwriters* insisted was not commerce among the states. The net effect of the two decades of the reign of the McCarran Act has been to return us very nearly to the position which the Stone dissent urged upon us initially—a recognition that the contract law of insurance was and should properly remain state law. Once the fear of loss of state revenue from taxation of insurance companies was laid to rest we could inquire at leisure into the question of the proper and pragmatic division of regulatory labor between the nation and the states.

McCarran's writ, we can now assert, runs no further than to the insurer-insured relationship. But this aspect of the *National Securities* case is not necessarily the most important thing in the decision. Overshadowing in importance the interpretation of the McCarran Act is the Court's first-time-ever interpretation of S.E.C. Rule 10b-5. For here it was determined that a corporate merger, even when that merger is not cognizable as involving a sale of securities within the meaning of the Securities Act of 1933 (because of application of S.E.C. Rule 133, the so-called "no-sale" rule),[63] constitutes in itself a "sale" of securities within the contemplation of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder.

This result was not surprising to securities lawyers, but the very fact that it was decided, when Mr. Justice Harlan, concurring in part and dissenting in part, was more than mildly irritated that it had been taken up at all, suggests a need for analysis. Harlan concurred heartily in the Court's reading of the McCarran Act, but would have gone no further.[64] Was the Court's second holding, that a merger constitutes a Rule 10b-5 sale of securities, necessary to decision of the controversy?

One can imagine a situation in which the S.E.C.'s attempt to enjoin a not yet consummated merger would be merely prophylactic, as the S.E.C.'s initial action in the instant case was. But in that situation, however, Rule 10b-5 would not come into play unless a "sale" of securities were contemplated. By application of Rule 133, a "sale" within contemplation of the Securities Act would not be found in a statutory merger or in a purchase of assets. In order to

[62] *Supra* note 48.
[63] 17 C.F.R. § 230.133 (1970).
[64] S.E.C. v. National Sec., Inc., 393 U.S. 453, 469-72 (1969).

be able to act, the S.E.C. found it necessary to raise the question whether or not a Rule 133 "no-sale" was yet a "sale" under Rule 10b-5. To understand the problem in *National Securities* it is helpful to recall that a "sale" of securities (under either the Securities Act or the Exchange Act) can be found where there is nothing more than a modification of existing shareholders rights.[65] Securities law rather than state insurance law then applies. So teaches the first part of *National Securities*; but this is necessarily tied to the teaching of the second part of *National Securities* that any merger constitutes a Rule 10b-5 sale.

That which emerges in the end from the *National Securities* opinion is a flat declaration that any provisions inserted into a state insurance code purporting to protect the interests of one who owns stock in an insurance company are not within the sweep of the McCarran Act. The only relationship accepted as being within the contemplation of the McCarran Act is the relation of insurer to insured. We have already speculated that the Stone dissent in *South-Eastern Underwriters* could have come remarkably close to our present position, leaving states supreme in the regulation of the precise act of formation of the insurance contract, but subjecting ancillary transactions of insurance companies, and certainly transactions wherein equity securities are issued, to already existing generalized federal statutes. The *National Securities* opinion, having delineated the distinction between "the business of insurance" and the totality of business in which insurance companies might engage, does suggest that certain other things may be within "the business of insurance." Beyond cavil, rate fixing (which otherwise would be in violation of the Sherman Act) is part of the business of insurance, and is recognized to be a cooperative necessity in the proper construction of policies, setting of premiums, and accumulation of reserves. Two other items suggested by the *National Securities* opinion to fall within the business of insurance[66]—advertising of policies, by citation of *National Casualty*, and licensing of companies and their agents, by citation of *Robertson v. California*—are, as we have seen, more dubious. If the view be accepted that these latter inclusions are suspect, then the congruence between Stone's dissent and the *National Securities* case can be regarded as nearly complete.

IV. Conclusion

The McCarran Act sought to assure that: (1) the states could continue to tax an interstate insurance business—even in a discriminatory fashion; (2) the states could continue to approve or require collective rate making—for the purpose of preserving insurer solvency; (3) in general, state law regulating "the business of insurance" would take priority over federal law otherwise generally applicable—unless the federal law "specifically relates to the business of insurance." The power of the states to tax an interstate insurance business in a

[65] *Cf.* Western Air Lines v. Sobieski, 191 Cal. App. 2d 399, 12 Cal. Rptr. 719 (Cal. Dist. Ct. of App. 1961).
[66] S.E.C. v. National Sec., Inc., 393 U.S. 453, 460 (1969).

non-discriminatory fashion probably never was in peril, but the McCarran Act's preservation of state taxing powers is neither especially controversial nor unwelcome. State regulation of collective insurance rate making is rather on a par with state regulation of public utility rate making generally—which varies from good to horrendous, and which may in time be supplanted by federal agency oversight.

The solution given by the McCarran Act in relation to the specific problems arising before its enactment has endured; but its attempt to deal prospectively with federal-state relations in respect of regulation of advertising, corporate organization, mergers, issuance of securities, and, in increasing measure, policing of fiduciary duty,[67] has not been successful. Bowing to necessity, the courts have increasingly allowed general federal regulatory statutes to apply with full force to the activities of those engaged in the insurance business. This has been accomplished, in the teeth of the McCarran Act, by giving to the phrase "the business of insurance" an increasingly narrowed meaning. No longer is the insurance business congruent with "the business of insurance." "The business of insurance," rather, comprehends little more than the writing of orthodox insurance contracts, *simpliciter*.

Unsettled areas remain. In particular, it is far from clear whether or to what extent the federal antitrust authorities have jurisdiction over insurance company advertising or insurance company mergers and reorganizations. It does appear to be settled, however, that the federal securities acts apply fully to the activities of insurance companies, albeit with surrogate state regulation in respect of certain Exchange Act requirements. Consistent with *National Securities*, exclusive (or, at least, concurrent) jurisdiction over advertising and mergers would be assigned to federal regulatory authorities. This can be done without amendment of the McCarran Act by the simple expedient of declaring even more positively, in an appropriate case, that "the business of insurance" is nothing more than the act of forming and performing orthodox fixed value insurance and annuity contracts.

Instant acceptance of the full implications of the *South-Eastern Underwriters* decision was frankly impossible, if acceptance meant that the controlling law relating to formation and enforcement of insurance contracts was to become federal law. The McCarran Act did appropriately negate that supposi-

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[67] *See* Superintendent of Ins. v. Bankers Life & Cas. Co., 92 S. Ct. 165 (1971). Here, for example, the Superintendent of Insurance of the State of New York, the most powerful and important insurance regulatory authority in the nation, presses his claim against parties accused of looting an insurance company. He does so in the United States District Court, basing his claim on alleged violations of federal securities law. The Bankers Life case at least entertains the supposition that the Superintendent of Insurance, in his role as conservator, may press a Rule 10b-5 claim on behalf of arguably injured creditors and policyholders rather than an injured insurance company purchaser or seller of securities. If the Superintendent of Insurance is quite cognizant of the superiority of federal claims and remedies over those provided by state law, can the litigating public be far behind? What has become of the belief that the solvency and stability of insurance companies was adequately and exclusively a matter of state law? Even a Brandeis might admit that federal remedies are not now impotent.

tion. What lesson we have learned from the sequence of supposedly revolutionary judicial decision and Congressional correction of that decision is not yet clear. That very course of action which Mr. Justice Black bravely, some would say, brazenly,[68] undertook in *South-Eastern Underwriters*, the Court, but a few weeks ago, refused to take in *Flood v. Kuhn*.[69] The situation in the insurance business circa 1944 cried out for recognition that the judicially approved definition of interstate commerce was out of joint with the times. In 1972 it is readily conceded that the judicial definition of interstate commerce with respect to professional baseball is similarly out of joint. This exemption from the antitrust laws was judicially created and ought, consistent with *South-Eastern Underwriters*, to be judicially removed. But the courage, or temerity, of a Black is missing in a Blackmun. This is not said disparagingly. It is a matter of taste. The present Court, in its refusal to come to grips with the issue in *Flood v. Kuhn*, may be reflecting our collective experience with the sequence of *South-Eastern Underwriters* followed by McCarran. The present Court may simply have resolved that, given the necessity for eventual Congressional action in the premises, the invitation ought to be extended politely to redefine commerce. The hand of Congress arguably ought not be forced as the *South-Eastern Underwriters* decision did a generation ago.

The approaches are markedly different. A comparison of the two would provide material for essays on both the Commerce Clause and the jurisprudence of judicial restraint. Neither are the subject matter of this Article. It suffices to observe that no outcry greeted the *National Securities* decision, though the McCarran Act is thereby certainly somewhat weakened, and potentially decimated. The insurance industry seems relatively unmoved, its fear of federal regulation being centered now less on variable life insurance than on federal enactment of no-fault, and some resolution of the tort law-injury compensation quagmire into which we have fallen. But the lessons of *South-Eastern Underwriters* and its McCarran Act sequel are instructive here too. The McCarran Act was in large part necessitated by the realization that the federal government had available no comprehensive body of contract law. It still does not. The law of insurance contracts, and the law of conveyancing, and the law of torts are, and must foreseeably remain, state law. Unless we are prepared to substitute for that the jurisprudence of federal statutes and regulations and administrative adjudication—which we now have in connection with securities regulation—we should proceed with caution before blithely declaring that the old must go and the new be ushered in. If McCarran be dead, and if McCarran's shield be shattered, yet it is true that McCarran lives, and from the grave rules both Court and Congress, which hesitate to duplicate the performance of 1944-45 wherein the critical and controversial *South-Eastern Underwriters* decision was precipitously followed by the less than carefully drawn McCarran Act.

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[68] *See generally* Powell, *Insurance as Commerce*, 57 HARV. L. REV. 937 (1944).
[69] Flood v. Kuhn, 92 S. Ct. 2099 (1972).