THE McCARRAN-FERGUSON CONTROVERSY: SHOULD PROBLEMS IN STATE REGULATORY DEPARTMENTS TRIGGER FEDERAL REFORM?

INTRODUCTION

Regulation of the insurance industry has been a controversial subject in the United States for many years.[1] One issue currently under discussion is the suitability of the McCarran-Ferguson Act[2] to today's insurance industry.

The McCarran-Ferguson Act was enacted in 1945 to promote state regulation of the insurance industry at a time when it was uncertain whether states had the right to regulate and tax the insurance business. To accomplish this objective, the Act provides that the insurance industry is subject to federal antitrust laws only to the extent the industry is not regulated by the states.[3] Federal antitrust immunity is, therefore, implied from the Act's primary promotion of state regulation and supplemental dependence on federal law. Because all of the states immediately enacted

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1. Scholars offer various rationales for regulating the insurance industry, but the primary concern is the need to preserve the stability and solvency of insurers. *See* Anderson, *Insurance and Antitrust Law: The McCarran-Ferguson Act and Beyond*, 25 WM. & MARY L. REV. 81, 83 n.7 (1983); R. KEETON, INSURANCE LAW—BASIC TEXT § 8.3, at 554-55 (1971); Kimball & Boyce, *The Adequacy of State Insurance Rate Regulation: The McCarran-Ferguson Act in Historical Perspective*, 56 MICH. L. REV. 545, 546 (1958).
2. 15 U.S.C. §§ 1011-1015 (1982) [hereinafter cited as McCarran-Ferguson Act].
3. The Act provides, in pertinent part:

   [1.] 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.

   [2.] (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 30, 1948, . . . the Sherman Act, and . . . the Clayton Act, and . . . the Federal Trade Commission Act . . . shall be applicable to the business of insurance to the extent such business is not regulated by State law.

   [3.] (a) Until June 30, 1948 . . . the Sherman Act, and . . . the Clayton Act, and . . . the Federal Trade Commission Act, and . . . the Robinson-Patman Anti-Discrimination Act, shall not apply to the business of insurance or to acts in the conduct thereof. (b) Nothing contained in this chapter shall render the said Sherman Act inapplicable to any agreement to boycott, coerce, or intimidate, or act of boycott, coercion, or intimidation.

   [4.] Nothing contained in this chapter shall be construed to affect in any manner the application of the business of insurance of the . . . National Labor Relations Act, or . . . the Fair Labor Standards Act of 1938, or . . . the Merchant Marine Act, 1920.

   McCarran-Ferguson Act, ch. 20, 59 Stat. 33 (1945) (codified as amended at 15 U.S.C. §§ 1011-1015 (1982)) (emphasis in original).

regulatory legislation,[4] the insurance industry has been effectively immune from federal antitrust laws.[5]

The McCarran-Ferguson Act recently has been the subject of intensive study to determine how its provisions might be contributing to the nation's insurance crisis. A major study conducted during the Ford Administration by a Justice Department task force favored a dual system of regulation, which would enable insurers to opt between a state or federal charter.[6] Another study was conducted by the Carter Commission on Antitrust Laws and Procedures.[7] The Carter Commission recommended the repeal of the McCarran-Ferguson Act. Finally, in 1981, the General Accounting Office reviewed the effectiveness of state insurance regulation and suggested that federal regulation might be preferable to the existing scheme.[8] These studies reflect the increasing concern regarding the suitability of McCarran-Ferguson. Although the Act has remained free from legislative alteration thus far,[9] it has been the target of many recent proposals for reform.[10]

This section will examine the McCarran-Ferguson controversy. It will outline the events that led to the enactment of the Act and show that McCarran-Ferguson's effect on the insurance industry is contrary to the

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4. In response to the McCarran-Ferguson Act, all states had adopted fire and casualty rating laws by 1951. Generally, these statutes were patterned after a model law developed by the National Association of Insurance Commissioners. This model law required prior approval of insurance rates by state officials.

   Today, there are two methods of regulating insurance industry rates in the states. Seventeen states adhere to an open-rating or open-competition system, in which rates are set by insurers without prior approval of state insurance commissioners. The other 33 states use a regulatory system called prior approval. In a prior approval jurisdiction, insurers must get approval of rates from state insurance commissioners through the process of formal hearings. *See* COMPTROLLER GENERAL OF THE UNITED STATES, REPORT TO THE CONGRESS OF THE UNITED STATES: ISSUES AND NEEDED IMPROVEMENTS IN STATE REGULATION OF THE INSURANCE BUSINESS 213-16 (1979) [hereinafter cited as GAO REPORT]; *Sudden Riches for the Casualty Insurers*, BUS. WEEK, May 1, 1978, at 66.
5. The antitrust exemption is not complete, however. Even if insurer activity is within the "business of insurance" and state law effectively regulates it, the activity is not outside the purview of the Sherman Act if it entails a boycott, coercion or intimidation. McCarran-Ferguson Act, *supra* note 2, § 3(b).
6. UNITED STATES DEPARTMENT OF JUSTICE, A REPORT TO THE TASK GROUP ON ANTITRUST IMMUNITIES: THE PRICING AND MARKETING OF INSURANCE 359-72 (1977) [hereinafter cited as JUSTICE DEPARTMENT REPORT].
7. NATIONAL COMMISSION ON ANTITRUST LAWS AND PROCEDURES, A REPORT TO THE PRESIDENT AND THE ATTORNEY GENERAL FOR THE REVIEW OF ANTITRUST LAWS AND PROCEDURES 225 (1979) [hereinafter cited as CARTER COMMISSION REPORT].
8. It should be noted that the GAO Report made no solid recommendations and characterized its own findings as being preliminary and inconclusive. GAO REPORT, *supra* note 4, at viii.
9. A number of changes in the Act's allocation of power have resulted from judicial interpretation. *See* Kimball & Heaney, *Emasculation of the McCarran-Ferguson Act: A Study in Judicial Activism*, 1985 UTAH L. REV. 1 (1985).
10. On Jan. 6, 1987, Sen. Metzenbaum introduced S. 80, which calls for repeal of the McCarran-Ferguson Act. A number of other bills calling for repeal or reform of McCarran-Ferguson have been introduced in Congress: H.R. 1860, 96th Cong., 1st Sess.; H.R. 1861, 96th Cong., 1st Sess.; H.R. 1862, 96th Cong., 1st Sess.; H.R. 1863, 96th Cong., 1st Sess.; H.R. 1864, 96th Cong., 1st Sess.; H.R. 1865, 96th Cong., 1st Sess.; H.R. 2635, 96th Cong., 1st Sess.; H.R. 4500, 99th Cong., 2d Sess.; H.R. 4501, 99th Cong., 2d Sess.; H.R. 4502, 99th Cong., 2d Sess.; H.R. 4503, 99th Cong., 2d Sess.; H.R. 4504, 99th Cong., 2d Sess.; H.R. 5713, 99th Cong., 2d Sess.; S. 2458, 99th Cong., 2d Sess.; S. 2848, 99th Cong., 2d Sess.

Act's intended purpose. The section then will show how regulation of the insurance industry by the states, regardless of quality or comprehensiveness, enables insurance companies to engage in collective activities, free of interference from federal antitrust laws. Finally, this section will show how developments in the law may allow insurance companies to engage in collective activities, even without the implied grant of immunity in the McCarran-Ferguson Act.

THE DEVELOPMENT OF STATE REGULATION OF THE INSURANCE INDUSTRY

From its beginning, the insurance business has been regarded as a local matter, to be regulated by the states. In 1868, the Supreme Court ruled in *Paul v. Virginia*[11] that an insurance contract did not constitute "commerce" within the meaning of the Commerce Clause of the U.S. Constitution.[12] This placed the insurance industry outside the federal government's regulatory powers. As a result, regulation of the industry was left to the states.[13]

In 1944, the Supreme Court reversed precedent and ruled in *United States v. South-Eastern Underwriters Association*[14] that interstate insurance transactions constituted interstate commerce and were subject to federal antitrust laws.[15] This decision distressed insurance industry officials[16] and many state regulators, who thought the insurance industry would inevitably become subject to federal regulation.[17] State regulators feared that many state controls over insurance companies might be invalidated as undue

11. 75 U.S. 168 (1868).
12. *Id.* at 173. A number of Supreme Court decisions subsequent to Paul v. Virginia have affirmed this principle: Ducat v. Chicago, 77 U.S. 410 (1871); Nutting v. Massachusetts, 183 U.S. 553 (1902); Northwestern Mutual Life Ins. Co. v. Wisconsin, 247 U.S. 132 (1918); Colgate v. Harvey, 296 U.S. 404 (1935).
13. State regulation usually entailed rate regulatory statutes, which authorized the formation of private rating bureaus. Generally, these rating bureaus operated under the supervision of the states' insurance departments. The states thereby retained authority to approve the fixing of insurance rates. *See* Wiley, *Pups, Plants and Package Policies—Or the Insurance Antitrust Exemption Re-examined*, 6 VILL. L. REV. 281, 313-14 (1961).
14. 322 U.S. 533 (1944).
15. *Id.* at 539.
16. An insurance industry publication complained in an editorial:

    > Insurance D Day fell just a few hours before Eisenhower's D Day. . . . [T]he mental commotion of insurance men was pitiable, as their attention was torn between invasion headlines and their efforts to apprehend the consequences of the epochal, adverse U.S. Supreme Court decision . . . . Decisions upon which the whole system of state supervision of insurance has been founded and under which the business has operated apparently are juridicial museum pieces.

    THE NATIONAL UNDERWRITER, LIFE INS. ED., June 9, 1944, at 1.
17. Chief Justice Stone, in his dissent in U.S. v. South-Eastern Underwriters Association, was fearful of subjecting the insurance industry to the uncertainties of congressional action. 322 U.S. 533, 562 (1944). Justice Stone pointed out that a number of bills providing for federal regulation of the insurance industry had been introduced between 1902 and 1908, but the judiciary committees of the House and Senate concluded that "the regulation of the business of . . . insurance was beyond Congressional power." *Id.* at 576. *See also* S. Rep. No. 4406, 59th Cong., 1st Sess. (1906); H. Rep. No. 2491, 59th Cong., 1st Sess. 12-25 (1906).

burdens on interstate commerce, and tax authorities anticipated a loss of revenue.[18]

In 1945, in reaction to *South-Eastern Underwriters*, Congress passed the McCarran-Ferguson Act.[19] This Act clarifies the parameters of permissible federal regulation and promotes state regulation and taxation of the "business of insurance."[20] The Act does not make the states supreme in regulating all activities of insurance companies, but only those that constitute the "business of insurance."[21]

The McCarran-Ferguson Act was passed in order to permit state regulatory mechanisms to function without federal intervention.[22] This purpose is evidenced by the Act's language and its legislative history. McCarran-Ferguson, however, was not enacted without limitation. It was never the intent of Congress to give the industry broad license to operate without antitrust scrutiny. The legislative history of McCarran-Ferguson expresses the intent of Congress with regard to antitrust immunity:

> Nothing in this bill is to be so construed as indicating it to be the intent or desire of Congress to require or encourage the several States to enact legislation that would make it compulsory for any insurance company to become a member of rating bureaus or charge uniform rates. It is the opinion of Congress that competitive rates of a sound financial basis are in the public interest.[23]

Further insight into the scope of the antitrust immunity under the Act was furnished by President Franklin D. Roosevelt, who stated that

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18. *See* Kimball & Boyce, *supra* note 1, at 554.
19. *See supra* notes 2-3 and accompanying text.
20. *Id.* § 2(a).
21. An operational definition of "business of insurance" is key in determining the scope of the Act. In S.E.C. v. National Securities, Inc., 393 U.S. 453 (1969), Justice Marshall laid down the following definition:

> Congress was concerned with the type of state regulation that centers around the contract of insurance, the transaction which Paul v. Virginia held was not *commerce*. The relationship between insurer and insured; the type of policy which could be issued; its reliability, interpretaton, and enforcement—these were the core of the business of insurance . . . .

Id. at 460.

The Supreme Court, however, has recently indicated that it opposes a broad construction of the "business of insurance" exception to the antitrust laws. Although lower courts had adopted fairly broad constructions of the statute, the Supreme Court has rendered three recent decisions that overrule a substantial body of this decisional law.

In two of the decisions, United Labor Life Insurance Co. v. Pireno, 458 U.S. 119 (1982) (arrangement whereby a health insurer obtained professional advice from a peer review committee of a state chiropractic association) and Group Life & Health Insurance Co. v. Royal Drug, 440 U.S. 205 (1979) (pharmacy agreements between Blue Shield and participating pharmacies challenged on the ground that the agreements fixed the price of drugs provided to Blue Shield's policyholders), the Court narrowly construed the phrase "business of insurance" to exclude the challenged activities of the respective insurers. 458 U.S. at 134; 440 U.S. at 233.

In the third case, St. Paul Fire & Marine Insurance Co. v. Barry, 438 U.S. 531 (1978), which involved insurer activities that concededly were part of the business of insurance, the boycott exception to the antitrust exemption was analyzed and expansively interpreted so as to deny the exemption to the challenged activities of the insurers. *Id.* at 554.

22. McCarran-Ferguson Act, *supra* note 2, § 2(b).
23. *McCarran-Ferguson Act: Hearings on H.R. 143 Before the House Comm. on the Judiciary*, 79th Cong., 1st Sess. 2; *reprinted in* 1945 U.S. CODE CONG. & AD. NEWS 670, 671 [hereinafter cited as *McCarran-Ferguson Act Hearings*].

"Congress did not permit private rate fixing, which the Antitrust Act forbids, but was willing to permit actual regulation of rates by affirmative actions of the States."[24]

It is apparent from the Act's language and legislative history that the primary purpose of the McCarran-Ferguson Act was to promote state regulation of the insurance industry. A secondary purpose of the Act, according to legislative history, was to secure *more adequate* regulation of the business of insurance.[25] Given this history, it is doubtful that Congress intended the Act to affect the insurance industry in the manner it does today. Both Congress and President Roosevelt seemed to have acted under the assumption that the states would enact adequate and effective regulation. In fact, the supplemental role of the federal antitrust laws seems to imply that Congress considered such laws, at the very least, as minimum regulatory standards.

Critics argue that the insurance industry today uses private rating bureaus and displays cartel-like behavior, contrary to congressional intent.[26] Because all the states have enacted regulatory legislation, what Congress intended to be an *implied* grant of antitrust immunity actually functions as an *express* grant of antitrust immunity. The following section will focus on the causes of this broad antitrust immunity and the effects such immunity has on the insurance industry.

CURRENT OPERATION OF THE INSURANCE INDUSTRY

The Adequacy of State Regulation

Critics of state regulation do not believe the insurance industry is effectively regulated at the state level.[27] One reason is that Congress, in passing the Act, failed to enact accompanying standards for judging the *quality* of state regulatory efforts.[28] Critics charge that most state insurance

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24. As quoted in ABA SECTION OF INS. LAW PROCEEDINGS 105 (1946).
25. *See McCarran-Ferguson Act Hearings*, *supra* note 23, at 672.
26. As an excerpt from the Congressional Record indicates, it was not the intent of Congress to abolish rating bureaus. Rather, Congress' intent in enacting the McCarran-Ferguson Act was to control anticompetitive activities through adequate and effective state regulation:

> Mr. Ferguson: This bill would permit—and I think it fair to say that it is intended to permit—rating bureaus . . . . [W]e believe that State rights should permit a State to say that it believes in a rating bureau.
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> . . . .
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> Mr. Pepper: In other words, the Senator believes in a form of rate fixing?
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> Mr. Ferguson: Yes. There is no doubt the bill allows it; but we believe that all the wisdom is not here in Congress. We believe that there is some wisdom left in the legislatures that they should exercise their judgments and *regulate* insurance, except in the respects which we have enumerated.

91 CONG. REC. 1481 (1945) (emphasis added).

27. *See* GAO REPORT, *supra* note 4, at 2.
28. The interpretation of the proviso in § 2(b) is critical to a determination of what constitutes sufficient state regulation to preclude application of the antitrust laws. Unfortunately, the Supreme Court has never defined the phrase "to the extent that" in the McCarran-Ferguson Act. In F.T.C. v. National Casualty Co., 357 U.S. 560 (1958), the Court held that general state legislation was not insufficient *per se* to satisfy the section 2(b) requirement. *Id.* at 564-65. *See also* Anderson, *supra* note 1, at 99.

departments do not adequately protect consumers[29] because state insurance regulatory departments are inadequately staffed and funded.[30] Additionally, critics of state regulation contend that state regulatory departments are ineffective because they have been dominated by "revolving door" commissioners.[31] Finally, critics of state regulation charge that state reg-

29. Commercial purchasers are better able to deal with problems encountered in the insurance industry than are consumers. When the product liability market tightened in the early 1980s, Congress enacted the Product Liability Risk Retention Act, Pub. L. No. 97-45, 95 Stat. 949 (1981). Congress was lobbied successfully by commercial purchasers to create risk retention groups, which allow businesses to band together to purchase commercial liability insurance. The Risk Retention Act overrides anticompetitive, anti-group state laws for the benefit of commercial purchasers.

Additionally, rating bureaus have less of an effect on commercial lines of insurance than on personal lines. From 1980 through late 1983, the Insurance Services Organization, an insurance rating bureau, suggested certain price changes for commercial lines and personal lines. The industry adopted rates that were quite different from ISO's recommendations for commercial lines but tracked ISO closely for personal lines:

	ISO Recommended Companies Raise Rates By:	Companies Raised Rates By:	Difference:
COMMERCIAL LINES			
Automobile	+40%	0%	40%
General Liability	+12	-1	27
Multi-peril	+30	+03	27
PERSONAL LINES			
Automobile	+26%	+21%	05%
Homeowners	+26	+24	02

Competition in the Insurance Industry, 1984: Hearings Before the Subcomm. on Monopolies and Commercial Law of the House Comm. on the Judiciary, 98th Cong., 2d Sess. 387 (1984) (statement by J. Robert Hunter, President, National Insurance Consumer Organization) [hereinafter cited as *Competition Hearings*].

30. This belief is reflected in the following statistics:

—Twenty states have no actuaries on their staffs, making sophisticated review of rate filings or competitive levels impossible. Actuaries are experts in evaluating the cost of insurance coverage. They analyze the probability of loss occurrences and arrive at the price that must be charged to insure against their losses—a price that will enable companies to provide coverage and make a reasonable profit.

—The amount spent on regulation by the states is five percent of the taxes and fees paid into the states by insurance companies. Although critics of state regulation have cited the percentage of premium taxes used for regulation as showing that the states do not commit sufficient resources to regulation, some insurance commissioners and other advocates of state regulation charge that this is a meaningless figure because the purpose of premium taxes is to raise revenue for the state and not to support regulation. GAO REPORT, *supra* note 4, at 24.

—On a per-company licensed basis, eleven jurisdictions spend less than $1,000 per company for all regulation. It is impossible, however, to evaluate the adequacy of insurance regulatory expenditures based *only* on the overall budget figures. Budget figures must be viewed in the context of an overall assessment of state regulation as measured by several criteria, such as state population, overall state budget and insurance business in the state. Nonetheless, state insurance department budgets in relation to total state budgets and the amount of insurance business in the state *do* show that there are great differences in the amount of available resources that the states commit to insurance regulation.

—Five states have no examiners. Examiners are responsible for the surveillance of insurance companies in the areas of financial requirements and trade practices. *Competition Hearings*, *supra* note 29, at 375-76. For a more detailed assessment, *see* GAO REPORT, *supra* note 4, at 24-25.

31. The term "revolving door" applies because insurance regulators are typically chosen from the insurance industry but then return to it after short terms of service. Under such circumstances, critics contend that the regulators' points of view may be formed by their industry background, and their judgment may be shaped by the anticipation that they will be returning to the industry. *See* GAO REPORT, *supra* note 4, at 2.

ulatory departments are ineffective because they protect insurance companies and agents, rather than the public, and fail to address major consumer protection issues.[32]

Inadequate state regulation raises an additional concern in that immunity from federal antitrust laws enables insurance companies to participate in anticompetitive activities. Insurance companies contend that antitrust immunity is necessary because of the unique nature of the insurance business. Critics argue, however, that the immunity allows insurance companies to engage in anticompetitive activities to the detriment of the consumer.

Insurers' Use of Anticompetitive Activities

Practices traditionally viewed as anticompetitive, but used extensively in the insurance industry today, include price fixing agreements, market allocation agreements and resale price maintenance agreements.

Price Fixing Agreements

The most notorious anticompetitive practice is collective rate setting through rating bureaus.[33] After the passage of McCarran-Ferguson, states adopted statutes that enabled insurance companies to participate in rating bureaus and pool information concerning risks. These private rating bureaus are still used extensively in the industry. The activities of these organizations often go beyond the collection of industry loss data.[34] They include the averaging of information for specific risk classifications and the trending of data for past years to predict probable loss expenses for specified future rate periods.[35] The resulting prices are published as "bureau rates" for the use of a bureau's members.[36] Although some rating bureaus publish only advisory rates, other bureaus operate as cartels. The National Council on Compensation Insurance, for instance, has rate- and rule-adherence requirements in its constitution.[37]

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32. *Id.*
33. Rating bureaus are more prevalent in the property-liability industry than in the life-health industry. This is because the information and risk problems faced by life-health insurers are less severe than in the property-liability industry. In the life-health industry, life expectancy tables and health data are readily accessible and more predictable for future periods. As a result, life-health insurers generally have not engaged in extensive cooperative activities. Life-health insurers also have not been subject to extensive state rate regulation. *See* CARTER COMMISSION REPORT, *supra* note 7, at 228, *reprinted in Competition Hearings*, *supra* note 29, at 13.
34. *Competition Hearings*, *supra* note 29, at 13 (testimony of Hon. Griffin Bell).
35. *Id.*
36. Illinois, which has no rating law, permits rating bureaus only to collect and compute statistics based on the loss component of insurance premiums. Consequently, unlike insurers in other states, each Illinois insurer is responsible for rates that reflect its own expense projections. *See* CARTER COMMISSION REPORT, *supra* note 7, at 231, *reprinted in Competition Hearings*, *supra* note 29, at 14.
37. The constitution of the National Council on Compensation Insurance states:

> Each member shall adhere to all filings made by the National Council on its behalf with state supervisory authorities, except to the extent that such members shall obtain the right to depart from such filings in accordance with the requirements of law specifically applicable thereto or the applicable law precludes, either directly or indirectly, agreements to adhere. . . .

Competition Hearings, *supra* note 29, at 382.

Although rating bureaus were established to enable insurance companies to engage in cooperative operations, insurance companies argue that the rating bureaus are essential for competitive operations.[38] The insurance industry can benefit from the antitrust immunity, they contend, because it is different than other industries. The insurance industry is more decentralized and more competitive, and the market share of the largest company is smaller than in other industries.[39] The pooling of information and collective activities, therefore, enables smaller insurance companies, which otherwise would be too small to determine rates effectively, to compete in the insurance market.[40] This practice is not anticompetitive, they argue, but procompetitive.

Market Allocation Agreements

Another anticompetitive practice tolerated in most states is the use of market allocation agreements, or horizontal agreements, which are private, collusive agreements between insurance companies. Market allocation agreements are determinations within the insurance industry of which companies will operate where.[41] These agreements have long been held to be *per se* illegal under the antitrust laws because they lack redeeming economic justification.[42]

Resale Price Maintenance Agreements

Resale price maintenance agreements, or vertical price restraints, are private restraints on competition. Typically called anti-rebate statutes, they operate on the premise that the retail (agent's) price is set exclusively by the wholesaler (insurance company). Thus, when an individual buys insurance from a particular insurance company, that individual pays the same price, no matter which agent the buyer chooses. An efficient agent cannot compete for market share by reducing his or her commission.

Anti-rebate laws were once called "fair trade" statutes and were permitted for some years as an exception to the antitrust laws. Congress,

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38. *See* Brostoff, *McCarran-Ferguson Debate Seen Continuing,* NATIONAL UNDERWRITER—LIFE HEALTH EDITION, May 25, 1985, at 30.
39. *See id. See also* CARTER COMMISSION REPORT, *supra* note 7, at 229. Characterized by a lack of significant economies of scale, relatively standardized policies and low barriers to entry, the property-liability industry appears competitively structured. There are about 2,886 property-liability insurance companies in the United States, of which the eight largest earned 31.9 percent of total industry premiums in 1977.
40. *See* Brostoff, *supra* note 38, at 30.
41 *See Competition Hearings, supra* note 29, at 380.
42. The Supreme Court has elaborated on the principle of *per se* illegality. In construing and applying the Sherman Act's ban against contracts, conspiracies and combinations in restraint of trade, the Supreme Court has held that certain agreements or practices are so "plainly anticompetitive" and so often "lack . . . any redeeming virtue" that they are conclusively presumed illegal without further examination under the rule of reason generally applied in Sherman Act cases. Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36, 57-58, nn.27, 28 (1977); United States v. Topco Associates, Inc., 405 U.S., 596, 609 n.10 (1972); Northern Pac. R. Co. v. United States, 356 U.S. 1, 5 (1958).

however, repealed the general authorization for such state laws in 1975.[43] In *California Retail Liquor Dealer's Association v. Midcal Aluminum, Inc.*,[44] the Supreme Court held that state laws authorizing manufacturer determinations of wholesale and retail prices for alcoholic beverages were pre-empted under federal antitrust laws.[45]

In the insurance industry, anti-rebate laws are still common. Because of the insurance industry's market structure, the effect of anti-rebate laws on the consumer is especially significant. Direct policy writing through local agents is highly concentrated and enjoys consistently high profits.[46] Also, entry into this market is relatively easy.[47] Despite the fact that all of the elements for a potentially competitive environment exist, anti-rebate statutes prohibit effective price competition.

Proponents of anti-rebate laws in the insurance industry have characterized the situations that might occur if the anti-rebate laws were repealed:

> It seems quite possible that rebating could foster: (1) unethical sales practices; (2) gimmickry; (3) misrepresentation; (4) policy replacement; (5) discrimination; (6) payola and kickbacks; (7) less service by agents; and (8) discounting for the wealthy at the expense of the average policy purchaser.[48]

As a further example of potential harm, proponents of anti-rebate statutes point to the situation as it existed before 1908, when rebating was a national scandal:

> Rich people were demanding and getting huge rebates at the expense of the poor. Union bosses were getting rebates and buying inferior products at the expense of the workers. Bribes, kickbacks and rebates had corrupted the buying process to the point where public confidence in the entire insurance industry was badly shaken.[49]

Nonetheless, consumerists challenging the anti-rebate laws won a recent victory in Florida. In *Department of Insurance v. Dade County Consumer Advocates Office*,[50] the Florida Supreme Court held that statutes prohibiting insurance agents from accepting commissions lower than those set by insurers are unconstitutional in that they unnecessarily limit the bargaining power of the consuming public.[51]

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43. Consumer Goods Pricing Act of 1975, Pub. L. No. 94-145, 89 Stat. 801 (amending 15 U.S.C. §§ 1, 45(a) (1982)).
44. 445 U.S. 97 (1980).
45. *Id.* at 105.
46. *See* JUSTICE DEPARTMENT REPORT, *supra* note 6, at 9.
47. *Id.*
48. *See* Fogerty, *The Case Against Rebating*, BEST'S REVIEW: LIFE-HEALTH INSURANCE EDITION, Aug. 1985, at 32.
49. *Id.*
50. 492 So. 2d 1032 (Fla. 1986).
51. *Id.* at 1035. For more than eight years, consumerists in Florida argued that the anti-rebate provisions were a fair-trade law and against the public interest because discounts were barred. The Florida insurance department and the life insurance industry were in opposition. In reaching a decision for the consumer groups, the Florida Supreme Court found "no identifiable relationship between the anti-rebate statutes and a legitimate state purpose in safeguarding the public health, safety or general welfare." *Id.* at 1035. The expectation is that the highest court of each state will be called upon soon to review the same critical issue. *See* Saks, *Florida Finds Anti-*

ALTERNATIVE SOURCES OF ANTITRUST IMMUNITY

Insurance companies argue that the antitrust immunity provided by McCarran-Ferguson is necessary because they could not operate effectively without the exchange of information provided by the rating bureaus. Because of recent developments in the law, however, the insurance industry may not need McCarran-Ferguson's antitrust immunity to exchange such information. The Supreme Court has held that procompetitive and efficient collective action, such as sharing past loss data and pooling it to underwrite large risks, will be judged by a "rule of reason."[52]

The major case on the matter is *Broadcast Music v. Columbia Broadcasting System*,[53] in which the Supreme Court rejected the claim that the pooling of thousands of musical compositions for distribution by a common licensing agency was illegal *per se*.[54] Because the pooling reduced costs and enabled the composers to reach a broad market, the arrangement was upheld on remand as legal.[55] Under the same analysis, if the unique nature of the insurance industry means that collective activities are necessary to establish competitive costs, then insurance companies might not need the special grant of immunity to engage in procompetitive activities.[56]

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rebate Law Unconstitutional—Dramatic Impact Expected on Insurance Selling, 13 ESTATE PLANNING 310 (1986).

52. The "rule of reason" analysis is posited in the provisions of the Sherman Act, ch. 647, § 1, 26 Stat. 209 (1890) (current version at 15 U.S.C. § 1-7 (1982)).

Under the "rule of reason," the legality of restraints on trade is determined by weighing all the factors of a case, such as the history of the restraint, the evil believed to exist, the reason for adopting the particular remedy and the purpose or end sought. National Society of Professional Engineers v. United States, 435 U.S. 679, 681-92 (1978).

To constitute a crime under § 1 of the Sherman Act, a defendant's conduct must result in an unreasonable restraint of interstate commerce. It is for the jury to determine from a consideration of all the facts and circumstances, including the economic conditions of the industry and the effect on competition, whether a defendant's conduct creates an unreasonable restraint on interstate commerce. The "rule of reason" test is not, however, applied in instances of *per se* antitrust violation (e.g. price-fixing). United States v. Trenton Potteries Co., 273 U.S. 392, 400 (1926); American Tobacco Co. v. United States, 221 U.S. 106 (1911); Standard Oil v. United States, 221 U.S. 1, 60-68 (1911).

53. 441 U.S. 1 (1979).

54. *Id.* at 24. The Court pointed out what constitutes *per se* unreasonableness in Northern Pacific Railway Company v. United States, 356 U.S. 1 (1958):

> This principle of *per se* unreasonableness not only makes the type of restraints which are proscribed by the Sherman Act more certain to the benefit of everyone concerned, but it also avoids the necessity for an incredibly complicated and prolonged economic investigation into the entire history of the industry involved, as well as related industries, in an effort to determine at large whether a particular restraint has been unreasonable—an inquiry so often wholly fruitless when undertaken.

Id. at 5.

55. Columbia Broadcasting System v. ASCAP, 620 F.2d 930 (2d Cir. 1980), *on remand from sub nom*, Broadcast Music, Inc. v. Columbia Broadcasting System, 441 U.S. 1 (1979), *cert denied*, 450 U.S. 970 (1981).

56. *ASCAP* involved the use of a blanket license, which was used by licensing agencies to convey nondramatic performing rights to television networks, and which permitted the licensee to use any music in the repertory of the licensor, as often as desired for a one-time license fee. In deciding that this practice was not a *per se* violation of the antitrust laws, the Supreme Court reasoned that:

> [because] over the years, and in the face of available alternatives, the blanket license has provided an *acceptable mechanism* for at least a large part of the market for the

The Supreme Court also has elaborated on the proper scope of state regulation that qualifies for antitrust immunity under the state action doctrine.[57] The Court has laid down two standards: "First, the challenged restraint must be one clearly articulated and affirmatively expressed as state policy; second, the policy must be actively supervised by the State itself."[58]

Thus, if state statutes authorizing the formation of insurance rating bureaus are clearly expressed and mandated under state policy, and the bureaus are actively supervised by the state, then insurance companies may be immune from antitrust laws without McCarran-Ferguson's grant of immunity.

RECOMMENDATIONS

The business of insurance historically has been a local activity subject to state regulation. In enacting McCarran-Ferguson, Congress supported the policy of state regulation of the insurance industry. Although state regulation of insurance as a manifestation of federalism is clearly an important value, it is up to Congress to determine whether the circumstances of insurance regulation continue to be such that the value of decentralization of governmental authority outweighs other policy goals.[59]

> performing rights to copyrighted musical compositions, we cannot agree that it should automatically be declared illegal in all of its many manifestations. Rather, when attacked, it should be subjected to a more discriminating examination under the rule of reason.

Broadcast Music, Inc. v. Columbia Broadcasting System, 441 U.S. at 24 (emphasis added).

Therefore, absent federal antitrust immunity, if a preliminary determination showed that the collective activities performed by insurance-rating bureaus are acceptable mechanisms for pricing insurance and not *per se* violations, then the collective activities would be judged under the traditional rule of reason.

57. State action claims arise under the due process clause of the fourteenth amendment to the Constitution. Whether an action complained of constitutes state action within the purview of the fourteenth amendment depends on whether a sufficiently close nexus exists between the state and the challenged action so that the action may fairly be treated as that of the state itself. The concept of state action with reference to antitrust immunity was first laid down in Parker v. Brown, 317 U.S. 341, 352 (1943).

58. California Retail Liquor Dealer's Ass'n v. Midcal, 445 U.S. 105 (1980).

59. A government report dealing with the insurance issue has outlined circumstances in which the government has been forced to intervene and regulate a given market:

> Although the United States is basically a free market economy, the government intervenes when a particular market does not function efficiently or when the market produces undesirable consequences for society.
>
> Flaws in the marketplace that require regulatory intervention are known as market failures. Examples of market failures are:
>
> —Natural monopolies wherein the production of a commodity is characterized by substantial economies of scale. The largest firm in the industry is the most efficient and has the ability to underprice competing firms and drive them out of business. The surviving firm becomes a monopolist who tends to reduce output, raise prices and make excess profits.
>
> —Destructive competition, which exists when destabilizing price wars render an industry incapable of satisfying consumer demand. Prices and product availability fluctuate widely, sustained losses are incurred by firms, and wants go unsatisfied. Consumers and producers are injured.
>
> —Inadequate information in the marketplace, which prevents the best functioning of the market and results in poor decisions and wasted resources.

See GAO REPORT, *supra* note 4, at 9-10.

In the past, various proposals for reforming McCarran-Ferguson and subjecting the insurance industry to federal antitrust laws have been advanced.[60] If such measures of reform were to materialize, however, the system of dual regulation of the insurance industry that would inevitably develop certainly would lead to even greater confusion.[61]

Therefore, reform must take place in state legislatures. State regulation of the insurance industry enables local citizenry to assess their own needs and form suitable responses and permits state-by-state experimentation. Further, state regulatory systems already exist in all fifty states. Although insurance companies complain that it is inefficient to comply with the regulatory requirements of fifty different state insurance departments, an alternative scheme of federal regulation would have to be developed. To combat differing state regulatory requirements, better uniformity in state regulatory laws should continue to be pursued by the National Association of Insurance Commissioners.[62]

CONCLUSION

With the widespread publicity of the liability crisis in the insurance industry, it is probably unrealistic to believe that Congress will continue to support existing policies of state regulation of insurance. But even though amendment or repeal of McCarran-Ferguson is possible, state lawmakers still should strive to reform state regulatory departments in an effort to make the departments more responsive to the needs of consumers.

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60. *See, e.g., supra* note 10 and accompanying text. *See also* Comment, *Risky Business: Consumer Protection in the Insurance Industry*, 23 HARV. J. LEGIS. 287, 298 (1986) (advocating enactment of a National Insurance Consumer Organization proposal for federal oversight of the insurance industry); Nedrow, *The McCarran Controversy: Insurance and the Antitrust Law*, 12 CONN. L. REV. 205, 263 (1980) (suggesting a model amendment to the McCarran-Ferguson Act that would allow insurers to elect regulation under either a state or federal scheme).

61. Compare the complexity of regulatory legislation in the banking industry. The regulatory structure in which banks operate starts with the Comptroller of the Currency, who serves as the primary bank supervisor for the nation's national banks; the Federal Reserve Board, which is the primary bank supervisor for the state-chartered banks that are members of the Federal Reserve System; and the FDIC, which serves as the primary federal bank supervisor for the state banks that are not members of the Federal Reserve System.

    Paralleling this federal regulatory structure is a state banking supervisory structure. Additionally, Congress has created other federal agencies. One, the Federal Financial Institutions Examination Council, seeks to obtain greater uniformity in administration of the Federal Reserve Board, the FDIC and the Comptroller. Another, the Depository Institutions Deregulation Committee, was created to deregulate interest rates. *See Homogenization of Financial Institutions: The Legislative and Regulatory Response* 38 BUS. LAW. 241, 244-45 (1982).

62. The NAIC consists of the heads of the insurance departments of the 50 states, the District of Columbia, Guam, Puerto Rico and the Virgin Islands. NAIC's basic purpose is to provide necessary uniformity, cooperation and expertise to the various states and territories as they individually regulate the insurance business. Although the NAIC has no legal regulatory authority, it is an inherent and significant part of the system by which the insurance business is regulated. The primary functions of the NAIC are to:

    —draft model laws and regulations for voluntary adoption of the states:

    —gather and distribute information on regulatory matters, such as license revocations and securities valuations;

    —maintain computerized financial data aimed at early detection of insurer insolvency; and

    —conduct studies of nationally significant insurance issues.

    GAO REPORT, *supra* note 4, at 173-74.

Ideally, before pursuing any course of action, Congress should study existing state schemes of insurance regulation for positive and negative feedback to aid in developing future regulatory reform. A further ideal would be that, in the near future, the states would have more positive than negative feedback to offer.

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