THE MCCARRAN-FERGUSON ACT AND THE LIMITED INSURANCE ANTITRUST EXEMPTION: AN INDEFENSIBLE ABERRATION?

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I. Introduction

The regulation of insurance business in the United States is primarily the province of the states.[1] The McCarran-Ferguson Act of 1945[2] first reiterates this concept, and then accords the insurance business a limited exemption from federal antitrust laws to the extent that state laws address the area.[3] Agreements or acts of boycott, coercion, or intimidation, however, remain subject to federal regulation.[4]

With the liability insurance capacity crunch of the mid-1980s, the onslaught of tort reform, and the massive insurance antitrust suits in California and Texas, the adequacy of state regulation has become the center of many debates. In addition, the desire to install federal regulation, as well as the justification for the limited antitrust immunity enjoyed by the insurance industry under McCarran-Ferguson,[5] have also received a great weight of

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1 *See, e.g.*, Group Life & Health Insurance Co. v. Royal Drug Co., 440 U.S. 205 (1979); S.E.C. v. National Securities Inc., 343 U.S. 453 (1980).

2 McCarran-Ferguson Act, ch. 20, 59 Stat. 33 (1945) (codified as amended at 15 U.S.C. §§ 1011-1015 (1988).

3 15 U.S.C. § 1013(a). This section provides:

> (a) Until June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, . . ., the Clayton Act, . . ., and the Federal Trade Commission Act . . . shall not apply to the business of insurance or to the acts in the conduct thereof.

Id.

4 *Id.* § 1013(b). This section provides:

> (b) Nothing contained in this Act shall render said Sherman Act inapplicable to any agreement to boycott, coerce, or intimidate or act of boycott, coercion or intimidation. . . .

Id.

5 Section 1013(a) and (b) allows rating bureaus such as the Insurance Services

attention.

In that regard, this article examines the background of the McCarran-Ferguson Act, its scope, the arguments for and against its limited antitrust exemption, and the driving force behind repeal efforts. The article also examines whether the Act is an indefensible aberration and considers the potential ramifications of a repeal or modification.

II. Background to McCarran-Ferguson

A. *Paul v. Virginia*

In the 1869 landmark case of *Paul v. Virginia*,[6] the United States Supreme Court reviewed, for the first time, a challenge to the constitutionality of state regulation of insurance. Paul, a resident of Virginia, was an agent who represented several non-admitted fire insurers.[7] Virginia law required nonresident insurers and their agents to be licensed in order to transact business in Virginia.[8] A prerequisite for obtaining the license was the deposit of a security payment.[9] Paul did business without the payment and was indicted.[10] He challenged the constitutionality of the state licensing requirement arguing, among other things, that the writing of insurance in Virginia by non-admitted insurers was the transacting of interstate commerce.[11] As such, he contended Virginia could not purport to regulate such activity.[12] He argued that only the federal government, under the commerce clause of the United States Constitution, possessed that power.[13]

In ruling on this issue, the United States Supreme Court

Office (ISO) to share loss data in pricing insurance. The ISO also promulgates general liability, auto and homeowner policy rates, as well as issuing "advisory" rates. Advisory rates are suggested price rates for the insurance industry. They are based on "uncurreal loss estimates of the amount an insurer will eventually pay out on policies in effect in a given year." *Id. See generally* Clarke, Boulton, Smith & Simon, *Sources of the Liability Crisis in Liability Insurance: An Economic Analysis*, 15 YALE J. ON REG. 387, 404 (1988).

6 75 U.S. (8 Wall.) 168 (1869).

7 *Id.* at 169.

8 *Id.*

9 *Id.*

10 *Id.*

11 *Id.* at 172-73.

12 *Id.* at 173-74.

13 *Id.* at 174.

held that insurance was not commerce within the meaning of the commerce clause.[14] The Court stated that insurance contracts were like any other simple contract, only differing to the extent that they were governed by local law regardless of the residence of the parties.[15] The Court further reasoned that, although the contracting parties may be domiciled in different states, the insurance contracts themselves were not commodities shipped between states for sale.[16] This position held firm until the Court's decision in *United States v. South-Eastern Underwriters Association*.[17]

B. *The* South-Eastern Underwriters Association *Case*

In *South-Eastern*, the South-Eastern Underwriters Association (Association) was indicted in 1942 for violations of the Sherman Antitrust Act.[18] Until that time, the Association controlled ninety percent of the fire insurance and allied lines market in the southeast.[19] Their control came via fixed anticompetitive fire and allied lines rates, which compelled prospective insureds to purchase insurance only from its members on pain of boycott, refusing non-member insurers reinsurance opportunities, and denying the right of representation to agents who represented non-member insurers.[20] In defense of its position, the Association apparently believed that its actions were insulated by the holding of *Paul v. Virginia*.[21] They contended that insurance is not commerce, but rather an interstate relationship which is exempt under the Act.[22] The district court affirmed the defense and dismissed the indictment. Nevertheless, the case was appealed to the United States Supreme Court.[23]

The Supreme Court held that insurance was commerce falling within the contours of interstate commerce if transacted

14 *Id.* at 183.

15 *Id.*

16 *Id.*

17 322 U.S. 533 (1944).

18 *Id.*; Sherman Act, ch. 647, 26 Stat. 1397 (1890) (codified as amended at 15 U.S.C. §§ 1-7 (1988).

19 *South-Eastern Underwriters Ass'n*, 322 U.S. at 535.

20 *Id.* at 535-36.

21 *Id.*

22 *Id.* at 536.

23 *Id.*

across state lines.[24] The Court reasoned that although a contract of insurance does not itself constitute interstate commerce, nothing precluded their power to examine the entire transaction to determine whether or not a chain of interstate commerce is formed.[25] On that ground, the majority of the Court[26] refused to exempt the business of insurance from the regulatory power of Congress under the commerce clause, where such business was conducted across state lines.[27] The insurance business was therefore subject to federal antitrust laws.

III. The McCarran-Ferguson Act

A. *The Necessity of the Act*

Inevitably, confusion and uncertainty followed the *South-Eastern Underwriters Association* decision as to the constitutionality of state laws and the validity of state tax laws and regulatory provisions.[28] Many insurance companies refused, and others threatened refusal, to comply with state tax laws and other regulatory provisions.[29] The heart of their concerns was that civil and criminal penalties might attach to industry executives for misappropriation of company funds if state laws were subsequently

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24 *Id.* at 539-553.

25 *Id.* at 546-547.

26 Chief Justice Stone and Justice Frankfurter dissented. Chief Justice Stone recognized that the issue at bar was not whether the federal government had power to regulate the insurance companies but, rather, whether Congress did so by the Sherman Act. *Id.* at 563. In agreeing with the district court's opinion, he reiterated that the indictment concerned restraints in the "business of insurance," not in their performance. *Id.* at 565. It was, therefore, irrelevant that the Association used the mails and instrumentalities of interstate commerce. *Id.* at 565-66. The business was not in itself interstate commerce, and "the alleged conspiracies to restrain and to monopolize that business were not, without more, in restraint of interstate commerce." *Id.* at 566. In closing, the Chief Justice noted that although the incidents of interstate transportation attending the performance of an insurance contract is interstate commerce, this fails to "render the business of insurance itself interstate commerce." *Id.* at 567.

27 *Id.* at 553.

28 *See* H. REP. No. 143, 79th Cong., 1st Sess., *reprinted in* 1945 U.S. CODE CONG. SER. 670, 671. The House Committee on the Judiciary gave immediate consideration to S. 340 and H.R. 1973 (a similar bill) "so that states may know Congress' desire to protect the continued regulation and taxation of the business of insurance . . . ." *Id.*

29 *Id.*

held unconstitutional in light of the *South-Eastern Underwriters*.[30] Thus, Legislation was needed to eliminate the general indecisiveness generated by this opinion.[31]

The McCarran-Ferguson Act was introduced by Senators McCarran and Ferguson in December of 1944, and reintroduced in January of 1945 as S. 340.[32] The bill that was ultimately passed into law was proposed by the National Association of Insurance Commissioners (NAIC).[33] In particular, stock property and casualty insurance companies had lobbied for a total exemption from the Sherman[34] and Clayton Acts,[35] and supported the Walter-Hancock bill[36] which was passed by the House but subsequently rejected by the Senate.[37] The stock companies were fearful of antitrust indictments following the *South-Eastern Underwriters* decision.[38] The NAIC bill, by comparison, sought to preserve state regulation, not to eliminate the application of federal antitrust laws. After several changes in the NAIC bill, including changes initiated by Senators McCarran and Ferguson, S. 340 finally became law.[39] A main concern in passing McCarran-Ferguson was with collective rate making through rating bureaus and state taxation of insurers.[40] It was also meant to signal to the

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30 *Id.*

31 *Id.*

32 Weller, *The McCarran-Ferguson Act's Antitrust Exemption For Insurance: Language, History and Policy*, 1978 DUKE L. REV. 587, 595 (1978) [hereinafter Weller]; S. 340, 79th Cong., 1st Sess., 91 CONG. REC. 330 (1945).

33 Weller, *supra* note 32, at 592.

34 *See generally* Sherman Act, ch. 647, 26 Stat. 1397 (1890) (current version at 15 U.S.C. § 1 (1973)).

35 *See generally* Clayton Act, ch. 323, 38 Stat. 730 (1914) (current version at 15 U.S.C. § 18 (1982)).

36 H.R. 3270, 78th Cong., 1st Sess., 90 CONG. REC. 6524 (1944).

37 Weller, *supra* note 32, at 592.

38 *Id.* at 590-91.

39 President Roosevelt signed into law the conference report version of S. 340 adopted by the Senate. *Id.* at 597. This report was primarily a compromise version of S. 340 which made such amendments as adopting the Senate's boycott provisio (now section 3(b), and including the FTC Act in the section (2)(b) provisio clause). *Weller*, *supra* note 32, at 596-597.

40 *See* Group Life & Health Insurance Co. v. Royal Drug Co., 440 U.S. 205 (1979). The Court, in an attempt to put into perspective Congress' understanding that "the business of insurance is the underwriting and spreading the risk, reviewed the background (history) of the Act. *Id.* at 220-224. The justices made reference to Senator Ferguson's explanation of the purpose of the bill where he stated:

> This bill would permit—and I think is fair to say that it is intended to permit—voting bureaus, because in the last session we passed a bill for

states the desire of Congress to protect the continued regulation and taxation of the business of insurance by the several states, and to secure adequate regulation and control of the insurance business.[41]

B. *The Provisions of the Act*

The preamble to the Act states it is "[t]o express the intent of the Congress with reference to the regulation of the business of insurance."[42] Congress declared in section 1 "that the continued regulation and taxation by the several [s]tates of the business of insurance is in the public interest. . . ."[43] Section 2(b) provides that "[n]o Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any [s]tate for the purpose of regulating the business of insurance, . . . unless such Act specifically relates to the business of insurance. . . ."[44] This section further provides that after June 30, 1948, the Sherman, Clayton, and Federal Trade Commission Acts would apply "to the business of insurance to the extent that such business is not regulated by [s]tate [l]aw."[45] Section 3 exempts the business of insurance from the above until June 30, 1948, to allow the states to pass measures in these areas.[46] Section 3(b) provides, however, that the Sherman Act does apply to agreements or acts of boycott, coercion, or intimidation.[47]

> the District of Columbia allowing voting. What we saw as wrong was the fixing of rate without statutory authority in the State; but we believe that State rights should permit a State to say that it believes in a rating bureau. . .

Id. at 223. *See also* 91 CONG. REC. 1481 (1945). The Court also noted that President Roosevelt emphasized that the bill would allow cooperative rate regulation. *Id.* at 224.

41 *See* SEC v. National Securities, Inc., 393 U.S. 453, 458 (1969). Weller argues that Congress did not intend to "federalize" the regulation of insurance by establishing a new federal regulatory agency. Weller, *supra* note 32, at 600. He also notes that Congress, as reaffirmed by the NAIC bill, did not intend to return to the days of exclusive state regulation. *Id.* at 601. In recognizing this, Weller summarizes that section 2(b) of the Act illustrates a desire to give states "ultimate," rather than "exclusive" authority over the business of insurance. *Id.*

42 S. 340, 79th Cong. 1st Sess., 91 CONG. REC. 330 (1945).

43 15 U.S.C. § 1011-1015 (1985).

44 *Id.* § 1012(b).

45 *Id.*

46 *Id.* § 1013(a).

47 *Id.* § 1013(b).

C. *The Scope of the Antitrust Exemption*

Insurance is the only business that is exempt under the McCarran-Ferguson Act.[48] This has been narrowly construed to require three things. First, the practice must have the effect of transferring or spreading the insured's risk. Second, it must be an integral part of the policy relationship between the insurer and the policyholder. Third, the practice must be restricted to entities in the insurance field.[49]

In *Group Life & Health Insurance Co. v. Royal Drug Co.*,[50] non-participating pharmacies brought an antitrust action against the insurance company, Blue Cross, and several pharmacies for allegedly participating in a prescription drug agreement whereby insureds paid two dollars and Blue Cross paid the participating pharmacies for the cost of procuring the drug.[51] When the insureds patronized non-participating pharmacies, they had to pay the full cost of the prescription, and would only be reimbursed for seventy five percent of the difference between the amount paid and the two dollar deductible.[52] The non-participating pharmacies sued for price fixing under section 1 of the Sherman Act, and also alleged a boycott by insureds of non-participating pharmacies as a result of the agreement.[53] The trial court granted summary judgment on the ground that the agreements were exempt under section 2(b) of the McCarran-Ferguson Act as constituting the "business of insurance," which was regulated by Texas law.[54] The United States Supreme Court affirmed the court of appeals' decision reversing the trial court, on the grounds that the pharmacy agreements are not the business of insurance, which requires the spreading of risk.[55] In the agree-

48 The Court in Group Life & Health Ins. v. Royal Drug, 440 U.S. 205, 211 (1979), began its analysis with the premise that the McCarran-Ferguson Antitrust Exemption "is for the business of insurance, 'not business of insurers.'" *See also* Pireno v. New York State Chiropractic Ass'n, 650 F.2d 387 (2d Cir. 1981) *aff'd sub nom.* Union Labor Life Ins. Co. v. Pireno, 458 U.S. 119 (1982); S.E.C. v. National Securities Inc., 393 U.S. 453, 459-60 (1969).

49 *See* Union Labor Life Ins. Co. v. Pireno, 458 U.S. 119 (1981).

50 440 U.S. 205 (1979).

51 *Id.* at 209.

52 *Id.*

53 *Id.* at 207.

54 *Id.*

55 *Id.* at 233.

ment at issue, the Court found that Blue Shield simply bought goods and services at cost savings.[56] In addition, the Court noted, the business of insurance also requires contractual arrangements between the insurer and its insureds.[57] The arrangement before the Court was between Blue Shield and pharmacies.[58] In short, the Court concluded, when McCarran-Ferguson was enacted, plans like Blue Shield were not considered the business of insurance.[59]

In reaching its decision, the Court essentially set forth a three prong test to "determine whether a particular practice is part of the 'business of insurance'. . .," exempt under the McCarran-Ferguson Act.[60] This test requires a court to determine, first, whether the activity transfers or spreads the insured's risk; second, whether the activity is an essential or integral part of the policy relationship between the insurer and insured; and third, whether the activity or practice is limited to members within the insurance field.[61]

In *Union Labor Life Ins Co. v. Pireno*,[62] a chiropractor brought an action for declaratory and injunctive relief alleging violation of the Sherman Act against the New York State Chiropractic Association (NYSCA) and Union Labor Life Insurance Company (ULL).[63] Pireno alleged that the ULL and the NYSCA combined to restrain trade in violation of section 1 of the Sherman Act and that they additionally conspired to use the peer review committee as a means of fixing prices.[64] In dismissing the case, the district court felt that the McCarran-Ferguson Act, specifically section 2(b), exempted the activity from federal antitrust laws.[65] The court of appeals reversed, however, holding that the use of the peer review procedure by the insurer to determine the reasonableness of a chiropractor's fees did not spread risk, but merely

56 *Id.* at 214.
57 *Id.* at 215.
58 *Id.* at 216.
59 *Id.* at 229-30.
60 *Id.*
61 *Id.*
62 458 U.S. 119 (1981).
63 *Id.* at 124.
64 *Id.*
65 *Id.*

cut costs.[66] The court held that the business of insurance is to be limited to the quintessential insurance functions.[67] The peer review committee rendered opinions on the reasonableness of the charges of a chiropractor at the insurer's request.[68]

The United States Supreme Court granted *certiorari* to resolve the conflict between the decision in *Pireno*[69] and a fourth circuit decision in a factually identical case.[70] After examining its prior decision in *Royal Drug*,[71] the Supreme Court affirmed the second circuit's decision, using the three-pronged test laid down in that case. In applying these factors, the Court held, as to the first prong, that "ULL's use of NYSCA's Peer Review Committee plays no part in the 'spreading and underwriting of a policyholder's risk."[72] The Court relied in part on the court of appeals decision and noted that the transfer of the risk from the insured to ULL takes place when the insurance is purchased.[73] The interplay of Peer Review takes place "only after the risk has been transferred by the policy. . ."[74] Thus, held the Court, the peer review "is logically and temporally unconnected to the transfer of risk accomplished by ULL's insurance policy.[75] Under the second prong, the Court held that ULL's use of NYSCA's Peer Review Committee is not an integral part of the policy relationship because ULL's arrangement with NYSCA is distinct from the relationship with their policy holders.[76] Put another way, the arrangement is not "between insurer and insured."[77] As to the last prong, it was noted that the peer review's reach extends well beyond the confines of the insurance field,[78] extending to third par-

66 *Id.* at 125.

67 *Id.* at 127.

68 *Id.* at 128.

69 *Id.*

70 The fourth circuit decided Bartholomew v. Virginia Chiropractors Ass'n, 612 F.2d 812 (4th Cir. 1979), *cert. denied*, 446 U.S. 938 (1980) differently from the district court decision in *Pireno*. For other cases involving inter-industry restraints of trade, see Weller, *supra* note 32, at 622 nn.165-66.

71 440 U.S. 205 (1979).

72 458 U.S. at 130.

73 *Id.* at 131.

74 *Id.*

75 *Id.*

76 *Id.* at 131.

77 *Id.*

78 *Id.* at 132.

ties as well as practicing chiropractors.[79] Thus, the Court concluded that use of a peer review committee was not exempt from antitrust scrutiny.[80]

D. *Challenges to State Regulation and Taxation After McCarran-Ferguson*

State regulation and taxation were challenged under the Commerce Clause in several early cases. For example, in *Prudential Insurance Co. v. Benjamin*,[81] the United States Supreme Court, in its first McCarran Decision, upheld a South Carolina tax on out-of-state insurers. The Court stated "[o]bviously Congress' purpose was broadly to give support to the existing and future state systems for regulating and taxing the business of insurance. . . ."[82] In *Maryland Casualty Co. v. Cushing*,[83] the Court addressed the question whether Louisiana law encroached upon the maritime jurisdiction withdrawn from the state. In the following year, *Wilburn Boat Co. v. Fireman's Fund Insurance Co.*[84] raised the question whether a breach of an insurance contract is governed by Texas law. Finally, in *F.T.C. v. Travelers Health Association*,[85] the Court noted that the McCarran-Ferguson Act primarily sought to reaffirm state power to regulate tax insurance. In all of these cases, the Court construed Congressional history underlying the McCarran Act to uphold the right of the state to regulate insurance.[86] The Court relied upon Congressional policy to counter fears that states would be stripped of the power to regulate and tax insurance.[87]

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79 *Id.*
80 *Id.* at 134.
81 328 U.S. 408 (1946).
82 *Id.* at 429.
83 347 U.S. 409 (1954).
84 348 U.S. 310 (1955).
85 362 U.S. 293 (1960).
86 *See* Lent, *McCarran-Ferguson in Perspective*, 48 INS. COUNS. J. 411, 412 (1981); *see also* Weller, supra note 32, at 599-600 (where the author, relying on these cases, noted that state regulation and taxation was a preeminent objective of Congress).
87 *See* Weller, *supra* note 32, at 604.

IV. An Examination of Some of the Arguments For and Against the Limited Antitrust Exemption

A. *Arguments in Support of the Exemption*

One argument in support of the exemption is that it is limited in scope. In *St. Paul Fire & Marine Insurance Co. v. Barry*,[88] licensed physicians in Rhode Island and their patients brought a class action suit against four medical malpractice insurers, alleging a conspiracy in which three of the four insurers refused to deal on any terms with policyholders of the fourth insurer in violation of the Sherman Act.[89] The insurers opted to change the terms of their coverage from an "occurrence" basis to that of a "claim" basis.[90] This was allegedly effectuated by compelling the policyholders to submit to coverage changes by the fourth insurer whereby there would be no renewals of occurrence based coverage, but only an issuance of claims made coverage.[91] The district court dismissed the claim as barred by the McCarran-Ferguson Act.[92] Nevertheless, the court of appeals reversed and held that the claim was within the boycott exception of section 3(b) of the Act.[93] Upon review, the United States Supreme Court held that the "boycott" exception applies to certain types of disputes between policyholders and insurers, and is not limited to concerted activity directed against competitor insurers, or agencies or competitors of members of the boycotting group.[94]

In sum, the Court held that the type of private conduct alleged in *St. Paul*, which was directed against policyholders, constitutes a boycott within the meaning of section 3(b).[95] Such conduct, the Court noted, "accords with the common understanding of a boycott."[96] The agreement between the insurers erected a barrier between respondents and "any alternative source of the desired coverage, effectively foreclosing all possi-

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88 439 U.S. 531 (1978).
89 *Id.* at 533.
90 *Id.* at 535.
91 *Id.*
92 *Id.* at 533.
93 *Id.* at 534.
94 *Id.* at 552.
95 *Id.* at 554.
96 *Id.* at 552.

bility of competition anywhere in the relevant market."[97] Accordingly, the Court noted that the conduct occurred outside any regulatory or cooperative arrangement established by the laws of Rhode Island.[98] Further, the state had not decided that regulatory policy requires certain risks to be allocated in a particular fashion among insurers or authorized insurers to decline to insure particular risks.[99] In closing, the Court stated "a group of insurers decided to resolve by private action the problem of escalating damages claims and verdicts by coercing the policyholders of [one of the insurers] to accept a severe limitation of coverage."[100]

Both the *Royal Drug* and *Pierno* decisions bolster the arguments which support the exemption because of its limited scope. Also, the conduct must be regulated by state law, and cannot be an agreement or act of boycott, coercion or intimidation. Most recently, the eighth circuit found that employers alleging an agreement among workers' compensation insurers to charge the maximum rates set by the Minnesota Insurance Department had sufficiently established boycott, coercion, or intimidation under section 3(b) of the McCarran-Ferguson Act.[101] The court concluded that in view of the limited scope of the insurance exemption, the McCarran-Ferguson Act cannot be blamed for acts of boycott which it does not immunize.[102]

Another argument in favor of the exemption is that repeal of McCarran-Ferguson would leave the question of antitrust immunity to determinations under the state action doctrine, consid-

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97 *Id.* at 553.

98 *Id.*

99 *Id.* at 554.

100 *Id.* For a discussion of *St. Paul Fire,* 438 U.S. 531 (1979), its progeny and the "underpinnings" of the McCarran Act see Weller, *The "New" McCarran Ferguson Act Antitrust Exemption After Barry,* 50 INS. COUNS. J. 29 (1983). The article focuses on Justice Powell's opinion (in *St. Paul Fire*) and suggest that his construction of the boycott exemption has changed the complexion of McCarran jurisprudence, and how states regulate the "business of insurance." *Id.* at 33-34.

101 *In re* Workers' Compensation Insurance Antitrust Litigation, 867 F.2d 1552 (8th Cir. 1989) (holding that private rate setting by insurers constituted the "business of insurance within the meaning of the McCarran exemption from federal antitrust laws). *See generally* Vol. II, No. 28 National Law Journal, March 20, 1989, at 38 for a further discussion of the litigation.

102 *In re Worker's Comp.,* 867 F.2d at 1567.

ered by some an unsatisfactory substitute.[103] This argument is premised on the fact that the doctrine is judicially created, and had not had occasion to be applied to the insurance field until most recently.[104]

The state action doctrine holds that if an activity is not prohibited by the state, and is closely supervised by the state, that activity is immune from antitrust liability.[105] Some have argued that the state action doctrine could be the basis of determinations of antitrust immunity in absence of McCarran-Ferguson.[106] This is reinforced by the argument that Section 2(b) of the Act is really a codification of the state action doctrine.[107] Thus, if concerted rate-making is not prohibited by a state, and that state closely supervises rate-making activity, concerted rate-making is immune from antitrust liability in that state.[108]

The permissibility of antitrust immunity under the state action doctrine was first enunciated in the case of *Parker v. Brown*,[109] which held that anticompetitive conduct attributable to states is not prohibited by federal antitrust laws.[110] In *Parker*, a state law which attempted to serve uniform prices by impeding competition among raisin growers in California was upheld on the basis of state action.[111] The statute allowed the growers to devise a marketing system to set rates and have them enforced by an administrative committee.[112] The Supreme Court initially re-

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103 *See* Parker v. Brown, 317 U.S. 341 (1943); *see also* Nutter, *The Insurance Wars*, 18 A.B.A. SEC. TORT & INC. PRAC. The Brief, (Winter 1989); Idem "State Regulation of Insurance: A Study for those who Remember How but not Why," presented to the Tort and Insurance Practice Section of America Bar Assn. (A.B.A.), Washington, D.C. May, 1978, at 12-18.

104 *See* Nutter, *supra* note 103, at 15. The doctrine had not been applied to insurance at the time of Nutter's article.

105 *Weller, supra* note 32, at 615.

106 *Id.*

107 *Id.*

108 *See* Weller, The McCarran-Ferguson Act's Antitrust Exemption For Insurance: Language, History and Policy, 1978 DUKE L.J. 587, 615 (1978) (noting that the state action doctrine and the McCarran exemption are based on the interplay of state regulation); Blumstein and Calvani, *State Action as a Shield and a Sword in a Medical Antitrust Context:* Parker v. Brown *in a Constitutional Perspective*, 1978 DUKE L.J. 389 (1978).

109 317 U.S. 341 (1943).

110 *Id.* at 350-52.

111 *Id.*

112 *Id.* at 359.

stricted this doctrine to state action, not individual or corporate action.[113]

In *Town of Hallie v. City of Eau Claire*,[114] the Supreme Court established municipal autonomy from federal antitrust laws in the context of waste disposal.[115] The Court held that active state supervision is not required where a municipality is involved.[116] The doctrine is generally only applied to private defendants.[117] A few years later, in *Southern Motor Carriers Rate Conference v. United States*,[118] state regulation of collective intrastate rate submissions by motor carriers was held sufficient to protect the activity.[119] The motor carriers were allowed jointly to set and submit proposed rates to the Public Service Commissions of Georgia, North Carolina, Mississippi and Tennessee.[120] The Court held that the activity in question need not be compelled by the state.[121] Similarly, in *California Retail Liquor Dealers Assn. v. Midcal Aluminum, Inc.*,[122] an injunction issued to restrain enforcement of a California State statute requiring state licensed wine merchants to retail wine only at prices set in resale price schedules filed by wine producers and wholesalers.[123] The state did no more than require the filing of these schedules.[124] It did not directly control wine prices, nor did it oversee the reasonableness of the prices in the schedules.[125] Thus, in light of the close supervision requirement and in order to meet the requirements of the state action doctrine, an open competition or no file regulation might have to be

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113 *Id.* at 351. *See, e.g.*, Note, Parker v. Brown: *A Preemption Analysis*, 84 YALE L.J. 1164 (1974-75); Note, Town of Hallie v. City of Eau Claire: *Expanding Antitrust Immunity Under the State Action Exemption*, 17 ENVTL. L. 275 (1986).

114 471 U.S. 34 (1985).

115 *Id.* at 45.

116 *Id.*

117 *See* City of Lafayette v. Louisiana Power & Light Co., 435 U.S. 389 (1978). A few courts have required active state supervision of municipalities. *See, e.g.*, Corey v. Look, 641 F.2d 32 (1st Cir. 1981); Community Communications Co. v. City of Boulder, 630 F.2d 704 (10th Cir. 1980), *rev'd*, 455 U.S. 40 (1982).

118 471 U.S. 48 (1985).

119 *Id.* at 65.

120 *Id. See also* U.S. DEPT. OF JUSTICE ANTITRUST DIVISION, THE CRISIS IN PROPERTY-CASUALTY INSURANCE, at 3 (1986)

121 *Southern Motor Carriers*, 471 U.S. at 66.

122 445 U.S. 97 (1980).

123 *Id.* at 99-100.

124 *Id.* at 105.

125 *Id.*

abandoned for prior-approval systems which immunize collective rate-making.[126] It is argued that such a development, together with the costs of filing for and adjudicating rate changes, would negatively impact affordability.[127] It must be noted that there are others who see the state action doctrine as a better substitute for McCarran-Ferguson's limited antitrust immunity, since the *Royal Drug* and *Pireno* decisions give limited immunity to "insurers," a category which does not include rating bureaus.[128]

In support of McCarran-Ferguson, an argument is made that the Act promotes competition by allowing companies to benefit from actuarially sound industry wide loss data gathered for rate-making purposes. Without such activity, smaller companies might risk insolvency from pricing based on unreliable loss data. The insolvency of such smaller companies would not only reduce competition, but would also harm the policyholders of these companies.

Lastly, it has been argued that the property-casualty insurance industry is far from collusive and anticompetitive. In fact, it has been stressed that the industry remains competitive because past pricing mistakes cannot be passed on to new policyholders without losing market equity values.[129]

B. *Arguments Against the Exemption*

The primary argument against the exemption is that it has the effect of restricting competition in the property-liability insurance market by allowing data sharing and concerted rate-making. Thus, some have suggested a repeal of the exemption as a solution to the capacity crunch of the mid-1980s.[130] Others have gone as far as charging collusive and anticompetitive behavior on

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[126] *See* FEDERAL AND STATE INSURANCE WEEK, Vol. 1, No. 12, at 17.

[127] *See* Nutter, *supra* note 103, at 21, where the author notes that insurance pools may violate antitrust laws absent the exemption.

[128] *But see* Nutter, *supra* note 103 at 15, where he concludes that the state action doctrine is no substitute for McCarren-Ferguson because our current system would be replaced by "litigation for an orderly system of statutory laws and regulations.

[129] *See* Lacey, *The Competitiveness of the Property-Casualty Insurance Industry: A Look at Market Equity Values and Premium Prices*, 5 YALE J. ON REG. 501, 502-03 (1988) [hereinafter Lacey].

[130] Senator Howard Metzenbaum (D-Ohio) introduced a bill to repeal the Act. S. 80, 100th Cong., 1st Sess. (1987). *See also* Address of Senator Metzenbaum, 56 ANTITRUST L.J. 387 (1987).

the part of insurers under the protective umbrella of McCarran-Ferguson, and attribute the crisis to such collusion.[131] One author cites several boycott claims filed in consolidated antitrust suits in the District Court of California, in support of his arguments of collusion under McCarran-Ferguson, although the Act specifically denies protection for boycotts.[132] He blames the crisis on the anticompetitive Insurance Services Office (ISO) rate, while at the same time documenting the fact that insurers competed themselves into financial trouble and ignored the ISO advisory rate before the crisis.[133]

Another argument against the exemption stems from its preferential treatment of the insurance industry, since no other major industry enjoys statutory immunity for collective behavior under federal antitrust laws. It must be pointed out, however, that in no other industry is profitability inextricably tied to, among other things, a successful prediction of chance of loss. The law of large numbers, on which insurance operates, teaches that the wider the statistical base for predicting chance of loss, the more nearly actual results will approximate expected results. The danger of not allowing insurers to pool loss data and obtain reliable advisory rates is insolvency, and a concomitant loss of security by individuals, families and businesses.

A third argument is that McCarran-Ferguson encourages sharp pricing practices by the industry, since insurers know that they can collectively and legally raise prices to compensate for past excessive competition.[134] The liability insurance industry charged low rates in the wake of the depressed interest rates of the 1970's and early 1980's. This was followed by sudden pre-

131 *See, e.g.*, ASSOCIATION OF TRIAL LAWYERS OF AMERICA, THE INSURANCE CRISIS: A STUDY IN DECEPTION (1986); Glaberson and Farrell, *The Explosion in Liability Lawsuits is Nothing but A Myth*, BUSINESS WEEK, April 21, 1986, at 24; Stewart, *The "Tort Reform" Hoax*, TRIAL, July 1986, at 89.

132 Angoff, *Insurance Against Competition: How the McCarran-Ferguson Act Raises Prices and Profits in the Property-Casualty Insurance Industry*, 5 YALE J. ON REG. 397, 403 (1988) [hereinafter Angoff].

133 *Id.* at 406-08. The author also notes that certain events gave rise to the increase in insurance premiums. In particular, it was pointed out that the ISO's report entitled, 1985: *A Critical Year*, played a considerable part in the increases. That report identified an "advisory rate," which was utilized by insurance companies to triple and quadruple premiums. *Id.* In closing, the author noted that the McCarran exemption may perpetuate that process. *Id.*

134 *Id.* at 408. *But see* Lacey, *supra* note 129, at 503.

mium increases in 1985,[135] when interest rates fell and investment income diminished drastically. It would appear, however, that the excessive price cutting was encouraged, not by limited immunity under McCarran-Ferguson, but by the incidence of high interest rates and the expectation of substantial investment revenues.

V. Should McCarran-Ferguson be Repealed?

A. *The Driving Force Behind Repeal Efforts*

The driving force behind the move to repeal McCarran-Ferguson has been the liability insurance capacity crunch. Therefore, it becomes necessary to examine the possible role of the McCarran-Ferguson Act on the liability insurance crisis in order to evaluate the validity of repeal arguments. The insurance antitrust suits will also be examined since they have fueled the repeal drive.

1. Does McCarran-Ferguson Account for the Crisis?

The most direct contributing factor in the insurance crisis was excessive price competition in the property-liability insurance market in the late 1970s and early 1980s. This culminated in a pre-tax net operating loss of over $3.8 billion in 1984, premium increases and more selective underwriting.[136] The Justice Department takes a contrary position, concluding that alleged imprudent insurer business practices did not constitute a major factor in the crisis, because in the competitive market, smaller entrants would offer competitive prices.[137] It must be remembered, however, that a small new insurer will probably use bureau rates. The Justice Department report suggests that declining underwriting results were probably more of a factor, since net investment income as a percentage of earned premiums rose

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135 Angoff, *supra* note 132, at 406-07.

136 INSURANCE SERVICES OFFICE, INSURER PROFITABILITY—THE FACTS, 1986, at 13-16. Tax credits and realized capital gains totalled $5 billion, however, allowing a $1 billion overall gain. *Id.* It must be borne in mind that tax credits and capital gains are not pricing factors, and do not influence the assessment of a risk. *See also* Achampong, *The Liability Insurance Capacity Crunch and Tort Liability Reform*, 16 CAP. U.L. REV. 621, 622 (1987) [hereinafter Achampong].

137 *See* Table 2 of UNITED STATES JUSTICE DEPARTMENT, ANTITRUST DIVISION, THE CRISIS IN PROPERTY-CASUALTY INSURANCE, 1986.

from 7.88% over the 1967-80 period to 14.69% over the 1981-85 period.[138] We must not lose sight of the fact, however, that underwriting results deteriorated significantly over that period, and the combined net income over the two periods also deteriorated. This financial picture, together with the availability and affordability problems, supports the argument for excessive competition followed by conservatism in underwriting and pricing.[139]

One author notes that the insurance cycle is driven directly by market psychology and indirectly by economic factors.[140] Unfortunately, however, models of the crisis are usually created by scholars who know little about the real insurance world and who recognize only economic causes.[141] Another author sees three phases to the underwriting cycle in property-liability insurance: a reunderwriting phase in which insurers refuse business at old prices and accept new business or renewals only at higher prices after profitability has hit a low point; a competition phase when profits are generally visible and moving higher; and a crunch phase when profits are squeezed.[142] The crunch is typically triggered by frightening external events which occur when profit margins are already competitive and cause enough financial devastation to force a withdrawal from the market.[143]

Another factor contributing to the crisis was the unavailability and expense of reinsurance coverage, a necessary element in the stability of direct insurance. Such unavailability and expense was due to high reinsurer losses.[144]

The changing legal environment was yet another contributing factor to the crisis, with shifts in traditional notions of fault-

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138 *Id.*

139 *Id.*

140 Kimball, *Should McCarran-Ferguson be Repealed or Amended*, 17 J. OF INS. REG., 165, 172 (1988).

141 *Id.*

142 Stewart, *Profit Cycles in Property-Liability Insurance*, 1 ISSUES IN INSURANCE, at 273, 301-304 (3d ed. 1984); *see also* Kimball, *supra* note 140, at 172.

143 Achampong, *supra* note 136, at 622.

144 *See* Clark, Warren-Boulton, Smith, and Simon, *Sources of the Crisis in Liability Insurance: An Economic Analysis*, 5 YALE J. ON REG. 367 (1988) (the authors argue that developments in tort law account for the crisis and reject the argument that the crisis was caused by anticompetitive behavior shielded by McCarran-Ferguson). *But see* Angoff, *supra* note 132, at 402. (the author argues that the Act's limited insurance antitrust exemption is the cause of the insurance cycles, and shields collusive behavior).

based liability to strict liability under socialization of risk theories. For example, in *Kelley v. R.G. Industries*,[145] the court of appeals of Maryland refused to extend strict liability to manufacturers and marketers of hand guns.[146] The court recognized, however, that strict liability could be imposed if a trier of fact found that injuries were caused by a "Saturday night special." Apparently, since there is little or no legitimate use for such weapons, liability would be justifiably imposed.[147]

In a similar context, a theory of enterprise liability has been adopted such that liability is imposed on an entire industry, where the plaintiff cannot establish the identity of the particular manufacturer whose product caused the injury. Hence, all the manufacturers in the industry jointly control the risk of the product in question. In *Hall v. E.I. du Pont de Nemours & Co.*,[148] an action against six corporate defendants who manufactured virtually all blasting caps on the market,[149] the court held that the plaintiffs did not have to establish that a particular defendant's conduct was the proximate cause of their injury.[150] The court reasoned that plaintiff only had to show that it was more probable than not that one of the defendants manufactured the blasting caps which caused the injury.[151]

Market share liability has been adopted whereby, although a plaintiff is unable to establish that an injury-causing product was that of an identified manufacturer, the plaintiff can sue all the manufacturers who have a share of the market for the product. The plaintiff does not have to show a causal connection between the injury and any particular manufacturer's product and the defendants bear any judgment collectively. Thus, in *Sindell v. Abbott Laboratories*,[152] daughters of women who took the anti-miscarriage drug DES brought an action for damages for cancer which mani-

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145 304 Md. 124, 497 A.2d 1143 (1985).

146 *Id.* at 133, 497 A.2d at 1147.

147 *Id.* at 144-57, 497 A.2d at 1156-1157 (noting that Congressional policy singled out "Saturday Night Specials" as exhibiting little or no use and that the Maryland State Legislature held the same).

148 345 F. Supp. 353 (E.D.N.Y. 1972).

149 *Id.* at 359.

150 *Id.* at 379.

151 *Id.*

152 26 Cal.3d 588, 607 P.2d 924, 163 Cal. Rptr. 132, *cert. denied*, 449 U.S. 912 (1980).

fested itself years later. The lapse of time made it difficult to establish which defendant's product caused the injury. Nevertheless, market share liability was imposed on the defendants, who produced ninety percent of the drug in the United States.[153] Similarly, where the defendants are known to have distributed a drug in the state where an injury occurred, a theory of concert of action or alternative liability has been imposed.[154]

There have also been developments in the area of common law liability of accountants for negligence to non-contractual parties. Apparently, there has been a movement away from denying liability to third parties who rely on negligent financial statements. The new trend, in some states, is based upon a reasonable foreseeability theory, in which a reasonably foreseeable third party, who relies on financial statements received from an accountant's client for a proper purpose, may recover damages for negligent misstatements.[155] Other cases have adopted the formulation of the Restatement of Torts,[156] which allows recovery to specifically foreseen third parties who detrimentally rely on negligently prepared financial statements.[157] In *Raritan River Steel and Co. v. Beckaert*,[158] for example, the Court of Appeals of

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153 *Id.* at 611-13, 607 P.2d at 936-38, 163 Cal. Rptr. at 144-46.

154 *See, e.g.*, Collins v. Eli Lilly Co., 116 Wis. 2d 166, 342 N.W.2d 37, *cert. denied sub nom.* E.R. Squibb & Sons, Inc. v. Collins, 469 U.S. 826 (1984). There, plaintiff sued several manufacturers of DES for injuries sustained after ingesting the drug during pregnancy. *Id.*, 342 N.W.2d at 41. Similar to the plaintiff in *Sindell*, the plaintiff here could not identify the specific manufacturer. Thus, plaintiff attempted to persuade the court to adopt one of several theories of liability, such as those announced in *Sindell, Hall* and Summers v. Tice, 133 Cal. 2d 80, 199 P.2d 1 (1948). *Collins*, 116 Wis. at 174, 342 N.W.2d at 41. After a lengthy discussion, the court held that upon sufficient proof, plaintiff could sue one or several manufacturers. This approach, added the court, provided plaintiff a better advantage to recover because there was always a possibility that one defendant may be judgment proof. *Id.*

155 This theory has been adopted in several states. *See, e.g.*, Rosenblum, Inc. v. Adler, 93 N.J. 324, 461 A.2d 138 (1983); International Mortgage Co. v. John P. Butler Accountancy Corp., 177 Cal. App.3d 806, 223 Cal. Rptr. 218 (1986); Citizens State Bank v. Timm, Schmidt & Co., 113 Wis. 2d 376; 335 N.W.2d 361 (1983). These cases depart from the privity rule established in Ultramares Corp. v. Touche, 225 N.Y. 170, 174 N.E. 441 (1931).

156 RESTATEMENT (SECOND) OF TORTS § 552 (1977).

157 These cases include Haddon View Investment Co. v. Coopers & Lybrand, 70 Ohio St. 2d 154, 436 N.E.2d 212 (1982); Spherex, Inc. v. Alexander Grant & Co., 122 N.H. 898, 451 A.2d 1308 (1982). Rusch Factors, Inc. v. Levin, 284 F. Supp. 85 (D.R.I. 1968).

158 79 N.C. App. 81, 339 S.E.2d 62 (1986). *See also* ACHAMPONG, COMMON LAW

North Carolina held that lack of privity failed to bar a suit against accountants for negligent misrepresentation.[159] The court refused to follow the reasonably foreseeable test, because it was concerned with the magnitude of losses that could result from widespread circulation of misinformation.[160] It also refused to use the Restatement formulation in view of the Restatement's arbitrary limit on the class of potential plaintiffs.[161] Thus, the court adopted a balancing test, which focused on the extent to which the transaction was intended to affect the plaintiff, whether the plaintiff had suffered injury whether the defendant's negligence was the proximate cause of the plaintiff's injury, and whether failure to discover financial discrepancies would harm creditors who extended credit in reliance on an audit.[162]

There are some who argue that the tort liability system did not contribute to the liability insurance capacity crunch. This argument seems contrary to the argument that the tort system is completely to blame for the crisis.[163]

Rising legal defense costs also contributed to the conservatism in underwriting and pricing which preceded the crisis. In 1984, legal defense costs reportedly constituted 36% of general liability insurer losses, as compared with 27% in 1980.[164]

Lastly, increasing jury awards were also a contributing factor to the capacity crunch. Awards for product injuries averaged $1.07 million in 1984, a year in which the average malpractice

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LIABILITY OF ACCOUNTANTS FOR NEGLIGENCE TO NON CONTRACTUAL PARTIES: RECENT DEVELOPMENTS, Vol. 91, No. 3.

159 *Raritan River Steel*, 79 N.C. App. at 88, 339 S.E.2d at 67.

160 *Id.* at 91, 339 S.E.2d at 68.

161 *Id.*

162 *Id.* at 90, 339 S.E.2d at 68.

163 *See, e.g.*, Angoff, *supra* note 132, at 398-402. Angoff alleges in support of his argument that rates did not fall after tort reform. *Id.* at 398. It is a well documented fact, however, that liability insurance premiums were drastically reduced in 1988 due to a softening of the market. *See, e.g.*, Business Insurance, May 16, 1988, at 1; Business Insurance, July 4, 1988, at 1; Business Insurance, Nov. 28, 1989, at 1; *see also Rate cutting abounds and capacity expands*, Business Insurance 1989 at 1, where rate cuts ranging between 10% to 33% in liability insurance are reported. Although the softening of the market may be more attributable to premium increases and selective underwriting prior to 1988, one cannot completely eliminate the possible contribution or tort reform to present availability and affordability, considering the psychological forces that drive the insurance cycle.

164 ALLIANCE OF AMERICAN INSURERS, *Questions and Answers on Availability*, at 4 (1985).

award was $950,000.[165] There were $400 million judgments nationwide in 1984, as opposed to $125 million in 1980.[166]

Research findings do not support the charge that the limited insurance antitrust exemption is the basis for anticompetitve practices. The Virginia State Corporation Commission, for example, found no evidence of anticompetitive actions by insurers in the commercial liability insurance area.[167] Professor Priest dismisses the cyclical, collusion and expanded corporate liability theories as inherently unsatisfactory explanations of the crisis.[168] He opines that the crisis repelled the socialization of risk by our courts, since it caused insurers to withdraw or to increase the price of certain coverages, ultimately harming the poor it was meant to help.[169] Other researchers find no direct evidence of collusive activity in the property-liability insurance industry.[170]

To counter arguments of lack of competition, reference is made to the ease of entry by new companies into the property-liability insurance market and the fact that the largest insurer does not control more that 8.6% of the market.[171] The increases in premiums for the 1984-86 period have been explained as an attempt to price insurance at levels commensurate with projected cash flows, not an attempt to make up for past pricing errors.[172]

2. The Insurance Antitrust Suits and Repeal Efforts

The antitrust suits filed in Federal District Court in San Francisco and state court in Texas against various insurers, rein-

165 Wall Street Journal, Jan. 21, 1986.

166 *See* TORT POLICY WORKING GROUP, AN UPDATE ON THE LIABILITY CRISIS, at 33 (March 1987), where data issued by the Rand Corporation is analyzed. The report notes that most of the increases occurred in the 1980-1984 period.

167 *See* REPORT OF THE STATE CORPORATION COMMISSION ON THE LEVEL OF COMPETITION, AVAILABILITY AND AFFORDABILITY IN THE COMMERCIAL LIABILITY INSURANCE INDUSTRY.

168 Priest, *The Current Insurance Crisis and Modern Tort Law*, 96 YALE L.J. 1521 (1987).

169 *Id.*

170 Lacey, *Recent Evidence on the Liability Crisis*, Vol. LV, No. 3 JOURNAL OF RISK AND INSURANCE, at 499 (September 1988). *See also* U.S. DEPARTMENT OF JUSTICE, ANTITRUST DIVISION, THE CRISIS IN PROPERTY-CASUALTY INSURANCE, Vol. LV, at 9-10 (1986).

171 Wall Street Journal, April 8, 1988, at 16. There are about 3,500 property/liability insurers. *Id.*

172 Lacey, *supra* note 129, at 515.

surers, reinsurance brokers and insurance trade associations added momentum to efforts to repeal or modify McCarran-Ferguson. The defendants were generally charged with conspiring to eliminate occurrence based general liability forms, draft restrictive claims made forms, and eliminate pollution coverage completely from the commercial general liability form.[173] The suits demanded damages and injunctive relief against both individual and corporate defendants.[174]

The suits specifically alleged that the defendants[175] coerced the ISO to rewrite its new commercial general liability forms so as to exclude pollution coverage completely and to include a retroactive date in the claims made form. The ISO was allegedly prepared to offer accidental pollution coverage. The suits alleged that members of the Reinsurance Association of America threatened not to reinsure occurrence based forms, entering into an agreement with Lloyd's of London Underwriters to boycott reinsurance of such forms as well as pollution exposures.[176] The

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173 See Business Insurance, March 28, 1988 at 1. The Texas suit seeks to ban the I.S.O. from operating in Texas. The San Francisco class action suits involve seventeen state Attorneys-General and several other private plaintiffs. Claims of up to $100,000 are being made against individual defendants, and up to $1 million against corporate defendants, with a trebling of awards under the Sherman Act being sought in a jury trial. Settlement agreements have been reached between the state of Texas and two of the defendants in this suit—the Travelers Insurance Co. and St. Paul Fire & Marine Insurance Co. The two companies admitted to no wrongdoing, but indicated that they wished to cap their legal expenses. Each company agreed to pay the state of Texas $500,000 each in attorney's fees and investigative costs (for a total of $1 million). Both insurers also agreed not to serve on four committees of the Insurance Services Office for three years. These are the executive committee, board of directors, commercial lines committee and nominating committee. *See* Business Insurance, Oct. 16, 1989, at 1. The other defendants are still pressing on with the suit.

174 The suits sought an order that the I.S.O. issue policy forms as originally revised in 1984 before the changes complained of; that the I.S.O. maintain rating support for the old 1973 commercial general liability form; that the activities of the I.S.O. and the Reinsurance Association of America be restricted to the development of rates and policy forms; and that reinsurer defendants withdraw any requirements that direct insurers use claims-made forms. *See* Business Insurance, March 28, 1988, at 1.

175 Named defendants include Aetna Casualty & Surety, the Hartford Fire Insurance Co., Allstate, CIGNA, Prudential Reinsurance Co., General Reinsurance Corporation, certain reinsurance brokers, trade organizations and individuals.

176 These suits are Civ. 88-0981, 88-0983, 88-0984, 88-0985, 88-0986, 88-0987, 88-0988, all filed on March 22, 1988, and 88-1009 filed on March 23, 1988. *See* Business Insurance March 28, 1988, at 39.

suits, therefore, charged agreements and acts of boycott, coercion and intimidation within section 3(b) of the McCarran-Ferguson Act.

In *St. Paul Fire & Marine Insurance Co. v. Barry*,[177] the United States Supreme Court held that the term "boycott" included a concerted activity directed at other insurers, agents and policyholders of the boycotting group.[178] Accordingly, the Court held that a refusal to deal on any terms with policyholders constitutes a boycott.[179] The Court noted that the concerted refusal to deal challenged by *Barry* went well beyond a private agreement to fix rates and terms of coverage, as it denied policy holders the benefits of competition in vital matters such as claims policy and quality of service.[180] The Court emphasized that the conduct "occurred outside of any regulatory or cooperative arrangement established by the laws of Rhode Island."[181] Therefore, the court held, the state did not authorize the conduct at issue.[182]

The *Barry* court noted "a group of insurers decided to resolve, by private action, the problem of escalating damages claims and verdicts by coercing the policyholders of St. Paul to accept a severe limitation of coverage essential to the provision of medical services."[183] In recognizing this activity, the court concluded "conduct by individual actors falling short of concerted activity is not a 'boycott' within Section 3(b)."[184]

In *UNR Industries, Inc. v. Continental Ins. Co.*,[185] an insured debtor filed antitrust and related actions based on state law against several insurers who had issued liability policies covering the manufacture of asbestos products.[186] The plaintiff first alleged that the insurers conspired to reduce the services con-

177 439 U.S. 531 (1978).
178 *Id.* at 552.
179 *Id.*
180 *Id.* at 553.
181 *Id.*
182 *Id.*
183 *Id.* at 554. The complaint filed by the Attorney-General for the State of New York alleged that the State of New York did not regulate the reinsurance business, nor did it admit insurers who wrote commercial general liability insurance for New York risks or excess umbrella coverage as to rates or forms.
184 *Id.* at 555.
185 607 F. Supp. 855 (N.D. Ill. 1984).
186 *Id.*

tracted for and changed the terms of the policies.[187] Secondly, the plaintiffs charged, among other things, that the defendants also conspired to eliminate the market for occurrence policies and substitute claims made polices which provided less coverage at higher premiums by means of a boycott.[188]

The District Court for the northern district of Illinois held that a joint decision by insurers to offer one type of policy rather than another is the type of decision that is protected by the McCarran-Ferguson Act.[189] The court also held that the activity met the requirements laid down in *Pireno* to make the activity the "business of insurance," since it involved an agreement to change the type of policy offered.[190] Such an agreement, added the court, "affects the spreading of risk, which is at the very heart of the policy relationship, and the agreement is limited to insurance companies."[191] Furthermore, the activity was regulated by the State of Illinois.[192] In addition, the court held that an agreement to change to a new type of policy is not a boycott, and does not constitute coercion or intimidation.[193]

A concerted refusal by reinsurers to deal with insurers unless direct coverage is written on claims made forms, coupled with concerted acts designed to compel direct insurers to comply with their demands, may constitute agreements or acts of coercion and intimidation within section 3(b) of the McCarran-Ferguson Act. A refusal to reinsure occurrence forms is not a refusal to deal on any terms within the meaning of *St. Paul Fire & Marine*. It would appear from that decision that agreements relating to the terms on which coverage will be written, including whether pollution coverage would be offered, fall outside the purview of the "boycott" exception in section 3(b) of the McCarran-Ferguson Act. This is reaffirmed because such decisions merely constitute a refusal to deal on certain terms, rather than a refusal to deal altogether.

On September 21, 1989, Judge Schwarzer dismissed the

187 *Id.* at 858.
188 *Id.* at 862.
189 *Id.*
190 *Id.*
191 *Id.*
192 *Id.*
193 *Id.*

suits filed in the federal district court in San Francisco, finding *inter alia*, that the states had failed to establish that the insurance industry defendants violated the McCarran-Ferguson Act by engaging in a boycott.[194] This was a reaffirmation of his earlier proposed order issued in July.[195] Judge Schwarzer also granted the defendants' motion to dismiss based on the state action doctrine[196] as well as the global conspiracy charge alleging that United States insurers and certain trade associations conspired with foreign reinsurers to restrict coverage under general liability insurance policies.[197] He also dismissed foreign defendants from the suit on the basis of comity, a reciprocal respect for foreign law.[198] Judge Schwarzer distinguished the *St. Paul Fire & Marine v. Barry*[199] case, finding that the defendants in the case before him had only been charged with an agreement to restrict coverage, whereas the *Barry* case involved concerted refusals to deal which denied customers access to the markets for the desired coverages.[200] The plaintiff plans to appeal to the Ninth U.S. Circuit Court of Appeals on the ground of an erroneous interpretation of relevant case law.[201]

As already pointed out, one contributing factor to the liability insurance capacity crunch was the unavailability and expense of reinsurance. Since most general liability insurance at the time of the crisis was written on occurrence forms,[202] the question arises whether there was a possible link between the crisis and the refusal to reinsure occurrence forms. The McCarran-Ferguson Act, however, cannot be indicted for those agreements or acts of boycott, coercion and intimidation for which it specifically denies antitrust immunity.

194 *See* Business Insurance, Sept. 25, 1989, at 37.

195 *Id.*

196 *Id.*

197 *Id.*

198 *Id.*

199 439 U.S. 531 (1978).

200 *See* Business Insurance, Sept. 25, 1989, at 37.

201 *Id.*

202 *See* INSURANCE INFORMATION INSTITUTE, INSURANCE ANTITRUST LITIGATION, THE CONSPIRACY THEORY AND RELATED PUBLIC ISSUES (April 1988,) where it is noted that less than 5% of all general liability forms were written on a claims-made basis.

VI. Potential Ramifications of Repeal or Modifications

Several repeal or modification attempts have already been made. Senator Howard Metzenbaum of Ohio introduced a bill in 1987 to repeal the McCarran-Ferguson Act.[203] Senator Paul Simon of Illinois introduced a bill in the same session to modify McCarran-Ferguson.[204] Later, Senators Metzenbaum, Simon, Biden of Delaware and Kennedy of Massachusetts introduced a compromise bill which would apply the antitrust laws to the business of insurance but allow dissemination of historical loss data, joint development of policy forms, joint underwriting and reinsurance.[205] Later in the same session, Congressman Edwards of California and others introduced a bill known as the "Fairness in Insurance Act."[206]

A repeal would remove the limited antitrust immunity presently enjoyed by the industry for collective rate-making and product development. Thus, joint rate-making and product development would run afoul of the Sherman Act. Joint pricing would then be a per se violation of the Sherman Act, attracting both criminal and civil penalties.[207] Rating bureaus such as ISO would have to make drastic changes in their functions and operations to avoid violating the antitrust laws. The inability to share loss data by the industry would deny smaller companies the benefit of actuarially sound loss data for rate-making purposes. This would affect their ability to set adequate and competitive rates, creating a risk of insolvency. Not only would this reduce competition in the insurance market, it would also harm the policy holders of such companies.

A repeal would leave any possible immunity from antitrust liability to the state action doctrine, which immunizes an activity from antitrust liability if the activity is not prohibited by a state and is closely supervised by that state. Thus, if concerted rate-

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203 S. 80, 100th Cong., 1st Sess. (1987).

204 S. 804, 100th Cong., 1st Sess. (1987).

205 S. 1299, 100th Cong., 1st Sess. (1987).

206 H.R. 2727, 100th Cong., 1st Sess. (1987). *See* Weller, *supra* note 32, at 615. The National Association of Insurance Commissioners (NAIC) staff prepared a relevant study and made the same observation. *Id.* One case, *Allstate Ins. Co. v. Lanier*, specifically acknowledged that Section 2(b) was a codification of the state action doctrine. 242 F. Supp. 73 (E.D.N.C. 1965), *cert. denied*, 385 U.S. 930 (1966).

207 *See generally* Sherman Act, ch. 647, 26 stat. 1397 (1890) (current version at 15 U.S.C. § 1 (1908).

making were not prohibited by a state, and that state closely supervised rates, concerted rate-making might be immune from antitrust liability in that state. The close supervision requirement would necessitate discarding open competition or no-file rate regulation for prior-approval and flex rating systems of rate regulation. Such a development could negatively impact affordability.

A modification of McCarran-Ferguson as has been suggested by the proposed Fairness in Insurance Act will also require far-reaching changes in the way the industry operates. As amended by the House Subcommittee on Monopolies and Commercial Law, certain insurer activities would be prohibited regardless of state law. These include price fixing, agreements between insurers on where or to whom insurance will be sold,[208] and tying the sale of one type of insurance to the sale or purchase of another. These activities, by the terms of the bill, would not be insulated from antitrust liability under the state action doctrine, since they are made unlawful regardless of state law. The bill would thus pre-empt the operation of the state action doctrine.

The bill would protect certain other activities. The collection, compilation or dissemination of historical loss data would be protected. Such data could not include information on expenses,[209] or any trending factors. Both Senator Metzenbaum and Representative Edwards are working on renewing their efforts at modification during the present session of Congress.[210]

VII. Conclusion

Tort reform, premium increases in the "reunderwriting" stage of the insurance cycle and the formation of risk retention groups under the Risk Retention Amendments of 1986[211] to the Product Liability Risk Retention Act of 1981[212] have helped ease

208 Geographical allocations between competitors are addressed in section 2(b) of the proposed bill.

209 Hence the designation "historical." A four-year transition period would be allowed for companies with annual premiums below $20 million to engage in trending.

210 *See* Business Insurance, Jan. 30, 1989, at 1.

211 Pub. L. No. 99-563, 100 Stat. 3170 (1986).

212 15 U.S.C. §§ 3901-3904 (1988). The 1981 law only allowed risk retention groups for product liability and completed operations. The amendments allow a

the availability and affordability problems of the mid-1980s. Insurance cycles, however, are as inevitable as cycles in the economy as a whole, and excessive competition undoubtedly exacerbates the severity of the cycle.

Rate regulation has traditionally sought to ensure that rates are adequate, not excessive and not unfairly discriminatory. State insurance departments need to institute or better enforce already existing measures designed to ensure adequate rates. Cash flow underwriting should be impermissible if inadequate rates are being charted, to prevent an exacerbation of the competition phase future cycles.[213] Prior-approval or flex rating systems should be employed to reduce the effects of the "reunderwriting" stage of future cycles.

The limited insurance antitrust exemption should be retained, since the ability of insurers to share loss data for rating purposes, come together to form pools for insuring large risks and engage in joint product development ensures the continued strength and financial vitality of insurers, thus according a direct benefit to consumers. The exception is not the cause of availability or affordability problems, and does not immunize agreements or acts of boycott, coercion and intimidation. Attacking the limited insurance antitrust exemption as the culprit for availability or affordability problems, agreements or acts of boycott, coercion or intimidation is a misdirection of effort which diverts attention from the real issues that need to be addressed in the attempt to alleviate future availability and affordability problems.

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broader group of organizations and entities to form risk retention and purchasing groups. *See* Achampong, *supra* note 136, at 628-29.

213 State laws generally define inadequacy of rates in terms of unreasonably low rates that threaten solvency or a monopoly. A redefinition in state laws would appear necessary to take into account low rates which might tend to exacerbate future insurance cycles.