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Federal Courts and the Regulation of the Insurance Industry: An Empirical and Historical Analysis of Courts' Ineffectual Attempts to Harmonize Federal Antitrust, Arbitration, and Insolvency Statutes with The McCarran-Ferguson Act--1941-1993

Willy E. Rice

St. Mary's University School of Law, wrice@stmarytx.edu

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**FEDERAL COURTS AND THE REGULATION OF
THE INSURANCE INDUSTRY: AN EMPIRICAL
AND HISTORICAL ANALYSIS OF COURTS'
INEFFECTUAL ATTEMPTS TO HARMONIZE
FEDERAL ANTITRUST, ARBITRATION, AND
INSOLVENCY STATUTES WITH THE McCARRAN-
FERGUSON ACT—1941-1993**

*Willy E. Rice**

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* Professor of Law, Texas Tech University. M.A. 1972, Ph.D. 1975, University of North Carolina at Chapel Hill; Postdoctoral Fellow 1977, The Johns Hopkins University; J.D. 1982, The University of Texas at Austin. This research was supported in part with funds provided by the American Bar Endowment while the author was a visiting scholar at the American Bar Foundation. The author genuinely thanks Manning G. Warren, III and Francis A. Bottini, Jr. for evaluating the merits of the arguments and recommendations raised in the Article. Any errors or omissions are the author's alone. In addition, the views expressed are those of the author and not necessarily those of the American Bar Foundation.

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I. INTRODUCTION

Nearly 125 years ago, the United States Supreme Court in *Paul v. Virginia*,¹ adopted the view that state commissioners and agencies are pri-

1. 75 U.S. (8 Wall.) 168, 183-86 (1869) (noting that insurance contracts were "local transactions . . . governed by . . . local law" and that the business of insurance was not

marily responsible for regulating the insurance industry.² Since *Paul*, state insurance commissions have had to resolve a variety of insurance-related conflicts and problems. Congress, however, has intervened only once to correct a problem insurers described as a national crisis.

Seventy-six years after *Paul*, the Supreme Court ruled in *United States v. South-Eastern Underwriters Ass'n*,³ that a transaction between an insurer and a policyholder from different states constitutes interstate commerce and is therefore subject to federal antitrust laws and regulations.⁴ *South-Eastern Underwriters* effectively overruled *Paul* and created major turbulence within the insurance industry. Congress responded to the crisis⁵ by enacting the McCarran-Ferguson Act (the Act).⁶

commerce under the Commerce Clause of the U.S. Constitution, and holding that Congress had no authority to regulate the insurance industry).

2. See generally Frederick Rose, *Congressional Proposals on Insurance Would End Primacy of State Regulation*, WALL ST. J., Aug. 5, 1991, at B4. See also *Insurance Company Solvency: Hearing on Insurance Company Solvency and Reporting Methods Before the Subcomm. on Antitrust, Monopolies and Business Rights of the Senate Comm. on the Judiciary*, 101st Cong., 2d Sess. 2 (1990) [hereinafter *Hearing on Insurance Solvency*] (statement of Sen. Metzenbaum) ("Under current laws, State regulators have the primary responsibility for the regulation of premium rates and the availability of insurance, for the regulation of investments by insurance companies, and for the solvency of 2,400 life insurers and 3,850 property/casualty companies.").

3. 322 U.S. 533 (1944).

4. *Id.* at 561-62.

5. See Jere W. Glover, *Should Congress Repeal McCarran-Ferguson?: It's Time to Repeal McCarran-Ferguson*, ANTITRUST, Summer 1987, at 31, 33 ("[F]orty years ago the insurance industry managed to persuade Congress that the McCarran-Ferguson Act was essential, both to preserve the states' autonomy to regulate and tax insurance, and to permit beneficial cooperation among insurers." (statement of James C. Miller, III, Chairman, Federal Trade Commission)); see also S.J. Res. 5482-01, 100th Cong., 1st Sess., 133 CONG. REC. 9735 (1987) ("[I]n 1945, Congress, apprehensive about the effect of *South-Eastern Underwriters* on the powers of states to tax and regulate insurance, adopted the McCarran-Ferguson Act granting the insurance industry broad exemption from most provisions of the Sherman and Clayton Acts, including the proscriptions against such anticompetitive practices as price-fixing, agreements not to compete, monopolization, tying agreements, and a wide range of other conduct that is unlawful for nearly every firm outside the insurance industry . . .").

6. 15 U.S.C. §§ 1011-1015 (1988). The Act states:

§ 1011 Declaration of Policy

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.

§ 1012. Regulation by State law; Federal law relating specifically to insurance; applicability of certain Federal laws after June 30, 1948

(a) State regulation

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.

As of this writing, consumer groups, lobbyists, and other interested parties are arguing that “turmoil”⁷—more serious than the *South-Eastern Underwriters*-generated chaos—is again crippling the nation’s insurance industry. Some state prosecutors, for example, maintain that “numerous big insurance companies illegally conspired to control the insurance market during the mid-1980s,” resulting in “skyrocketing insurance rates.”⁸

(b) Federal regulation

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 Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State Law.

§ 1013. Suspension until June 30, 1948, of application of certain Federal Laws; Sherman Act applicable to agreements to, or acts or, boycott, coercion, or intimidation

(a) Until June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, and the Act of June 19, 1936, known as 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.

§ 1014. Effect on other laws

Nothing contained in this chapter shall be construed to affect in any manner the application to the business of insurance of the Act of July 5, 1935, as amended, known as the National Labor Relations Act, or the Act of June 25, 1938, as amended, known as the Fair Labor Standards Act of 1938, or the Act of June 5, 1920, known as the Merchant Marine Act, 1920.

§ 1015. “State” defined

As used in this chapter, the term “State” includes the several States, Alaska, Hawaii, Puerto Rico, Guam, and the District of Columbia.

15 U.S.C. §§ 1011-1015 (citations and notes omitted).

7. See Rose, *supra* note 2, at B4. One observer noted that “[w]ith the turmoil in the industry right now, this is no time for amateurs in insurance regulation.” *Id.* (quoting William McCartney, Nebraska Commissioner of Insurance, Vice President, National Association of Insurance Commissioners).

8. Richard B. Schmitt, *Court Revives Antitrust Suit Against Insurers*, WALL ST. J., June 19, 1991, at B4 (“The states had asserted the companies conspired to limit liability coverage and drive up rates for businesses and governments, amounting to an illegal boycott that limited the availability of liability insurance in the U.S.”); see also Paul M. Barrett, *Justices to Rule on Bid by States to Sue Insurers*, WALL ST. J., Oct. 6, 1992, at A2, A6 (“The attorneys general of 19 states, led by California, filed antitrust lawsuits against four major U.S. primary insurers A federal trial judge dismissed the lawsuits, concluding that defendants were protected by the McCarran-Ferguson Act The Supreme Court

Also, consumer advocates stress that the industry continually abuses insurance consumers with impunity; they note that “policyholders in the last decade have had to confront either three- to five-fold rate increases or the cancellation of their policies.”⁹

Perhaps the strongest evidence of an insurance crisis is insurers’ insolvency data. Consumer lobbyists and others observe that “[t]he number of insurance failures has increased alarmingly over the last several years.”¹⁰ For instance, at least eighty-five life & health and 226 property & casualty insurance insolvencies occurred during the 1980s.¹¹ More important, the failure of some of the nation’s largest and most prestigious insurers¹² has

[on October 5, 1992] agreed to hear the insurers’ appeal of that decision.”); Richard W. Stevenson, *Court Ruling Sets Back Insurers*, N.Y. TIMES, June 19, 1991, at D1 (discussing the Ninth Circuit’s ruling “in a case brought by 19 states against 32 American and foreign insurance companies” in which the court “found that a lower court had erred in dismissing the case largely on the ground that the insurers were exempt from antitrust suits”).

9. Sanford M. Gage & Johnathan T. Zackey, *The Insurance Wars: The Battle Over McCarran-Ferguson—Repeal It!*, THE BRIEF, Winter 1989, at 11, 13 (“[T]he insurance industry has exhibited a cavalier attitude toward consumers and a bloated self-confidence in the face of state regulation. As a result of these abuses . . . [a]cross-the-board cancellations have become commonplace.”); see also Paulette Thomas, *House Panel Votes to Curb Insurer Links*, WALL ST. J., Nov. 20, 1991, at A3 (“Consumer groups contend that the law, which allows insurance companies to share actuarial information, also lets them fix prices and shield themselves from antitrust suit.”).

10. *Regulation of Insurance Companies and the Role of the National Association of Insurance Commissioners: Hearing Before the Subcomm. on Policy Research and Insurance of the House Comm. on Banking, Finance and Urban Affairs*, 102d Cong., 1st Sess. 32 (1991) [hereinafter *Hearing on Insurance and NAIC’s Role*] (statement of Rep. Erdreich).

11. *Id.* Representative Ben Erdreich, Chairman of the Subcommittee, stated:

During the [1970s], there were 108 property/casualty insolvencies; during the 1980s, there were 226 insolvencies, with a significant increase beginning in 1984. During the first half of the 1980s, there were 20 life/health company insolvencies; during the last half there were 65 insolvencies, with 26 in 1989 and 13 in 1990.

Id. (statement of Rep. Erdreich).

12. See Paulette Thomas, *Dingell Unveils Insurance Industry Bill That Would Impose U.S. Rules on Firms*, WALL ST. J., Apr. 10, 1992, at A6 (“Mr. Dingell said that last year’s collapse of Mutual Benefit Life Insurance Co. and First Executive Corp.’s Executive Life Insurance Co., as well as shortcomings in state regulation, convinced him that a federal system is needed . . . ‘to correct obvious deficiencies in solvency regulation before an industrywide crisis occurs’”); see also Susan Pulliam, *Regulators Draft Plan on Mutual Benefit After Insurers Reject a Group Bailout*, WALL ST. J., June 11, 1992, at B6 (“New Jersey regulators are devising a new bailout plan for Mutual Benefit Life Insurance Co. after a group of the nation’s largest life insurers rejected a proposal for them to foot the entire \$800 million bill, said the state’s insurance commissioner.”); Susan Pulliam, *Met Life Agrees to Manage Mutual Benefit*, WALL ST. J., Aug. 5, 1991, at B4. Pulliam stated:

Metropolitan . . . and Prudential Insurance Co. of America have begun working with regulators on a plan to restructure Mutual Benefit, the Newark, N.J.-based insurer seized by state regulators After the failure of

....

generated much anxiety among all levels of government¹³ and contributed to the view that disarray permeates the insurance industry.

Obviously, whether one labels the problem a "crisis" or "turmoil," something is gravely wrong within "the \$2 trillion industry."¹⁴ This discontent over the state of the insurance industry has caused a plea for "Congress to 'do something' about insurance" and conditions plaguing the insurance industry.¹⁵ But what should be done to cure the reported ills? Both consumers and consumer advocates believe the answer is simple: amend or repeal the McCarran-Ferguson Act.¹⁶

One advocate has observed correctly that fear of adverse economic conditions influenced Congress' decision to enact the McCarran-Ferguson Act. Those concerns, however, no longer exist, leading some to suggest that the Act should be amended.¹⁷ Others, however, stress that the insurance industry should be subjected to the full scope of federal anti-

Baldwin-United Corp. in the early 1980s, Metropolitan and other insurers also stepped forward to assume some of its liabilities and cover part of its shortfall in capital.

Id.

13. See Robert D. Haase & Gregory C. Krohm, *The Ailing Health Insurance Industry*, THE BRIEF, Winter 1991, at 14, 15 ("Not only is the number of insolvencies growing; the assessments levied on the remaining members of the industry have risen even more rapidly. . . . The insurance industry's inability to shoulder assessments . . . has raised questions about the need for alternative methods of funding insolvencies."). Constance B. Foster, Pennsylvania Insurance Commissioner, stated:

There is no doubt that insurance company solvency is of compelling interest on both the national and state levels. The recent publicity surrounding the financial difficulties of Executive Life Insurance Company, First Capital Life Insurance Company and Mutual Benefit Life Insurance Company illustrate [sic] the real life problems faced by policyholders of insolvent or troubled companies. As we have seen . . . people can be hurt by insurance company failures.

Hearing on Insurance and NAIC's Role, *supra* note 10, at 100 (statement of Constance B. Foster).

14. Paulette Thomas, *Powerful Insurance Lobby Is Being Fragmented Just When It Needs to Put a Premium on Unity*, WALL ST. J., June 27, 1991, at A16.

15. Edward O. Correia, *The Antitrust Laws and Insurance: Applying Federal Policy to a State-Regulated Industry*, 26 TORT & INS. L.J. 813, 815 (1991).

16. See generally Gage & Zackey, *supra* note 9 (arguing for repeal of the McCarran-Ferguson Act); Glover, *supra* note 5, at 33 (arguing for a "complete revision" of the McCarran-Ferguson Act).

17. Glover, *supra* note 5, at 33.

[I]t is a tragic irony for consumers that the McCarran-Ferguson Act is not needed to accomplish any of the Act's original goals. The time is ripe for a complete revision of the McCarran-Ferguson Act. No longer is there any need to unjustly burden small businesses with ever higher insurance rates. The antitrust exemption for the business of insurance is overbroad and fosters an anticompetitive market Legislation tailored more closely to the requirements of the industry should be enacted to replace the Act.

Id.

trust laws.¹⁸ They note that “[m]ajor American financial corporations, such as banks, investment companies, securities firms, and the savings and loan industry are subject to extensive federal regulation.”¹⁹ Therefore, consumer advocates believe the Act should be repealed outright because the insurance industry presents no compelling justification for either a partial or total exemption from antitrust scrutiny.²⁰

Finally, consumer lobbyists argue that Congress should “create a federal agency endowed with broad powers over state regulators in [all] insurance activities.”²¹ The creation of an oversight agency “would end the

18. See 15 U.S.C. § 1012(b) (1992). Section 1012(b) states in pertinent part:

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 Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State Law.

Id. (second emphasis added) (citation omitted).

19. Correia, *supra* note 15, at 819. “Congress could simply decide that the insurance industry is too large, too complex, and too national in scope (or even international in some cases) . . .” *Id.* Removing the industry’s federal antitrust immunity “would . . . establish[] uniform federal standards to certain aspects of insurance—e.g., solvency, risk pools, and consumer disclosure.” *Id.* (footnote omitted).

20. See, e.g., Gage & Zackey, *supra* note 9, at 13.

Under the Sherman Act, geographical or territorial market allocations are illegal per se; . . . they are conclusively presumed to violate the prohibition on contracts in restraint of trade. Yet, because of its antitrust exemption, the insurance industry is able to make agreements in which companies agree to assign certain territories to each other

The insurance industry euphemistically refers to tying arrangements as “packaging,” which means that in order to get the line of insurance desired, consumers must buy other lines of less popular or less desirable insurance, often against their will. Under antitrust law, such tying arrangements are per se illegal.

Id. The authors argue that insurance companies would never engage in such exploitive conduct if they did not have antitrust immunity. *Id.* Kenneth G. Starling, former Deputy Assistant Attorney General for the Antitrust Division, remarked on the McCarran-Ferguson Act and the state regulation of the business of insurance:

The Department [of Justice] has always been opposed to antitrust exemptions in the absence of a strong showing by those who advocate immunity that there is an actual or potential conflict between the antitrust laws and some other societal goal. The nation’s fundamental economic policy of competition, promoted by the antitrust laws, produces the maximum amount of consumer welfare.

Kenneth G. Starling, Address Before the 1987 Law Conference of the Reinsurance Association of America 1 (Sept. 18, 1987) (transcript on file with the *Catholic University Law Review*).

21. Rose, *supra* note 2, at B4. “[F]ederal oversight has gained political stature with a recent burst of the largest insurance failures in the nation’s history and with widening concern that the patchwork of state oversight may be inadequate.” *Id.*

123-year primacy of state regulation in insurance,"²² and would have the power to establish "a form of federally-chartered insurance company beholden to no one state."²³

Arguments against amending or repealing the McCarran-Ferguson Act abound as well. First, defenders of the industry claim that any reform "could make insurers less stable financially and could actually impose tougher antitrust rules on insurers than on any other industries."²⁴ Moreover, opponents of reform argue that a "[r]epeal of the limited exemption from the Sherman Act will . . . create instability in rate making and will reduce the number of insurers competing in the marketplace."²⁵

Supporters of the McCarran-Ferguson Act also assert that "[f]ederal banking regulation has not prevented bank failures, nor has federal securities regulation deterred insider trading."²⁶ Furthermore, opponents con-

22. *Id.*

23. *Id.* "Among the most striking powers of the new corporation would be the authority to allow industry self-regulatory organizations, monitored by the corporation, to approve members for interstate business in insurance." *Id.*

24. Thomas, *supra* note 9, at 4. Insurers argue that any repeal of the McCarran-Ferguson Act would hurt the insurance industry:

It would subject the industry to Federal Trade Commission consumer provisions, as well as [to] antitrust law. Insurance advertising, for example, could fall under FTC scrutiny . . . Relationships between insurance companies and insurance agents that spell out the sorts of products that agents may sell could be regulated, as well.

Id.

25. Robert S. Seiler, *McCarran-Ferguson is Not the Problem*, ANTITRUST, Summer 1987, at 31, 32. Mr. Seiler stressed that "McCarran immunity has not resulted in a non-competitive marketplace. Rather it has helped create an industry which is atomistic and which has no barriers to entry . . ." *Id.*

26. Franklin W. Nutter, *The Insurance Wars: The Battle Over McCarran-Ferguson—Keep It!*, THE BRIEF, Winter 1989, at 10, 15; Seiler, *supra* note 25, at 33 ("Federal regulation has not prevented bank and [savings and loans] insolvencies or insider trading. In addition, insurance is the sum of local transactions reflecting differing economic, social, and political conditions. A federal regulator cannot, and will not, be able to cope with those differences."). In fact, defenders of the insurance industry argue that the "dual system" of state and federal regulation is partially responsible for the problems in the banking and S&L industries. See, e.g., Thomas, *supra* note 12, at A6. Representative John Dingell introduced a bill in the House of Representatives in 1992 aimed at regulating the insurance industry. H.R. 4900, The Federal Insurance Solvency Act of 1992. 138 Cong. Rec. E 1035 (daily ed. April 10, 1992). Under the bill, certain aspects are left to the states:

States would continue to monitor the safety of insurance companies that chose not to join the federal system . . . States, moreover, also would continue to regulate rates and marketing rules.

But such a dual system is what the [insurance] industry fears most. "If there is any lesson of the S&Ls and banks, it's that there are serious problems with a dual system," said William McCartney, president of the National Association of Insurance Commissioners and insurance commissioner for Nebraska. "You wind up with no one in charge."

Thomas, *supra* note 12, at A6.

tend that “[r]epealing the [Act] may not make insurance significantly more widely available at lower prices. In particular, repeal [may not] solve the crisis in certain lines of property/casualty insurance.”²⁷ Within the past six years, Congress has introduced several bills proposing to repeal or modify the McCarran-Ferguson Act.²⁸

This Article is not written to stimulate debate about whether a major insurance crisis exists, whether the insurance industry should be subjected to the full scope of federal antitrust laws, or whether the McCarran-Ferguson Act should be repealed outright. Much already has been written about each issue.²⁹ Instead, this Article presents an historical and empiri-

27. Starling, *supra* note 20, at 5-6.

28. See, e.g., S. 430, 102d Cong., 1st Sess. (1991) (modifying the antitrust exemption applicable to insurance industry); H.R. 10, 102d Cong., 1st Sess. (1991) (same); S. 719, 101st Cong., 1st Sess. (1989) (same); S. 1299, 100th Cong., 1st Sess. (1987) (same); S. 804, 100th Cong., 1st Sess., (1987) (proposing Insurance Competition Act of 1987 to strike all deference to “insurance” in the McCarran-Ferguson Act); S. 80, 100th Cong., 1st Sess. (1987) (proposing repeal of the McCarran-Ferguson Act); see also *The McCarran-Ferguson Act—State Antitrust Action Against Insurance Agencies: Hearings on S. 1299 Before the Senate Comm. on the Judiciary*, 100th Cong., 2d Sess. (1988); *To Repeal or Revise the McCarran-Ferguson Act: Hearings on S. 80 and S. 1299 Before the Senate Comm. on the Judiciary*, 100th Cong., 1st Sess. (1987).

29. See generally Kenneth S. Abraham, *Making Sense of the Liability Insurance Crisis*, 48 OHIO ST. L.J. 399, 399 (1987) (analyzing causes and possible cures for the crises in liability insurance cost and availability); Jay 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, 397 (1988) (suggesting the cause of any crisis in insurance rates is due to the cyclical nature of the industry resulting from the McCarran-Ferguson Act); Robert G. Berger, *The Impact of Tort Law Development On Insurance: The Availability/Affordability Crisis and Its Potential Solutions*, 37 AM. U. L. REV. 285, 286 (1988) (focusing on the development of tort law in the area of products liability and its impact on the availability and affordability of insurance); David Burrow & John E. Collins, *Insurance “Crisis”—Texas Style: The Case for Insurance Reform*, 18 ST. MARY’S L.J. 759, 761, 793 (1987) (examining the Texas insurance crisis and suggesting various modifications, including the repeal of the McCarran-Ferguson Act); Richard N. Clarke et al., *Sources of the Crisis in Liability Insurance: An Economic Analysis*, 5 YALE J. ON REG. 367, 368, 394-95 (1988) (focusing on the economic aspects of insurance and concluding that a repeal of the McCarran-Ferguson Act would have limited effect in solving the “limited” crisis that exists); Joseph E. Coughlin, *Losing McCarran Act Protection Through “Boycott, Coercion, or Intimidation,”* 54 ANTITRUST L.J. 1281, 1282 (1986) (discussing the proper reading of section 3(b) exemption of McCarran-Ferguson); Frank P. Darr, *Federal Claims in Insurance Insolvencies*, 25 TORT & INS. L.J. 601, 603 (1989) (examining state and federal regulation of insurance company insolvencies); Robert W. Hammesfahr, *Antitrust Exemptions Applicable to the Business of Insurance Other Than the McCarran-Ferguson Act: The State Action Exemption and The Noerr-Pennington Doctrine*, 54 ANTITRUST L.J. 1321, 1321 (1986) (relating the state action exemption and the Noerr-Pennington doctrine to the McCarran-Ferguson Act); Nelson 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 (1988) (discussing market equity as superior to profitability in evaluating the financial performance of insurance firms); Peter A. Lefkin, *Shattering Some Myths on the Insurance Liability Crisis: A Comment on the Article by Clarke, Warren-Boulton, Smith, and Simon*, 5

cal analysis of a repeatedly overlooked but significant phenomenon: the prominent role of federal courts in areas of insurance regulation. Without doubt, “[c]ourts have scrutinized many long-standing insurance industry practices, such as peer review mechanisms, agreements with hospitals, doctors or health care providers and agreements with auto body shops.”³⁰ Furthermore, rulings by both the Supreme Court and the federal appellate courts often affect the economic health of consumers and insurers more seriously than state insurance commissioners’ regulatory and enforcement schemes.³¹

More disturbing, however, are the frequently ambiguous, poorly reasoned, and inconsistent decisions of federal appellate courts.³² It is only

YALE J. ON REG. 417, 418 (1988) (finding that changing standards in tort liability results in an insurance crisis and concluding that a limited antitrust exemption is necessary and beneficial to the public); Banks McDowell, *Competition as a Regulatory Mechanism in Insurance*, 19 CONN. L. REV. 287, 280 (1987) (discussing the negative ramifications of an unregulated insurance industry); George L. Priest, *The Antitrust Suits and the Public Understanding of Insurance*, 63 TUL. L. REV. 999, 1002 (1989) (indicating that antitrust claims against insurers hinder the availability of insurance coverage); Ralph A. Winter, *The Liability Crisis and the Dynamics of Competitive Insurance Markets*, 5 YALE J. ON REG. 455, 458 (1988) (proposing a model of a competitive insurance market to solve the insurance crisis); Eliot M. Blake, Comment, *Rumors of Crisis: Considering the Insurance Crisis and Tort Reform in an Information Vacuum*, 37 EMORY L.J. 401, 403 (1988) (discussing the relationship between tort litigation and the insurance industry); Frank T. Herdman, Comment, *Doctors, Insurers, and the Antitrust Laws*, 37 BUFF. L. REV. 789, 789 (1989) (applying the McCarran-Ferguson exemption for insurance to health care providers); John H. Leskera, Comment, *Change From “Pure” Comparative Negligence to “Modified” Comparative Negligence—Will It Alleviate the Insurance Crisis?*, 32 ST. LOUIS U. L.J. 753, 755 (1988) (indicating that changing from pure comparative negligence to modified comparative negligence may alleviate a state’s insurance crisis); Nancy L. Manzer, Comment, *1986 Tort Reform Legislation: A Systematic Evaluation of Caps on Damages and Limitations on Joint and Several Liability*, 73 CORNELL L. REV. 628, 652 (1988) (concluding that a limit on joint and several tort liability is an appropriate response to the insurance crisis rather than limiting non-economic damage awards); Nancy R. Page, Comment, *Risky Business: Consumer Protection in the Insurance Industry*, 23 HARV. J. ON LEGIS. 287, 280 (1986) (concluding that federal regulation of insurance is necessary to protect consumers); Sara R. Slaughter, Comment, *Statutory and Non-Statutory Responses to the Director and Officer Liability Insurance Crisis*, 63 IND. L.J. 181, 182-83 (1988) (discussing the insurance crisis with respect to director and officer liability insurance).

30. Nutter, *supra* note 26, at 15; see also ROBERT E. KEETON & ALAN I. WIDISS, *INSURANCE LAW: A GUIDE TO FUNDAMENTAL PRINCIPLES, LEGAL DOCTRINES, AND COMMERCIAL PRACTICES* § 8.1(c), at 938 (1988) (“Insurance transactions and institutions are often subject to judicial scrutiny . . .”).

31. See KEETON & WIDISS, *supra* note 30, at 938. “The influence of the courts on insurance transactions through doctrinal developments has sometimes been considerably more significant than the enforcement of regulatory measures by the commissioner of insurance.” *Id.*

32. Cf. *id.* § 8.1(b), at 937 (“There is no definitive answer in regard to what tests or standards should or will be applied by the federal courts . . .”); *id.* § 8.3(a), at 943 n.1 (“Judicial decisions interpreting legislative definitions of insurance frequently are . . . rela-

too clear that insurance consumers, insurers, and consumer advocates are affected severely when courts issue such rulings. Moreover, insurance activists apparently do not understand that inconsistently applied and ambiguous judicial rulings are implicated in many of the problems facing the insurance industry,³³ and that preserving, amending, or repealing the McCarran-Ferguson Act will not necessarily correct the insurance industry's ills. The movement to maintain or alter the Act is misplaced; rather, efforts should focus on removing federal courts from all areas of insurance regulation.

This Article presents both historical and empirical evidence to support the view that the Supreme Court and the lower federal courts are inferior forums for resolving insurance-related controversies. It is amply apparent that "inferior" is an appropriate description of federal courts that have tried to harmonize federal antitrust, insolvency, and "superpriority" statutes with key sections of the McCarran-Ferguson Act.

Part I presents a brief overview of the McCarran-Ferguson Act and the Act's allocation of power among state governments, federal agencies, and courts. In particular, Part I examines the origin and breadth of the courts' power to regulate the insurance industry.

Parts II, III, and IV offer several discussions of intercircuit conflicts involving key provisions of the McCarran-Ferguson Act. Specifically, Part II discusses the intercircuit conflict over the definition of "business of insurance." Does the definition encompass both "for-profit" and "nonprofit" insurers? Or are the nation's Blue Cross and Blue Shield companies engaged in the "business of insurance"? Unquestionably, a serious conflict exists among federal courts of appeals over these and similar questions. Moreover, this disagreement is producing significant problems for both consumers and the insurance industry.

Part III examines important antitrust issues surrounding the insurance industry and the business of insurance. The McCarran-Ferguson Act clearly states that federal antitrust laws "shall be applicable to the business of insurance to the extent that such business is not regulated by State Law."³⁴ The Act also states that the Sherman Act shall apply to *any*

tively imprecise and generally provide little guidance in regard to . . . statutory provisions.").

33. See generally E. Neil Young et al., *Insurance Contract Interpretation: Issues and Trends*, 625 *INS. L.J.* 71, 72-73 (1975) (observing correctly that "[a] continuing legal conflict [exists] between insurance companies and policyholders" and that courts often referee this conflict; consequently, judges "twist[] existing doctrines," apply "inconsistent doctrines," and create an "untidy [body of law] where neither party to the insurance contract knows precisely what the contract does or does not provide until after the fact of litigation").

34. 15 U.S.C. § 1012(b) (1988).

insurance-related agreement or activity involving boycott, coercion, or intimidation.³⁵ Federal appellate courts, however, are profoundly divided over the types of insurance activities and agreements which are prohibited under the Sherman Act. Part III examines this important issue highlighting the effects of poorly reasoned boycott decisions in cases involving Blue Cross and Blue Shield companies.

Part IV discusses the issue of federal preemption. Assuming that a company is engaged in the business of insurance and that state insurance law effectively regulates the insurer's activity, does the McCarran Act's "state action" provision³⁶ preempt all federal statutes which attempt to regulate or outlaw offensive insurance-related conduct? Stated differently, does the McCarran Act prevent a plaintiff from commencing an action against an insurer under federal insolvency and superpriority statutes? Some courts say yes, while others say no.

Finally, Part V presents a case study of the disposition of 275 McCarran-Ferguson cases in federal courts between 1941 and 1993. An empirical analysis reveals that the Supreme Court as well as federal appellate courts permit extra-legal factors to influence whether a case is decided in favor of state insurance commissioners and insurance consumers or in favor of insurance companies. The study reveals that federal courts are deciding a variety of insurance-related questions on the basis of factors which have little to do with the legal issues presented in the complaints.

This Article concludes that the movement to reform the McCarran-Ferguson Act is misplaced. Instead, Congress should prevent federal courts from deciding any legal issue or question concerning the business of insurance or the massive insurance industry. Presently, the Supreme Court and federal appellate courts unwittingly exercise an inordinate amount of control over the industry and are performing extremely poorly in this role.³⁷ This Article recommends that Congress create a federal insurance agency and give that body the authority to regulate the business of insurance within and across state boundaries. Such an agency would hear and resolve all substantive and procedural issues involving insurance-related disputes, thereby effectively removing the need for federal courts' intervention.

35. See 15 U.S.C. § 1013(b).

36. See *supra* note 34 and accompanying text.

37. Courts are unwittingly exercising this control partly because the McCarran-Ferguson Act, as well as bills designed to reform or repeal the Act, contain many ambiguous words and phrases. Often, state insurance commissioners, insurance consumers, and insurers ask federal courts to resolve such ambiguities. When federal courts resolve these ambiguities, they unwittingly exercise great power, and in so doing become extremely ineffective regulators of the nation's insurance industry.

II. A BRIEF OVERVIEW OF THE McCARRAN-FERGUSON ACT AND THE ACT'S ALLOCATION OF POWER AMONG STATES, THE FEDERAL TRADE COMMISSION, AND FEDERAL COURTS

Many insurers viewed the Supreme Court's decision in *United States v. South-Eastern Underwriters Ass'n*³⁸ as an assault on states' authority to regulate the business of insurance within state boundaries.³⁹ Therefore, Congress enacted the McCarran-Ferguson Act⁴⁰ to calm the anxieties of local and national carriers.⁴¹ The Act allocates regulatory power to state insurance commissions and, under some limited conditions, to the Federal Trade Commission.⁴² But a careful examination also reveals that the Act *does not* allocate any regulatory authority to federal courts. Yet, since the Act's enactment, the Supreme Court as well as lower federal courts have willingly or unwittingly accepted or seized opportunities to regulate significant portions of the nation's insurance industry.⁴³ The exercise of such unwarranted judicial power has produced conflicting rules for both national insurers and consumers.⁴⁴

The language of the McCarran-Ferguson Act is less clear regarding two other important matters. First, whether state insurance regulations and enforcement proceedings must be merely adequate or genuinely effective, before intervention of some federal agency, is not easily discerni-

38. 322 U.S. 533 (1944).

39. The Supreme Court noted that "in *South Eastern Underwriters*, [the Court] held that an insurance company that conducted business across state lines was engaged in interstate commerce and thereby was subject to the antitrust laws. This result, naturally, was widely perceived as a threat to state power to tax and regulate the insurance industry." *United States Dep't of Treasury v. Fabe*, 113 S. Ct. 2202, 2207 (1993).

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

41. The Supreme Court observed: "Obviously Congress' purpose [in enacting the McCarran-Ferguson Act] was broadly to give support to the existing and future state systems for regulating and taxing the business of insurance." *Prudential Ins. Co. v. Benjamin*, 328 U.S. 408, 429 (1946); *see also Fabe*, 113 S. Ct. at 2207 (outlining the history of the McCarran-Ferguson Act).

42. *See* 15 U.S.C. § 1012(b); *see also supra* note 18 and accompanying text.

43. *See, e.g.*, Spencer L. Kimball & Barbara P. Heaney, *Emasculation of the McCarran-Ferguson Act: A Study in Judicial Activism*, 1985 UTAH L. REV. 1, 1-2. The authors state:

Though McCarran has . . . remained free from *legislative* alteration, some changes in the Act's allocation of power have resulted from judicial interpretation. In some recent decisions the United States Supreme Court has strikingly altered the Act's meaning to an extent that might be thought of as "emasculation." . . . The almost random selection of cases presented to and selected by the Court contributes to the unevenness with which the Act has been interpreted and the uncertainty that remains.

Id. (footnote omitted).

44. *See infra* notes 54-199 and accompanying text.

ble.⁴⁵ This silence has generated some expected confusion among lower federal courts. For example, the United States Courts of Appeals for the Third, Fifth, Sixth and Ninth Circuits have held that only reasonable or sufficient state regulatory schemes are required to avert federal control of insurance activities.⁴⁶ Courts in the Second and District of Columbia Circuits, however, have suggested that they would require active and effective state regulation of the business of insurance before preventing federal intervention.⁴⁷

Second, the McCarran-Ferguson Act allocates power to the Federal Trade Commission.⁴⁸ But does the Act grant regulatory authority to other federal agencies? Under the Act, such agencies are neither encouraged to regulate nor prevented from regulating national or regional insurance companies.⁴⁹ Nevertheless, in recent years, the Departments of

45. See *supra* note 6. Section 1012(b) of the McCarran-Ferguson Act only states that federal antitrust laws "shall be applicable to the business of insurance to the extent that such business is not regulated by State Law." 15 U.S.C. § 1012(b) (emphasis added). As of this writing, however, the Supreme Court has not defined the phrase "to the extent that." But cf. Alan M. Anderson, *Insurance and Antitrust Law: The McCarran-Ferguson Act and Beyond*, 25 WM. & MARY L. REV. 81, 100-101 (1983) ("The legislative history of the Act . . . indicates that Congress intended [federal intervention] . . . only when [in]effective state regulation exists. Otherwise, neither federal nor state law actually would regulate insurer activity, leaving the public unprotected." (footnote omitted)).

46. See, e.g., *Crawford v. American Title Ins. Co.*, 518 F.2d 217, 220 (5th Cir. 1975) (refusing to require established, supervised rate-making procedures); *Ohio AFL-CIO v. Insurance Rating Bd.*, 451 F.2d 1178, 1182-84 (6th Cir. 1971) (requiring states to implement sufficient regulatory mechanism), *cert. denied*, 409 U.S. 917 (1972); *Steinberg v. Guardian Life Ins. Co.*, 486 F. Supp. 122, 124 (E.D. Pa. 1980) (requiring only the presence of a regulatory scheme within the state); *California League of Indep. Ins. Producers v. Aetna Casualty & Sur. Co.*, 175 F. Supp. 857, 860 (N.D. Cal. 1959) (requiring the state to implement a reasonably comprehensive regulation and enforcement scheme).

The court in *Crawford* stated:

That no rate bureau provisions have been made for title insurance (or for life or health and accident insurance) does not . . . mean that the provisions of the Trade Practices Act are not applicable or that the Commissioner cannot enforce those provisions against such companies. . . .

Accordingly, the Court concludes that the Alabama Insurance Trade Practices Law is fully applicable and the McCarron [sic] Act exemption from the federal antitrust laws is therefore activated.

Crawford, 518 F.2d at 220 (emphasis added) (citation omitted).

47. See *Proctor v. State Farm Mut. Auto Ins. Co.*, 675 F.2d 308, 316 (D.C. Cir.), *cert. denied*, 459 U.S. 839 (1982); *Pireno v. New York State Chiropractic Ass'n*, 650 F.2d 387, 390 n.5 (2d Cir. 1981), *aff'd sub nom. Union Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982); see also Anderson, *supra* note 45, at 100 n.93.

48. 15 U.S.C. § 1012(b). The McCarran-Ferguson Act provides that "The Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State Law." *Id.* (citation omitted).

49. Cf. 15 U.S.C. §§ 1011-1015.

Defense, Health & Human Services, Housing & Urban Development, Justice, and Treasury adopted the position that the Act does not prevent those federal agencies from regulating the insurance industry within and across state boundaries.⁵⁰ The Securities and Exchange Commission and the Equal Employment Opportunity Commission also embrace this perspective.⁵¹

From the viewpoint of these federal agencies, the insurance industry is massive and the business of insurance overlaps and interacts with many of the activities under the control of the federal government. Therefore, it is only natural for federal agencies to monitor and regulate insurers' activities. Unfortunately, many lower courts support this position.⁵² Nevertheless, as argued more forcefully in Part VII, a policy permitting a variety of federal agencies and commissions to regulate various parts of the insurance industry only encourages the delivery of expensive insurance services to consumers.⁵³

50. See *Gordon v. United States Dep't of Treasury*, 846 F.2d 272, 273 (4th Cir.) (holding that the government's claim under the federal priority statute could prevail over contrary state regulation of the business of insurance companies), *cert. denied*, 488 U.S. 954 (1988); *Mackey v. Nationwide Ins. Cos.*, 724 F.2d 419, 421 (4th Cir. 1984) (holding that the McCarran-Ferguson Act does not bar the U.S. Department of Housing and Urban Development's regulatory schemes and plaintiff's claims under the Fair Housing Act and the Civil Rights Acts); *Colonial Penn Ins. Co. v. Heckler*, 721 F.2d 431, 442 n.6 (3d Cir. 1983) (holding that the Act does not prevent the Secretary of Health and Human Services from issuing insurance (Medicare) regulations); *United States v. Crocker Nat'l Corp.*, 656 F.2d 428, 453 (9th Cir. 1981) (accepting the Department of Justice's right to prevent interlocking directorates between competing banks and insurance companies and between bank holding companies and insurance companies), *rev'd sub nom. BankAmerica Corp. v. United States*, 462 U.S. 122 (1983); *Royal Standard Ins. Co. v. McNamara*, 344 F.2d 240, 243 (8th Cir. 1965) (adopting the Department of Defense's assertion that the Department's regulation of automobile liability insurance on military reservations does not violate the McCarran-Ferguson Act); *Idaho ex rel. Soward v. Internal Revenue Serv.*, 662 F. Supp. 60, 63 (D. Idaho 1987) (holding that the government's claim under the federal priority statute could prevail over contrary state regulation of the business of insurance), *rev'd*, 858 F.2d 445 (9th Cir. 1988), *cert. denied*, 490 U.S. 1065 (1989); *McDiarmid v. Economy Fire & Casualty Co.*, 604 F. Supp. 105, 108 (S.D. Ohio 1984) (holding that the McCarran-Ferguson Act does not bar the Department of Housing and Urban Development's regulatory schemes and plaintiff's claims under the Fair Housing Act and the Civil Rights Acts); *Abrams v. Heckler*, 582 F. Supp. 1155, 1164 n.8 (S.D.N.Y. 1984) (holding that the Act does not prevent the Secretary of Health and Human Services from issuing insurance (Medicare) regulations).

51. See *SEC v. National Sec., Inc.*, 393 U.S. 453, 462-63 (1969) (acknowledging the Securities and Exchange Commission's authority to restrain insurance companies from obtaining shareholder approval for a merger through the use of fraudulent misrepresentation); *EEOC v. Wooster Brush Co.*, 523 F. Supp. 1256, 1258-67 (N.D. Ohio 1981) (adopting the EEOC's assertion of its authority to prevent a company from awarding insurance benefits in a sexually discriminatory manner), *aff'd in part and rev'd in part*, 727 F.2d 566 (6th Cir. 1984).

52. See cases cited *supra* notes 47 and 50.

53. See *infra* part VII.

III. INTERCIRCUIT CONFLICTS OVER THE DEFINITION OF BUSINESS OF INSURANCE BEFORE AND AFTER THE SUPREME COURT'S DECISION IN *GROUP LIFE & HEALTH INSURANCE CO. V. ROYAL DRUG*

Section 2(a) of the McCarran-Ferguson Act states that “[t]he business of insurance, and every person engaged therein, shall be subject to the laws of the several States.”⁵⁴ But what is the “business of insurance”? The McCarran-Ferguson Act does not define or outline the scope of the phrase, and the legislative history of the Act provides little meaningful assistance.⁵⁵

Absent guidance from an express statutory definition, federal courts have had to define the scope of the business of insurance. Unfortunately, these definitions are often conflicting and confuse both insurers and insurance consumers. Although the Supreme Court has identified the relevant parameters encompassing the term,⁵⁶ lower federal courts continue to disagree about two significant matters: 1) whether insurers’ premium-rates or price-setting agreements are part of the business of insurance; and 2) whether the activities of Blue Cross and Blue Shield companies—the nation’s largest providers of health insurance services—are truly the business of insurance.

A. *Intercircuit Conflicts Over Whether Horizontal “Rate-Setting,” “Premium-Rates,” and “Price-Setting” Agreements Are Part of the “Business of Insurance”*

The Supreme Court decided *United States v. South-Eastern Underwriters Ass’n*⁵⁷ in 1944, implicitly accepting in dictum, the view that premium-rates agreements are part of the business of insurance.⁵⁸ Twenty-five years after *South-Eastern Underwriters* the Court decided *SEC v. Na-*

54. 15 U.S.C. § 1012(a) (1988).

55. See *National Securities*, 393 U.S. at 458-459. The Court stated:

The legislative history of the McCarran-Ferguson Act offers no real assistance. Congress was mainly concerned with the relationship between insurance ratemaking and the antitrust laws, and with the power of the States to tax insurance companies. The debates centered on these issues, and the Committee reports shed little light on the meaning of the words “business of insurance.”

Id. (citation omitted).

56. See *infra* notes 57-62 and accompanying text.

57. 322 U.S. 533 (1944).

58. *Id.* at 562. “Few states go so far as to permit private insurance companies, without state supervision, to agree upon and fix uniform insurance rates. . . . [I]t cannot be that any companies have acquired a vested right to engage in such destructive business practices.” *Id.* (emphasis added) (footnote omitted).

*tional Securities, Inc.*⁵⁹ Writing for the majority, Justice Marshall observed: "Certainly the fixing of rates is part of [the] business [of insurance]; that is what *South-Eastern Underwriters* was all about."⁶⁰ Nevertheless, the dicta appearing in these two decisions have not prevented federal courts from issuing conflicting horizontal⁶¹ price-fixing and rate-fixing rulings.⁶²

For example, nearly thirty-five years ago, the United States District Court for the Northern District of California held that an agreement to fix insurance agents' commissions is part of the business of insurance.⁶³ More recently, a federal district court in the Third Circuit and the United States Court of Appeals for the Sixth Circuit ruled that agreements to fix title insurance fees and automobile premiums are insurance-related business activities.⁶⁴ On the other hand, the Fifth Circuit has held that actions involving premium rates are not part of the business of insurance.⁶⁵

These conflicting rulings occurred *before* the Supreme Court clearly identified the relevant criteria for determining whether an activity is part

59. 393 U.S. 453 (1969).

60. *Id.* at 460.

61. See BARRY R. FURROW ET AL., *HEALTH LAW* 787 (2d ed. 1991). Professor Furrow explained that:

Courts generally view horizontal restraints, as compared to vertical restraints, as more likely to violate [section 1 of the Sherman Act, 15 U.S.C. § 1 (1988)]. Horizontal restraints are those among competitors at the same level of production or distribution. Examples include an agreement among area hospitals to charge the same *per diem* room prices (possibly, price-fixing). . . . Vertical restraints involve concerted action between competitors at different levels of production or distribution; for example, between buyers and sellers or manufacturers and retailers.

Id.

62. See *infra* notes 63-65 and accompanying text.

63. *California League of Indep. Ins. Producers v. Aetna Casualty & Sur. Co.*, 179 F. Supp. 65, 66 (N.D. Cal. 1959) (finding price-fixing conspiracies in the insurance industry accomplished through boycott, coercion, or intimidation are not immune from antitrust laws).

64. See *Ohio AFL-CIO v. Insurance Rating Bd.*, 451 F.2d 1178, 1179-80 (6th Cir. 1971) (finding that the business of insurance includes the fixing of automobile insurance premiums by rating organization and its members), *cert. denied*, 409 U.S. 917 (1972); *Schwartz v. Commonwealth Land Title Ins. Co.*, 374 F. Supp. 564, 572-75 (E.D. Pa. 1974) (finding that a conspiracy among title insurance companies and their rate association to fix a title insurance sellers' charge is part of the business of insurance).

65. *Perry v. Fidelity Union Life Ins. Co.*, 606 F.2d 468, 470 (5th Cir. 1979), *cert. denied*, 446 U.S. 987 (1980). In *Perry*, an insurance company offered loans to finance insurance premium payments. *Id.* at 469. The court ruled that the loan operation was not part of the business of insurance. *Id.* at 470. In addition, the court observed that "business activities of insurance companies *not peculiar to the insurance industry* are outside the scope of the 'business of insurance.'" *Id.* (emphasis added) (citations omitted) (quoting *Royal Drug Co. v. Group Life & Health Ins. Co.*, 556 F.2d 1375, 1386 (5th Cir. 1977), *aff'd*, 440 U.S. 205 (1979)).

of the business of insurance.⁶⁶ The Court therefore arguably shares some of the responsibility for intercircuit conflict on this issue. It would appear that had the Court decided this matter early on, the division among the circuits would not have occurred.

The facts, however, do not support this line of reasoning. Instead, evidence shows that *even after* the Supreme Court outlined the defining parameters of the phrase, courts of appeals have continued to disagree about whether price-fixing or premium rate-setting agreements are part of the business of insurance. In 1979, the Supreme Court decided *Group Life & Health Insurance Co. v. Royal Drug*.⁶⁷ The Court in *Royal Drug* stated in dictum that the core of the business of insurance includes: 1) “the contract between the insurer and the insured”;⁶⁸ 2) “the relationship between the insurance company and the policyholder”;⁶⁹ and 3) “the type of policy which could be issued, its reliability, interpretation, and enforcement.”⁷⁰ Three years after *Royal Drug*, the Court set forth a formal definition of the business of insurance in *Union Labor Life Insurance Co. v. Pireno*.⁷¹ Writing for the *Pireno* Court’s majority, Justice Brennan ruled that a practice is part of the business of insurance if: 1) “the practice has the effect of transferring or spreading a policyholder’s risk”;⁷² 2) “the practice is an integral part of the policy relationship between the insurer and the insured”;⁷³ and 3) “the practice is limited to entities within the insurance industry.”⁷⁴ Justice Brennan also stressed that “[n]one of these criteria is necessarily determinative in itself.”⁷⁵

Therefore, in light of the *Pireno/Royal Drug* criteria, the question arises whether horizontal price-fixing or rate-making agreements are part of the business of insurance. A careful review of post-*Royal Drug* and *Pireno* decisions reveals a serious split among the federal circuits on this

66. *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982).

67. 440 U.S. 205 (1979).

68. *Id.* at 215.

69. *Id.* at 216 (quoting *SEC v. National Sec., Inc.*, 393 U.S. 453, 460 (1969)).

70. *Id.* at 215-16 (quoting *National Securities*, 393 U.S. at 460); *see also* *FTC v. National Casualty Co.*, 357 U.S. 560, 562-64 (1958) (accepting without holding on the issue that the selling and advertising of policies is part of the business of insurance); *Robertson v. California*, 328 U.S. 440, 449 (1946) (accepting the notion that the licensing of companies and of their agents is within the scope of the business of insurance).

71. 458 U.S. 119 (1982).

72. *Id.*

73. *Id.*

74. *Id.*

75. *Id.* (emphasis added).

issue. The Third,⁷⁶ Eighth,⁷⁷ and District of Columbia⁷⁸ Circuits hold that price-fixing and rate-making agreements are part of the business of insurance, while the Ninth Circuit holds they are not.⁷⁹ It is obvious that the Supreme Court must resolve the disagreement between the circuits. An unstated policy that allows two *national* health-insurance carriers to fix premiums jointly in the Second Circuit but not in the Ninth Circuit is flawed and encourages unwarranted discrimination among purchasers of health insurance. More important, where such price-fixing behavior is condoned, increases in the cost of health insurance are less likely to be constrained.⁸⁰

B. Intercircuit Conflicts Over Whether Blue Cross and Blue Shield Corporations Are Engaged in the "Business of Insurance"

If one were to ask the typical policyholder to explain why she regularly pays premiums to a Blue Cross and Blue Shield company, the consumer would likely state that she is purchasing insurance from a health insurance company. From the perspective of millions of consumers, Blue Cross and Blue Shield are insurance companies.⁸¹ Furthermore, typical health insurance purchasers accept a common notion that Blue Cross and Blue Shield's activities are part of the business of insurance and those activities often generate extremely large financial reserves in the form of profits.⁸²

76. *Owens v. Aetna Life & Casualty Co.*, 654 F.2d 218, 225-26 (3d Cir.) (observing that associations' rate-setting and risk-classification agreements are the business of insurance), *cert. denied*, 454 U.S. 1092 (1981).

77. *In re Workers' Compensation Ins. Antitrust Litig.*, 867 F.2d 1552, 1556 (8th Cir.) ("Although a price fixing agreement may maximize profit, it is axiomatic that the fixing of rates is central to transferring and spreading the insurance risk."), *cert. denied*, 492 U.S. 920, and *cert. denied*, 493 U.S. 818 (1989).

78. *Proctor v. State Farm Mut. Auto. Ins. Co.*, 675 F.2d 308, 321-25 (D.C. Cir.) (observing that an insurers' horizontal price-fixing agreements involving a joint reimbursement formula for insurance claims is part of the business of insurance), *cert. denied*, 459 U.S. 839 (1982).

79. *United States v. Title Ins. Rating Bureau, Inc.*, 700 F.2d 1247, 1252 (9th Cir. 1983) (holding that a horizontal agreement involving joint escrow services is not the business of insurance), *cert. denied*, 467 U.S. 1240 (1984).

80. *See supra* notes 8-9 and accompanying text.

81. "Blue Cross and Blue Shield is the largest insurance group in the nation, covering approximately 80 million people . . ." Spencer Rich, *Blue Cross-Blue Shield Chief Adds Private Plan to Health Care Debate*, WASH. POST, Sept. 20, 1991, at A9. This public sentiment on the role of Blue Cross and Blue Shield has been expressed on the floor of the House of Representatives by one congresswoman who commended Blue Cross and Blue Shield for the content of their "private insurance packages." 137 CONG. REC. H4648-03 (daily ed. June 19, 1991) (statement of Rep. Oakar).

82. *See, e.g., Regional Earnings: Blue Cross Reports 37% Rise in Net Income*, L.A. TIMES, Nov. 19, 1991, at C9 ("For the first nine months of 1991, Blue Cross's [California]

Yet, thirty years after the establishment of the nation's Blue Shield and Blue Cross companies,⁸³ federal courts cannot agree on whether these companies are truly engaged in the business of insurance. This conflict existed before the Supreme Court decided *Royal Drug* and *Pireno* and the controversy remains even after the Supreme Court addressed the business of insurance issue.

For instance, prior to *Royal Drug* and *Pireno*, the United States Court of Appeals for the Third Circuit held on two occasions that Blue Cross' payment and charge agreements were part of the business of insurance.⁸⁴ The United States Court of Appeals for the Fifth Circuit, however, disagreed. In *Royal Drug Co. v. Group Life & Health Insurance Co.*,⁸⁵ the Fifth Circuit asserted that Blue Shield's agreements to reimburse pharmacies for patients' drugs were not directly related "to its status as a reliable insurer."⁸⁶

net income soared 73%, to \$122.5 million from \$70.7 million a year earlier, and its nine-month earned premiums rose 9%, to \$1.74 billion from \$1.59 billion.").

83. See Gary M. Smith, Comment, *Provider Control of Health Insurers: Are Doctors Still Calling the Shots?* 34 ST. LOUIS U. L.J. 1079, 1086 (1990). Smith notes:

Blue Cross and Blue Shield plans were first established in the 1930s by local hospitals and medical societies, respectively, as means to finance health services during the Depression. Although the Blue Cross and Blue Shield Association coordinates the Blue Cross/Blue Shield system, each plan operates independently under the regulation of state insurance laws.

Id. (footnotes omitted). Another author describes the Blue Cross and Blue Shield history: In 1932, the first Blue Cross plan was established in Sacramento, California. The plan negotiated payment rates with participating hospitals, charged a single community-wide premium rate to subscribers, and guaranteed agreed-upon payments to participating hospitals for the provision of selected services to subscribers.

. . . Blue Cross plans were incorporated under separate enabling legislation with their own sets of rules and regulations (e.g., regarding rate-setting and Blue Cross Board composition). In exchange for [s]tate tax-exempt status and relief from reserve requirements, [s]tates generally charged the plans with the responsibility to serve the entire community and to provide insurance for low- and moderate-income persons.

. . . .
In response to the expansion of commercial health insurance and to the lack of coverage by Blue Cross of physician services, Blue Shield plans were established . . . in 1939. Blue Shield plans reimbursed physicians, initially for the full cost of each service, based on a negotiated payment schedule.

FURROW, *supra* note 61, at 534-35.

84. *Frankford Hosp. v. Blue Cross*, 554 F.2d 1253, 1254 (3d Cir. 1977) (adopting the view that under the McCarran Act, the terms of Blue Cross' subscriber agreement were "the business of insurance"); *Travelers Ins. Co. v. Blue Cross*, 481 F.2d 80, 83 (3d Cir. 1973) (holding that hospital payments and subscribers' notes arrangements are "part of the business of insurance").

85. 556 F.2d 1375 (5th Cir. 1977), *aff'd*, 440 U.S. 205 (1979).

86. *Id.* at 1380. "It is beyond peradventure that every action taken by an insurance company to enhance its status as a 'reliable insurer' does not necessarily constitute the

Both intercircuit and intracircuit splits are found among post-*Royal Drug* and *Pireno* cases. For example, the United States Court of Appeals for the First Circuit has stated unequivocally that determining whether Blue Cross and Blue Shield is an insurance company is a waste of precious judicial resources.⁸⁷ It is enough to know that Blue Cross' "activities . . . constitute 'the business of insurance.'"⁸⁸ The United States Court of Appeals for the Tenth Circuit has adopted a very similar position.⁸⁹

This notion, however, has not been accepted in the Second and Sixth Circuits.⁹⁰ For example, in *Dana Corp. v. Blue Cross & Blue Shield Mutual*,⁹¹ the United States Court of Appeals for the Sixth Circuit, citing *Royal Drug*, held that an agreement requiring Blue Cross to pay Dana Corporation's medical claims was not part of the business of insurance.⁹² According to the court, the contractual agreement between Blue Cross and Dana did not qualify as business of insurance, because the contract did not satisfy the risk-underwriting prong of the *Royal Drug* test.⁹³

'business of insurance.'" *Id.* The Fifth Circuit found that Texas Blue Cross-Blue Shield's "contractual agreements . . . are somewhat related to the business of insurance. The relationship, however, is so attenuated that it must be subject to the antitrust laws."

87. *Ocean State Physicians Health Plan, Inc. v. Blue Cross & Blue Shield*, 883 F.2d 1101, 1108 (1st Cir. 1989), *cert. denied*, 494 U.S. 1027 (1990). The court noted that "[s]ince *Royal Drug*, the focus of the McCarran-Ferguson inquiry has been the nature of the conduct alleged to violate the antitrust laws, not whether the defendant is a traditional insurance company." *Id.* (citation omitted). The court further observed that "contracts between a Blue Cross plan and its subscribers have been found to be the 'business of insurance' within the meaning of the Act." *Id.*

88. *Id.* at 1108 n.7.

89. *Blue Cross & Blue Shield v. Bell*, 798 F.2d 1331, 1334 n.6, 1336 (10th Cir. 1986) (citing *Royal Drug* and holding that "[t]he Kansas mandated-provider statutes constitute the 'business of insurance' reserved to the states by the McCarran-Ferguson Act" and that Blue Cross' activities are included under the law).

90. *See, e.g., Dana Corp. v. Blue Cross & Blue Shield Mut.*, 900 F.2d 882 (6th Cir. 1990) (holding that Administrative Services Only contract was not within "business of insurance" for purposes of the McCarran-Ferguson Act); *Bernard B. v. Blue Cross & Blue Shield*, 528 F. Supp. 125 (S.D.N.Y. 1981), *aff'd*, 679 F.2d 7 (2d Cir. 1982). The district court in *Bernard B.* found that the provider agreements between Blue Cross and HHC, the local hospital, did not qualify as the business of insurance when the McCarran-Ferguson Act was enacted, and emphasized that "HHC points us to nothing since *Royal Drug* which alters this picture." *Id.* at 131.

91. 900 F.2d 882 (6th Cir. 1990).

92. *Id.* at 888. The court held that "the ASO contract [between Blue Cross and Dana] is not within the 'business of insurance' for the purposes of the Act." *Id.*

93. *Id.* The court observed:

The Supreme Court stated in *Group Life and Health Insurance Co. v. Royal Drug* that "many aspects of insurance companies are regulated by state law, but are not the 'business of insurance.'" Similarly, in the instant case, Ohio has chosen to regulate ASO contracts based upon a very different definition of the "business of insurance" than that used by the Supreme Court. Clearly the ASO contract does

Within the same circuit, federal courts of appeals have issued conflicting opinions regarding whether Blue Cross and Blue Shield's activities are part of the business of insurance. The United States Court of Appeals for the Fourth Circuit, for example, has stated on two occasions that Blue Shield's "provider agreements" are not the business of insurance.⁹⁴ The Fourth Circuit, however, also has stated that in Virginia, "Blue Cross and Blue Shield are properly considered insurers under certain circumstances."⁹⁵ Therefore, the carrier's activities are part of the business of insurance.⁹⁶

Similar inconsistencies appear among cases decided in the Eighth Circuit. In *National Gerimedical Hospital & Gerontology Center v. Blue Cross*,⁹⁷ The United States Court of Appeals for the Eighth Circuit held that Blue Cross contracts with hospitals were not part of the business of insurance.⁹⁸ Nevertheless, eight years later, the same court stated in *Health Care Equalization Committee of the Iowa Chiropractic Society v. Iowa Medical Society & Blue Shield*⁹⁹ that such subscriber contracts "are an integral part of the 'business of insurance' within the meaning of the McCarran-Ferguson Act."¹⁰⁰

The Supreme Court shares much of the blame for these conflicting intercircuit and intracircuit decisions. On several occasions, the Court has described the Blue Cross and Blue Shield Companies as private, health-

not meet the risk-transferring prong of the Court's definition of the business of insurance.

Id. (citations omitted).

94. See *Ratino v. Medical Serv.*, 718 F.2d 1260, 1267 (4th Cir. 1983) ("Applying *Pireno* and *Royal Drug* to the immediate case, the challenged activities [provider agreements] clearly cannot be characterized as the 'business of insurance.'"); *Virginia Academy of Clinical Psychologists v. Blue Shield*, 624 F.2d 476, 483 (4th Cir. 1980) (holding that Blue Shield's "conduct is not the 'business of insurance'" and asserting that Blue Shield's "policy regarding payment of clinical psychologists is only tangential to that relationship in that it does not affect the benefit conferred upon the subscriber"), *cert. denied*, 450 U.S. 916 (1981).

95. *Anglin v. Blue Shield*, 693 F.2d 315, 318 (4th Cir. 1982). The court held that activities of Blue Shield were protected by the McCarran-Ferguson Act given that the plaintiff failed to allege that Blue Shield's actions constituted a boycott. *Id.*

96. *Id.* at 321. "We thus conclude that the refusal of [Blue Shield of Virginia] to offer the type of policy requested by the plaintiff is in the 'business of insurance'" *Id.*

97. 479 F. Supp. 1012 (W.D. Mo. 1979), *aff'd*, 628 F.2d 1050 (8th Cir. 1980), *rev'd*, 452 U.S. 378 (1981).

98. *Id.* at 1017-18.

99. 851 F.2d 1020 (8th Cir. 1988).

100. *Id.* at 1028. The court observed: "The contracts between the Blues and their subscribers clearly have the effect of transferring or spreading a subscriber's risk. Subscribers pay a fixed premium to the Blues, unrelated to the actual health care expenses which are borne by the Blues. This is a classic insurance relationship." *Id.*

insurance companies.¹⁰¹ In other decisions, however, the Court characterized them as nonprofit service corporations.¹⁰² The Supreme Court has had good opportunity to decide conclusively whether the activities of the nation's largest health insurance carrier are part of the business of insurance. Regrettably, it has not. The Supreme Court must resolve this controversy and accept what many already know: "The differences between the practices of [Blue Cross and Blue Shield] and commercial insurers have diminished over time."¹⁰³

IV. INTERCIRCUIT CONFLICTS OVER THE EXTENT TO WHICH FEDERAL ANTITRUST STATUTES SHOULD APPLY TO THE "BUSINESS OF INSURANCE"

While the McCarran-Ferguson Act states that the federal antitrust laws compete with the state laws to regulate insurance,¹⁰⁴ the Act also states that the Sherman Act shall apply to all agreements involving boycotts,

101. See, e.g., *Aetna Life Ins. Co. v. Lavoie*, 475 U.S. 813, 817 (1986) ("One suit . . . brought on behalf of [Alabama Supreme Court Justice Embry] and as a representative of a class of all other Alabama state employees insured under a group plan by Blue Cross-Blue Shield of Alabama . . . alleged a willful and intentional plan to withhold payment on valid claims."); *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119, 126 (1982) ("The principal petitioner in *Royal Drug* was a Texas insurance company, Blue Shield . . ."); *Arizona v. Maricopa County Medical Soc.*, 457 U.S. 332, 353 (1982) ("[T]he Blue Shield plan challenged in *Group Life & Health Insurance Co. v. Royal Drug Co.* indicate[s] that insurers are capable not only of fixing maximum reimbursable prices but also of obtaining binding agreements with providers guaranteeing the insured full reimbursement of a participating provider's fee."); *Schweiker v. McClure*, 456 U.S. 188, 190 (1982) (noting that under the Medicare Part B program, "the private carriers that performed these tasks in California . . . were Blue Shield of California," a "private insurance carrier[]"); *Group Life & Health Ins. Co. v. Royal Drug*, 440 U.S. 205, 207 (1979) ("The respondents, 18 owners of independent pharmacies in San Antonio, Tex., brought an antitrust action . . . against the petitioners, Group Life and Health Insurance Co., known as Blue Shield of Texas (Blue Shield), and three pharmacies also doing business in San Antonio.").

102. See, e.g., *Metropolitan Life Ins. Co. v. Massachusetts*, 471 U.S. 724, 727 n.1 (1985) ("Group health insurance is provided either by commercial insurance companies or service corporations such as Blue Cross-Blue Shield."); *Blue Shield v. McCready*, 457 U.S. 465, 469 n.4 (1982) ("Blue Shield Plans are not insurance companies, though they are, to a degree, insurers. . . . [I]n a real and legal sense, the Blue Shield Plans are agents of their member physicians." (quoting *Virginia Academy of Clinical Psychologists v. Blue Shield of Virginia*, 624 F.2d 476, 480 (4th Cir. 1980) (alteration in original)); *National Gerimedical Hosp. & Gerontology Ctr. v. Blue Cross*, 452 U.S. 378, 380 (1981) (stating that Blue Cross is "a nonprofit provider of individual and group health-care reimbursement plans"); *accord Frankford Hosp. v. Blue Cross*, 417 F. Supp. 1104, 1106 (E.D. Pa. 1976) ("Blue Cross is not an insurer in the classic sense of that term."), *aff'd*, 554 F.2d 1253 (3d Cir.), *cert. denied*, 434 U.S. 860 (1977); see also *Smith*, *supra* note 83, at 1079 n.3 ("Blue Shield plans are actually quantity purchasers of health care services rather than insurers.").

103. See 135 CONG. REC. E3615-01 (daily ed. Oct. 31, 1989) (quoting Congressional Research Service study).

104. See 15 U.S.C. § 1012(b) (1988); see also *supra* note 6 and accompanying text.

coercion, or intimidation even if such agreements are regulated by the states.¹⁰⁵ Federal courts have had great difficulty harmonizing this language with section 1 of the Sherman Act; consequently, inconsistent rulings and intercourt conflicts are widespread.¹⁰⁶ This section examines the Sherman Act and the various rules that federal courts apply to determine whether insurers' activities violate the Sherman Act.

Next, this section discusses two different intercourt conflicts. The first analysis concerns whether various Blue Cross and Blue Shield agreements and combinations violate the Sherman Act.¹⁰⁷ The second concerns whether certain insurance-related activity constitutes a "boycott" under the McCarran-Ferguson Act.¹⁰⁸

A. A Brief Overview of the Sherman Act, the "Per Se Rule" of Illegality, and the "Rule of Reason"

The Sherman Act—as well as other federal antitrust laws—is proconsumer.¹⁰⁹ The Act is designed to encourage businesses to deliver a variety of goods and services to consumers at competitive prices.¹¹⁰ To help achieve this end, section 1 of the Sherman Act states that "[e]very contract, combination . . . or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal."¹¹¹

105. See 15 U.S.C. § 1013(b); *supra* note 6 and accompanying text.

106. See *infra* notes 122-46 and accompanying text.

107. See *infra* notes 122-31 and accompanying text.

108. See *infra* notes 132-46 and accompanying text.

109. See, e.g., *Allen Bradley Co. v. Local 3, Int'l Bhd. of Elec. Workers*, 325 U.S. 797, 806 (1945) (stressing that the purpose of the Sherman Act "was to protect consumers from monopoly prices"); *Marrese v. Interqual, Inc.*, 748 F.2d 373, 387 (7th Cir. 1984) ("We add that . . . a further concern of this court is to promote the intended purpose of the Sherman Act as a 'consumer welfare prescription.'" (quoting *NCAA v. Board of Regents of Univ. of Oklahoma*, 468 U.S. 85, 106 (1984)), *cert. denied*, 472 U.S. 1027 (1985).

110. Cf. *Central Florida Enters., Inc. v. FCC*, 683 F.2d 503, 507 n.20 (D.C. Cir. 1982) ("Our antitrust laws similarly dictate that competition—and, thereby, *consumers*—are to be protected rather than competitors."), *cert. denied*, 460 U.S. 1084 (1983); *Satellite Fin. Planning Corp. v. First Nat'l Bank*, 633 F. Supp. 386, 394 (D. Del.) (stating that "[a]ntitrust laws restrict anticompetitive conduct in order to advance consumer welfare" and "are not meant to redress personal wrongs that do not impact on competition or adversely affect consumers. The primary purpose of the antitrust statutes, to benefit consumers through competition, must guide the [c]ourt[s] in deciding antitrust issues before it."), *modified*, 643 F. Supp. 449 (D. Del. 1986).

111. 15 U.S.C. § 1 (Supp. IV. 1992). Section 1 further states:

Every person who shall make any contract or engage in any combination or conspiracy hereby declared to be illegal shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding \$10,000,000 if a corporation, or, if any other person, \$350,000, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court.

While section 1 prohibits any combination and every agreement that restrains trade, the Supreme Court has ruled that only “unreasonable restraints” are barred.¹¹² The Court has developed two rules to help determine whether business agreements, contracts, or combinations violate section one of the Sherman Act—the per se rule of illegality and the rule of reason.¹¹³

The per se rule only applies to restrictive agreements that are “manifestly anticompetitive.”¹¹⁴ The Supreme Court has found many per se violations where “combinations [were] formed for the purpose . . . of raising, depressing, fixing, pegging, or stabilizing the price of a commodity in interstate or foreign commerce.”¹¹⁵ The Court also has stated

Id.

112. *See, e.g.,* *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 723 (1988) (recognizing that the Court has historically prohibited only unreasonable restraints of trade); *NCAA v. Board of Regents of Univ. of Oklahoma*, 468 U.S. 85, 98 (1984) (stating that every contract is a restraint of free trade, but the Sherman Act prohibits only those unreasonable restraints of trade); *Arizona v. Maricopa County Medical Soc’y*, 457 U.S. 332, 342-43 (1982) (stating that Congress did not intend a literal interpretation of “every” restraint of trade and only unreasonable restraints of competition are unlawful); *Standard Oil Co. v. United States*, 221 U.S. 1, 87-88 (1911) (holding that only unreasonable contracts restraining trade are prohibited, and that all other contracts are unaffected by the Sherman Act).

113. *See infra* notes 114-21.

114. *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 49-50 (1977) (“*Per se* rules of illegality are appropriate only when they relate to conduct that is manifestly anticompetitive.”); *United States v. Trenton Potteries Co.*, 273 U.S. 392, 398 (1927) (holding that “it has since often been decided and always assumed that uniform price-fixing by those controlling in any substantial manner a trade or business in interstate commerce is prohibited by the Sherman [Act], despite the reasonableness of the particular prices agreed upon”). The Court has observed:

[T]here are certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use. 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

Northern Pac. R.R. Co. v. United States, 356 U.S. 1, 5 (1958); *see also* *Catalano, Inc. v. Target Sales, Inc.*, 446 U.S. 643, 649 (1980) (per curiam) (“[W]hen a particular concerted activity entails an obvious risk of anticompetitive impact with no apparent potentially redeeming value, the fact that a practice may turn out to be harmless in a particular set of circumstances will not prevent its being declared unlawful *per se*.”).

115. *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 223 (1940); *see also* *Broadcast Music, Inc. v. Columbia Broadcasting Sys., Inc.*, 441 U.S. 1, 9 (1979) (finding that those agreements that are clearly anticompetitive and have no redeeming value are violations); *Goldfarb v. Virginia State Bar*, 421 U.S. 773, 793 (1975) (finding that anticompetitive conduct by lawyers is prohibited by the Sherman Act); *United States v. Topco Assocs., Inc.*, 405 U.S. 596, 608 (1972) (finding that horizontal restraints on trade serve no purpose except to stifle competition, and are per se violations of the Sherman

that the *per se* rule applies to both vertical and horizontal arrangements.¹¹⁶

The Supreme Court moved away from a rigid *per se* rule of illegality in *Standard Oil Co. v. United States*,¹¹⁷ in which the Court developed a rule of reason analysis to condemn only undue and unreasonable restraints of trade.¹¹⁸ *Standard Oil* held that the rule of reason analysis was guided by traditional common law factors: the power held by the monopoly to fix prices and injure the public, the power to limit production, and the danger in deterioration in quality of a monopolized product.¹¹⁹ Later decisions by the Court attempted to characterize the type of restraint to balance the *per se* rule and the rule of reason.¹²⁰ As a result of the histor-

Act); *Albrecht v. Herald Co.*, 390 U.S. 145, 154 (1968) (finding combinations that unreasonably restrain trade are unlawful); *White Motor Co. v. United States*, 372 U.S. 253, 263 (1963) (finding that vertical limitations of trade violate the Sherman Act where "they have such a 'pernicious effect on competition and lack . . . any redeeming virtue'" (quoting *Northern Pac. R.R. Co. v. United States*, 356 U.S. 1, 5 (1958))); *Kiefer-Stewart Co. v. Joseph E. Seagram & Sons*, 340 U.S. 211, 213 (1951) (stating that agreements between competitors to fix pricing in an effort to restrain trade violates the Sherman Act); *United States v. Trenton Pottery Co.*, 273 U.S. 392, 397 (1927) (finding that 82% of all manufacturers and distributors of pottery fixtures agreed to fix prices and violated the Sherman Act); *Pennsylvania Dental Ass'n v. Medical Serv. Ass'n*, 745 F.2d 248, 256 (3d Cir. 1984) (holding that agreements to fix prices that are charged in transactions with third parties violate the Sherman Act), *cert. denied*, 471 U.S. 1016 (1985).

116. See, e.g., *Catalano*, 446 U.S. at 647-48 ("A horizontal agreement to fix prices is . . . unlawful *per se*. . . [A] horizontal agreement among competitors to use a specific method of quoting prices may be unlawful."). *But see* *Ratino v. Medical Serv.*, 718 F.2d 1260, 1269 (4th Cir. 1983) ("It is well settled, however, that the *per se* characterization is not to be applied as a talisman to every arrangement that involves a 'literal' fixing of prices. Many lawful contracts, mergers, and partnerships fix prices.").

117. 221 U.S. 1 (1911).

118. *Id.* at 63-64. The Court, after examining the Sherman Act, observed:

The merely generic enumeration which the statute makes of the acts to which it refers and the absence of any definition of restraint of trade as used in the statute leaves room for but one conclusion, which is, that it was expressly designed not to unduly limit the application of the act by precise definition, but while clearly fixing a standard, that is, by defining the ulterior boundaries which could not be transgressed with impunity, to leave it to be determined by the light of reason, guided by the principles of law and the duty to apply and enforce public policy embodied in the statute, in every given case whether any particular act or contract was within the contemplation of the statute.

Id.

119. *Id.* at 74-77.

120. See, e.g., *Broadcast Music, Inc. v. Columbia Broadcasting Sys., Inc.*, 441 U.S. 1, 8-9 (1979). The Court noted:

As generally used in the antitrust field, "price-fixing" is a shorthand way of describing certain categories of business behavior to which the *per se* rule has been held applicable. The Court of Appeals' literal approach does not alone establish that this particular practice is one of those types or that it is "plainly anticompetitive" and very likely without "redeeming virtue." Literalness is overly simplistic and often overbroad. When two partners set the price of their

ical development of the two rules, “[t]he practical difference between a *per se* offense and a rule of reason offense is that under the *per se* rule, anticompetitive impact of the alleged offense is presumed, while under the rule of reason, its anticompetitive impact must be proven.”¹²¹

B. Intercircuit Conflicts Over the Applicability of the “Per Se Rule” and the “Rule of Reason” in Disputes Involving the Nation’s Blue Cross and Blue Shield Companies

As reported above, the Supreme Court, as well as several federal appellate courts, view the activities of Blue Cross and Blue Shield as part of the business of insurance.¹²² In addition, the Blues—like for-profit health and property insurers—cannot engage in concerted activities which violate Section 1 of the Sherman Act. Specifically, Blue Cross and Blue Shield cannot participate in unreasonable price-fixing agreements and boycotts that restrict interstate and foreign commerce.¹²³

A careful examination of federal appellate court decisions, however, reveals that it is extremely difficult to ascertain whether Blue Cross and Blue Shield’s horizontal or vertical price-fixing agreements violate section 1 of the Sherman Act. The reason is quite simple: there is an inordinate amount of confusion over whether federal courts should perform a *per se* or a rule of reason analysis in price-fixing cases.

The Third and Sixth Circuits, for example, have adopted the *per se* rule to decide whether the Blues’ provider (price-fixing) agreements violate the Sherman Act.¹²⁴ The Second, Fourth, and Seventh Circuits, however,

goods or services they are literally “price-fixing,” but they are not *per se* in violation of the Sherman Act.

Id.

121. *Hospital Bldg. Co. v. Trustees of Rex Hosp.*, 691 F.2d 678, 684 (4th Cir. 1982), *cert. denied*, 464 U.S. 890, and *cert. denied*, 464 U.S. 904 (1983); *see also Hahn v. Oregon Physicians’ Serv.*, 868 F.2d 1022, 1026 (9th Cir. 1988), *cert. denied*, 493 U.S. 846 (1989). The Ninth Circuit stated in *Hahn*:

Per se violations are a limited class . . . and it is much more common for courts to analyze questionable activities under the rule of reason. The rule of reason looks beyond the inherent anticompetitive potential of an activity and examines its actual effect in practice. It imposes on the plaintiff the burden of establishing that the practice in question unreasonably restrains competition.

Id.

122. *See supra* notes 83-103 and accompanying text.

123. *See* 15 U.S.C. §§ 1012(b), 1013(b) (1988).

124. *See, e.g., Pennsylvania Dental Ass’n v. Medical Serv. Ass’n*, 745 F.2d 248, 258-59 (3d Cir. 1984) (applying the *per se* rule and holding that Blue Shield’s price-fixing agreements were neither unlawful vertical nor horizontal restraints), *cert. denied*, 471 U.S. 1016 (1985); *Glen Eden Hosp., Inc. v. Blue Cross & Blue Shield, Inc.*, 740 F.2d 423, 431 (6th Cir. 1984) (remanding the vertical price-fixing case to the district court and ordering that the court apply “a *per se* analysis”).

stress that allegedly unlawful price-fixing agreements must be analyzed under the rule of reason.¹²⁵ It scarcely can be denied that the most egregious and poorly reasoned decisions involving price-fixing agreements are found in other circuits. In particular, the Fifth and Ninth Circuits have stated that the legality of Blue Cross and Blue Shield's price-fixing arrangements may be analyzed under either the *per se* rule or the rule of reason.¹²⁶ Finally, some complainants have accused Blue Cross and Blue Shield of violating the Sherman Act's antiboycott provision. To resolve the disputes, federal courts have employed both the rule of reason and the *per se* rule to determine whether antitrust violations occurred.¹²⁷ The courts' efforts, however, have produced only an enlarged body of insurance law that is more inconsistent and less intelligible.

The Third and Sixth Circuits have held that a *per se* analysis must be performed to assess whether Blue Cross and Blue Shield's concerted ac-

125. See, e.g., *Brillhart v. Mutual Medical Ins., Inc.*, 768 F.2d 196, 199 & n.2 (7th Cir. 1985) (concluding that the vertical price-fixing agreement did not constitute an unreasonable restraint of trade under the rule of reason analysis and observing that "[t]his circuit has held that provider agreements should be subjected to a rule of reason analysis rather than a *per se* analysis under the antitrust laws"); *Ratino v. Medical Serv.*, 718 F.2d 1260, 1272 (4th Cir. 1983) (remanding the vertical price-fixing controversy to the district court and ordering that the court "analyze the practices under the rule of reason"); *Medical Arts Pharmacy, Inc. v. Blue Cross & Blue Shield, Inc.*, 675 F.2d 502, 505 (2d Cir. 1982) ("We agree with the courts and commentaries that have found that, like the price-fixing practice upheld in *Broadcast Music, Inc.*, Blue Cross pharmacy agreements are novel restraints with potential procompetitive effects, and therefore must be analyzed under the rule of reason.").

126. See, e.g., *Hahn v. Oregon Physicians' Serv.*, 868 F.2d 1022, 1028 (9th Cir. 1988) (reaffirming its position in *Barry v. Blue Cross* that Blue Cross' horizontal price-fixing plans may be analyzed "under either a *per se* or a rule of reason analysis"), *cert. denied*, 493 U.S. 846 (1989); *Barry v. Blue Cross*, 805 F.2d 866, 870-71 (9th Cir. 1986) ("We begin our analysis by determining whether the participating physician [vertical] agreements fall into a class of activity that has been condemned as *per se* unreasonable, or whether we should instead analyze them under the rule of reason."); *Royal Drug Co. v. Group Life & Health Ins. Co.*, 737 F.2d 1433, 1436, 1438 (5th Cir. 1984), *cert. denied*, 469 U.S. 1160 (1985). The court in *Royal Drug* stated:

Price fixing agreements have been held to be *per se* illegal. We find, however, that the conduct challenged here falls outside those categories of activity classified as *per se* illegal price fixing.

The pharmacy agreements do not constitute a *per se* illegal combination

. . . .

The plaintiffs have pled and tried this case as a *per se* case. They have not pled any anticompetitive effect. Assuming without deciding, however, that the complaint can be read to state a claim under the rule of reason, we conclude that summary judgment on a rule of reason claim was equally appropriate.

Id. (citations and footnote omitted).

127. See *infra* notes 128-31.

tivities are illegal boycotts under the Sherman Act.¹²⁸ On the other hand, the Fifth Circuit has adopted the indefensible position that the rule of reason should be used to resolve these types of controversies.¹²⁹ More distressing, the Fourth Circuit has utilized both *per se* and rule of reason analyses to decide whether Blue Cross and Blue Shield's refusals to deal with competitors violate Section 1 of the Sherman Act.¹³⁰ In addition, the Fourth Circuit continues to employ both rules, even though Congress clearly directed that "boycotts" be regarded as *per se* illegal under the Sherman and McCarran-Ferguson Acts.¹³¹

128. See, e.g., *Pennsylvania Dental Ass'n.*, 745 F.2d at 259-60; (applying a *per se* analysis to Blue Shield's price-fixing agreements); *Glen Eden Hospital*, 740 F.2d at 425, 430-31 (ordering the district court "to apply a *per se* analysis" when deciding the unlawful refusal to deal (boycott) claim). The Third Circuit in *Pennsylvania Dental Ass'n* held:

To establish proof of an illegal boycott under § 1, a plaintiff must show "concerted action with 'a purpose either to exclude a person or group from the market, or to accomplish some other anti-competitive objective, or both.'" In the context of addressing appellants' *per se* price-fixing contention, we have already demonstrated that Blue Shield's actions in setting the . . . reimbursement fee and entering into the provider agreements were purely unilateral.

. . . Thus . . . appellants' boycott claims fail to establish a *per se* violation under § 1.

Id. (quoting *Malley-Duff & Assocs. v. Crown Life Ins. Co.*, 734 F.2d 133, 140 (3d Cir. 1984) (quoting *DeFilippo v. Ford Motor Co.*, 516 F.2d 1313, 1318 (3d Cir.), *cert. denied*, 423 U.S. 912 (1975))).

129. See, e.g., *American Family Life Assurance Co. v. Blue Cross-Blue Shield, Inc.*, 346 F. Supp. 267, 271 (S.D. Fla. 1972), (finding no impermissible boycott and observing that "the 'rule of reason' . . . is the cornerstone of modern antitrust law"), *aff'd*, 486 F.2d 255 (5th Cir. 1973), *cert. denied*, 416 U.S. 905 (1974).

130. *Compare* *Ratino v. Medical Serv.*, 718 F.2d 1260, 1272 (4th Cir. 1983) (remanding the case and ordering the district court to apply both a *per se* and a rule of reason analysis) and *Virginia Academy of Clinical Psychologists v. Blue Shield*, 624 F.2d 476, 484-85 (4th Cir. 1980) (holding that "[t]he 'boycott' characterization, however, avails us little in determining whether an agreement such as [Blue Shield's] is *per se* illegal [W]e are not prepared to apply a *per se* rule of illegality to medical plans which refuse or condition payments to competing or potentially competing providers"), *cert denied*, 450 U.S. 916 (1981) with *Ballard v. Blue Shield, Inc.*, 543 F.2d 1075, 1078 (4th Cir. 1976), *cert denied*, 430 U.S. 922 (1977). The Fourth Circuit in *Ballard* observed:

The complaint alleges that the defendants have combined and conspired to refuse insurance coverage . . . and to refuse permission for chiropractors to participate as officers in the companies offering Blue Shield Plans. Although the complaint does not employ the term "boycott", we believe these allegations sufficiently charge a group boycott in violation of the Sherman Act.

Id.

131. Even in the face of the conflicting standards, the Fourth Circuit stated: "Congress expressly provided that the Sherman Act should remain applicable to boycotts and agreement to boycott. The Sherman Act proscribes even peaceful, primary boycott designed to dissuade persons from dealing with others. Consequently, the McCarran-Ferguson Act condemns this type of boycott." *Id.* (citations omitted).

C. *Intercircuit Conflicts Over the Definition of "Boycott"—Before and After the Supreme Court's Decision in St. Paul Fire & Marine Insurance Co. v. Barry*

The absence of a universal definition of "boycott" underlies much of the conflict reported in the preceding section. Neither the Sherman Act nor the McCarran-Ferguson Act defines the term.¹³² Several federal appellate courts have tried to fill the void by furnishing their own explanations. Unfortunately, this piecemeal process has produced many unintelligible and incompatible definitions and rulings.

Before the Supreme Court decided *St. Paul Fire & Marine Insurance Co. v. Barry*,¹³³ the Fifth and Ninth Circuits defined the scope of "boycott" very narrowly by insisting that only "blacklistings" were included.¹³⁴ The Fourth and District of Columbia Circuits, however, adopted a more liberal interpretation, holding that the definition also included concerted refusals to deal and conspiracy.¹³⁵

The Supreme Court in *St. Paul* tried to resolve the conflict by embracing a liberal interpretation of the term "boycott."¹³⁶ It did not accept, however, the Fourth and District of Columbia Circuits' explanations. Instead, the Court gave an exceedingly broad, two-pronged definition of "boycott": 1) "boycott refers to a method of pressuring a party with

132. There is, however, conflict among federal courts of appeals over whether the definition of "boycott" is identical under both acts. Compare *In re Workers' Compensation Ins. Antitrust Litig.*, 867 F.2d 1552, 1561 (8th Cir.) ("The [*St. Paul v. Barry*] Court indicated that for McCarran-Ferguson Act purposes, the terms boycott, coercion and intimidation should be given meanings consistent with their traditional Sherman Act usage."), *cert. denied*, 492 U.S. 920, and *cert. denied*, 493 U.S. 818 (1989) and *Owens v. Aetna Life & Casualty Co.*, 654 F.2d 218, 232 (3d Cir.) ("We agree . . . that in the *St. Paul* case the Supreme Court held that the term 'boycott' as used in Section 3(b) of the McCarran-Ferguson Act must be given the same breadth of definition and scope as under the Sherman Act."), *cert. denied*, 454 U.S. 1092 (1981) with *Card v. National Life Ins. Co.*, 603 F.2d 828, 833 (10th Cir. 1979) ([The *St. Paul* Court] resolved the issue whether the boycott exception applied to policyholders and insurers It did not, however, hold that the [McCarran-Ferguson] § 3(b) exception necessarily applied to 'all concerted activity violative of the Sherman Act'). See also *United States v. General Motors Corp.*, 384 U.S. 127, 145 (1966) (concluding that boycotts are generally characterized as per se offenses).

133. 438 U.S. 531 (1978).

134. See *Meicler v. Aetna Casualty & Sur. Co.*, 506 F.2d 732, 734 (5th Cir. 1975) (holding that the term boycott only applies to the blacklisting of insurance companies or agents by other insurers or agents); *Addrisi v. Equitable Life Assurance Soc'y*, 503 F.2d 725, 728-29 (9th Cir. 1974) (restricting the scope of boycott to blacklisting among insurers and agents), *cert. denied*, 420 U.S. 929 (1975).

135. *Proctor v. State Farm Mut. Auto. Ins. Co.*, 561 F.2d 262, 274-75 (D.C. Cir. 1977) (finding that conspiracies and an agreement to boycott are part of the definition of "boycott"), *vacated*, 440 U.S. 942 (1979); *Ballard*, 543 F.2d at 1078 (accepting the view that the term "boycott" includes conspiracies and agreements to refuse insurance coverage).

136. *St. Paul*, 438 U.S. at 545.

whom one has a dispute by withholding, or enlisting others to withhold, patronage or services from the target”;¹³⁷ and 2) “‘boycott’ is not limited to concerted activity against insurance companies or agents or . . . against competitors of members of the boycotting group.”¹³⁸

The Court’s unduly broad, two-tiered definition provides little guidance. Today, nearly fifteen years after *St. Paul*, the federal courts of appeals remain profoundly confused about the meaning of “boycott.” More significantly, the confusion exists across as well as within the federal circuits. For example, the United States Courts of Appeals for the Fourth, Sixth, and Seventh Circuits embraced the rule that a concerted refusal to deal is sufficient to establish a primary boycott.¹³⁹ But the Eighth and Tenth Circuits have concluded that a “boycott” must include a concerted refusal to deal or sell, plus either a conspiracy or coercion.¹⁴⁰

Extensive confusion also appears within some federal circuits. The Third Circuit has adopted the position that concert of action, a total exclusion, and a conspiracy are necessary to prove an illegal boycott.¹⁴¹

137. *Id.*

138. *Id.* at 552.

139. See *Indiana Fed’n of Dentists v. FTC*, 745 F.2d 1124, 1137 (7th Cir. 1984) (noting that the term “group boycott” has broad application and “generally applies to conduct involving a concerted refusal to deal, commonly defined as ‘an agreement by two or more persons not to do business with other individuals, or to do business with them only on specified terms’” (quoting 2 E. KINTNER, FEDERAL ANTITRUST LAW § 10.27, at 155 (1980))), *rev’d*, 476 U.S. 447 (1986); *Virginia Academy of Clinical Psychologists v. Blue Cross*, 624 F.2d 476, 484 (4th Cir. 1980) (finding a boycott where Blue Shield refused “to pay for services rendered by clinical psychologists”), *cert. denied*, 450 U.S. 916 (1981); *Nurse Midwifery Assocs. v. Hibbett*, 549 F. Supp. 1185, 1191-92 (M.D. Tenn. 1982) (holding that it is not “fatal to a boycott claim that plaintiffs have not alleged total exclusion from the supply market for medical malpractice insurance” and that “[t]he complain[ing] a concerted refusal to deal, aimed at restraining competition with the . . . market for maternity services, . . . is sufficient under Section 3(b)’s boycott provision”), *aff’d in part and rev’d in part*, 918 F.2d 605 (6th Cir. 1990), *cert. denied*, 112 S. Ct. 406 (1991).

140. See *In re Workers’ Compensation Ins. Antitrust Litig.*, 867 F.2d 1552, 1561 & n.14 (8th Cir.) (agreeing that “a refusal to deal except at a specified price, without more, is not within the confines of the term boycott under the McCarran-Ferguson Act” and noting that although federal courts differ over what constitutes an illegal boycott, “[a]ll hold that there must be a conspiracy causing irreparable damage to the business or property of the complainant” (quoting *Gompers v. Bucks Stove & Range Co.*, 221 U.S. 418, 437 (1911))), *cert. denied*, 492 U.S. 920, and *cert. denied*, 493 U.S. 818 (1989); *Card v. National Life Ins. Co.*, 603 F.2d 828, 834 (10th Cir. 1979) (failing to find a boycott and observing that for a boycott “there must first be concerted activity by individual actors” and “a boycott, the essence of which is the pressuring of a party with whom one has a dispute”).

141. See *Pennsylvania Dental Ass’n v. Medical Serv. Ass’n*, 745 F.2d 248, 259-60 (3d Cir. 1984), *cert. denied*, 471 U.S. 1016 (1985). The Court failed to find a “boycott” and stated that “[t]o establish proof of an illegal boycott under [Sherman Act] § 1, a plaintiff must show ‘concerted action with “a purpose either to exclude a person or group from the market.”’” *Id.* at 259-60 (quoting *Malley-Duff & Assocs. v. Crown Life Ins. Co.*, 734 F.2d 133, 140 (3d Cir. 1984) (quoting *DeFillipo v. Ford Motor Co.*, 516 F.2d 1313, 1318 (3d Cir.),

However, this court also has stated that to establish a boycott, there only must be concert of action;¹⁴² a total exclusion or a conspiracy is not an important element. The Court of Appeals for the Ninth Circuit also has issued inconsistent definitions of the term "boycott." In *Klamath-Lake Pharmaceutical Ass'n v. Klamath Medical Service Bureau*,¹⁴³ the Ninth Circuit cited one prong of the definition in *St. Paul* and held that a boycott need only include concerted activity and a refusal to deal.¹⁴⁴ However, in *In re Insurance Antitrust Litigation*,¹⁴⁵ the Ninth Circuit cited another part of *St. Paul's* boycott definition, and concluded that the definition of "boycott" necessarily includes the enlistment of third parties to an unlawful agreement, a refusal to deal, and coercion.¹⁴⁶

The Supreme Court's decision in *St. Paul* has spawned much of the dissension in this body of insurance law. In addition, federal courts cannot harmonize key sections of the Sherman and McCarran-Ferguson Acts. This morass will likely linger, but it does not *have* to continue. Congress can exercise its authority and prohibit federal courts from regulating any part of the insurance industry or the business of insurance.

cert. denied, 423 U.S. 912 (1975))). The Third Circuit also stated that the "claim must . . . fail for lack of concerted action because there [was] no evidence that Blue Shield conspired with any dentists." *Id.* at 260.

142. See *Owens v. Aetna Life & Casualty Co.*, 654 F.2d 218, 232 (3d Cir.), *cert. denied*, 454 U.S. 1092 (1981). In *Owens*, the Third Circuit did not find a boycott. The court stated: "Assuming . . . that the defendants participated in a rating bureau decision to boycott Owens or engaged in some other concerted refusal to deal with him, such an agreement would not be protected by the McCarran-Ferguson exemption. However, concert of action remains a *sine qua non* in a boycott case." *Id.*

143. 701 F.2d 1276 (9th Cir.), *cert. denied*, 464 U.S. 822 (1983).

144. *Id.* at 1287. The court failed to find a boycott on the facts and observed:

The [*St. Paul*] Court held that the boycott exception should take its broad Sherman Act meaning. Thus, boycotts were not merely limited "to concerted activity against insurance companies or agents or, more generally, against competitors of members of the boycotting group," but extended to refusals to deal with customers of some or all of those engaged in the boycott.

Id. (quoting *St. Paul Fire & Marine Ins. Co. v. Barry*, 438 U.S. 531, 552 (1978)).

145. 938 F.2d 919 (9th Cir. 1991), *aff'd in part and rev'd in part*, 113 S. Ct. 2891 (1993).

146. *Id.* at 929-30. The court found a boycott and quoted the *St. Paul* Court: "The enlistment of third parties in an agreement not to trade, as a means of compelling capitulation by the boycotted group, long has been viewed as conduct supporting a finding of unlawful boycott." *St. Paul*, 438 U.S. at 544-45 (quoted in *Insurance Antitrust Litigation*, 938 F.2d at 929). Also, the Ninth Circuit stated that in *St. Paul*, "the boycott at issue was not made as a definition excluding . . . refusals to deal The evil of a boycott is not its absolute character but the use of the economic power of a third party to force the boycott victim to agree to the boycott beneficiary's terms." *Insurance Antitrust Litigation*, 938 F.2d at 930.

V. INTERCIRCUIT CONFLICTS OVER WHETHER THE FEDERAL
ARBITRATION ACT AND INSOLVENCY STATUTE PREEMPT
STATES' AUTHORITY TO REGULATE INSOLVENT
INSURANCE COMPANIES

Hundreds of insurance companies failed during the late 1980s, leaving some of the nation's most prestigious health, life, property, and casualty insurers as victims.¹⁴⁷ More important, the insolvencies adversely affected thousands of innocent insurance consumers and creditors.¹⁴⁸ Insolvent companies were also unable to pay millions of tax dollars to federal, state, and local governments.¹⁴⁹

Section 1012(b) of the McCarran-Ferguson Act clearly states that "[n]o 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."¹⁵⁰ Nevertheless, given the large increase in the number of insolvencies, insurance commissioners, primary insurers, and reinsurers have asked federal courts to decide whether federal insolvency and priority statutes override state schemes that regulate insolvent insurance companies.¹⁵¹ Federal courts of appeals have been characteristically divided over whether key sections of the Federal Arbitration Act¹⁵² and the fed-

147. See *supra* notes 10-13 and accompanying text.

148. See *supra* note 13. See generally *Hearing on Insurance Solvency*, *supra* note 2.

149. See generally Darr, *supra* note 29, at 619-23 (noting that the taxing authorities' or taxing entities' claims against insolvent insurers are often "postponed in favor of policy-based claims").

150. 15 U.S.C. § 1012(b) (1988); see also *supra* note 6 and accompanying text.

151. See, e.g., Darr, *supra* note 29, at 622-23. The commentator correctly observes:

Protection of consumer interests in priority statutes or by guaranty funds is not unique to state insurance law. Congress and federal regulatory agencies are also in substantial agreement with the choice to demote federal and state claims, especially when consumer interests are at stake. . . .

. . . [S]tates have the obligation for liquidating an insolvent insurer. Congress, in the federal bankruptcy law, has left that function to the states. In response to that deference, states have adopted complicated schemes for the administration of insurance company liquidations. . . .

The limitation on state insolvency statutes arises because of the federal insolvency statute which provides for the priority of unsecured federal claims in insolvency proceedings not involving bankruptcy.

Id. (footnote omitted).

152. 9 U.S.C. §§ 1-15 (1988). Section 2 provides:

A written provision in . . . a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

eral priority statute¹⁵³ preempt section 1012(b) of the McCarran-Ferguson Act.

A. Intercircuit Conflicts Involving the McCarran-Ferguson and the Federal Arbitration Acts

An insurance policy is a private contract between a policyholder and an insurance company.¹⁵⁴ Similarly, a “treaty of insurance” between a primary insurer and a reinsurer is an enforceable contract.¹⁵⁵ These contracts may include an arbitration clause, which outlines alternative

Id. § 2.

153. 31 U.S.C. § 3713 (1988). The section provides in relevant part:

(a)(1) A claim of the United States Government shall be paid first when—

(A) a person indebted to the Government is insolvent and—

(i) the debtor without enough property to pay all debts makes a voluntary assignment of property;

(ii) property of the debtor, if absent, is attached; or

(iii) an act of bankruptcy is committed; or

(B) the estate of a deceased debtor, in the custody of the executor or administrator, is not enough to pay all debts of the debtor.

Id. § 3713(a)(1).

154. *See, e.g.*, *Standard Mot. Ins. Co. v. Bailey*, 868 F.2d 893, 896 (7th Cir. 1989) (stating that “an insurance contract is a contract between the insurer and the insured”); *Skirlick v. Fidelity & Deposit Co.*, 852 F.2d 1376, 1378 (D.C. Cir. 1988) (characterizing an insurance policy “as a contract between the insurer and insured”), *cert. denied*, 488 U.S. 1007 (1989); *Stewart v. Morosa Bros. Transp. Co.*, 611 F.2d 778, 781 (9th Cir. 1980) (stating that “[a]n insurance policy is a contract between insurer and insured”); *Bush v. Nationwide Mut. Ins. Co.*, 448 A.2d 782, 784 (R.I. 1982) (“An insurance policy is a contract between insurer and insured. It is essentially a contract of adhesion.”).

155. *See, e.g.*, *In re Midland Ins. Co.*, 590 N.E.2d 1186, 1188-89 (N.Y. 1992). The court stated:

A reinsurance contract is one by which a reinsurer agrees to indemnify a primary insurer for losses it pays to its policyholders. Such contracts are of two general types. Treaty reinsurance is obtained in advance of actual coverage and may cover any risk the primary insurer covers. The contract is formed when the primary insurer “cedes” part of the premiums for its policies and the losses on those policies to the reinsurer. A facultative reinsurance contract is one obtained to cover a particular risk. The reinsurer does not assume liability for losses paid in either case; its only obligation is to indemnify the primary insurer. . . .

Although reinsurance contracts are indemnity contracts, they commonly contain insolvency clauses which, even in the absence of a primary insurer’s payment to policyholders, permit a liquidator to collect from the reinsurer the amount of reinsurance proceeds that would have become due if the ceding company had not become insolvent. The New York statutes encourage such clauses by providing that unless the reinsurance contract contains an insolvency clause the primary insurer may not consider the reinsurance as an asset or claim a deduction for the amount ceded.

Id. (emphasis added) (citation omitted).

procedures for resolving disputes.¹⁵⁶ Furthermore, “the interpretation of [insurance] contracts is ordinarily a question of state law.”¹⁵⁷ But insurance “contracts involve[] interstate commerce” and, therefore, the Federal Arbitration Act “governs contracts in interstate commerce.”¹⁵⁸

Federal appellate courts must determine whether state law or the Federal Arbitration Act governs when an insurance company becomes insolvent and a valid arbitration clause outlines the liquidation procedures. Among the circuits considering this question, there has been an undue amount of confusion. The United States Courts of Appeals for the Second and Ninth Circuits have concluded that section 1012(b) of the McCarran-Ferguson Act does not preclude the application of the Federal Arbitration Act.¹⁵⁹ It also appears that the Court of Appeals for the Fifth Circuit supports this point of view. The Fifth Circuit has held that section 1012(b) does not bar the application of the Federal Arbitration

156. See generally ALAN I. WIDISS, *INSURANCE: MATERIALS ON THE FUNDAMENTAL PRINCIPLES, LEGAL DOCTRINES AND REGULATORY ACTS* 883-85 (1989).

157. *Volt Info. Sciences, Inc. v. Board of Trustees*, 489 U.S. 468, 474 (1989) (stating that section 4 of the Federal Arbitration Act allows for arbitration to proceed in the manner in which it is provided for in the contract or agreement between the parties).

158. *Id.* at 471-72.

159. See *Bennett v. Liberty Nat'l Fire Ins. Co.*, 968 F.2d 969, 970-73 (9th Cir. 1992) (concluding that Montana's insolvency statute does not regulate the business of insurance and therefore does not preempt the application of the Federal Arbitration Act's policy favoring arbitration in insolvency proceedings); *Hamilton Life Ins. Co. v. Republic Nat'l Life Ins. Co.*, 408 F.2d 606, 611 (2d Cir. 1969) (stating that the McCarran-Ferguson Act does not exempt the business of insurance from compliance with other federal statutes, unless such compliance would prompt state law). The Second Circuit in *Hamilton* drew from the language of the district court's opinion: “The plain and unambiguous statutory language is persuasive evidence that the McCarran-Ferguson Act was not intended to preclude the application of these federal statutes to insurance *unless* they invalidate, impair or supersede applicable state legislation regulating the business of insurance.” *Hamilton Life Ins. Co. v. Republic Nat'l Life Ins. Co.*, 291 F. Supp. 225, 230 (S.D.N.Y. 1968), *aff'd*, *Hamilton Life*, 408 F.2d at 606. The appellate court added that “[t]o avail itself of the McCarran Act, then, appellant must show that the application of the Federal Arbitration Act would ‘invalidate, impair or supersede any law enacted by any state for the purpose of regulating the business of insurance.’” *Hamilton Life*, 408 F.2d at 611 (quoting 15 U.S.C. § 1012(b) (1988)). *But see Washburn v. Corcoran*, 643 F. Supp. 554, 557 (S.D.N.Y. 1986). The court in *Washburn* stated:

The Arbitration Act is an “Act of Congress” that does not “specifically relate[] to the business of insurance.” Article 74 is a “law enacted by [a] . . . State for the purpose of regulating the business of insurance.” Enforcement of the Arbitration Act to require arbitration where it is forbidden by Article 74 and would undermine the scheme of exclusive jurisdiction established by Article 74 I conclude that Congress has determined that in such an instance the Arbitration Act shall yield to the state law regulating the business of insurance.

Id. (alterations in original) (quoting 15 U.S.C. § 1012(b)).

Act to the business of insurance even if a state statute regulates the insurer's activity.¹⁶⁰

Although the Court of Appeals for the Tenth Circuit has not specifically addressed the issue of whether an arbitration agreement between an insolvent insurer and a reinsurer should be governed by state or federal law, it has considered whether the Federal Arbitration Act preempts state law in other contexts. In 1971, the court held in *Hart v. Orion Insurance Co.*¹⁶¹ that section 1012(b) of the McCarran-Ferguson Act did not bar the application of the Federal Arbitration Act where the arbitration dispute involved a primary insurer and a policyholder.¹⁶² Twenty years later, however, the Tenth Circuit decided *Mutual Reinsurance Bureau v. Great Plains Mutual Insurance Co.*,¹⁶³ a case involving a disagreement between a primary insurer and a reinsurer.¹⁶⁴ The court held that Kansas law regulated both reinsurance agreements and primary insurance contracts.¹⁶⁵ Therefore, it concluded that section 1012(b) of "the McCarran-Ferguson Act preclude[d] the application of the [Federal Arbitration Act] to the reinsurance agreement."¹⁶⁶

Despite the clear pronouncement of section 1012(b) of the McCarran-Ferguson Act granting superiority to state statutes in regulating insurance, federal courts have continued to ignore the Act's language and held that *federal statutory law* takes precedence.¹⁶⁷ In an attempt to harmonize the McCarran-Ferguson Act with the Federal Arbitration Act, several courts have concluded that the Federal Arbitration Act controls.¹⁶⁸

160. See, e.g., *Miller v. National Fidelity Life Ins. Co.*, 588 F.2d 185, 187 (5th Cir. 1979) ("Based upon the clear meaning of 15 U.S.C.A. § 1012(b), the district court correctly concluded that McCarran-Ferguson did not apply and that the Federal Arbitration Act made the arbitration clause of the policy valid, enforceable, and irrevocable.").

161. 453 F.2d 1358 (10th Cir. 1971).

162. *Id.* at 1360. In *Hart*, an airline pilot tried to recover insurance proceeds under an occupational disability policy. *Id.* at 1359. There was disagreement about the validity and relevance of the policy's arbitration clause given that the policy was negotiated and delivered in Montana, the insurer's place of business was in Illinois, and the suit was filed in Colorado. *Id.* at 1360. Although the disability policy was a private, enforceable insurance contract, the court observed that "[n]one of the provisions of the Montana, Illinois, and Colorado statutes . . . regulate[d] the business of insurance. Instead, they [were] laws of general application pertaining to the method of handling contract dispute." *Id.* Under these facts, the Federal Arbitration Act was applied and the arbitration provisions were found enforceable. *Id.*

163. 969 F.2d 931 (10th Cir.), *cert. denied*, 113 S. Ct. 604 (1992).

164. *Id.* at 931-32.

165. *Id.* at 933.

166. *Id.* at 934.

167. See *supra* notes 47, 57-62 and accompanying text.

168. See *supra* notes 154-66 and accompanying text.

Clearly, Congress must act to correct this problem, one which it failed to anticipate when section 1012(b) was enacted.

B. Intercircuit Conflicts Involving the McCarran-Ferguson Act and the Federal Priority Statute

Following the collapse of an insurance company, numerous claims against the insolvent company must be satisfied. Often, consumers' and creditors' claims form the bulk of the outstanding obligations.¹⁶⁹ To reassure these persons, many states have enacted statutes to govern the liquidation of insolvent insurers.¹⁷⁰ In fact, a majority of states have adopted all or portions of the Uniform Insurers Liquidation Act to help resolve disputes and ensure that various claims are satisfied.¹⁷¹

In recent years, a crucial debate has developed over whether taxing authorities' claims against insolvent insurers are superior to the rights and interests of policyholders and creditors. In particular, the federal government has filed several suits in federal courts, arguing that the federal priority statute supersedes any state insurance liquidation priority scheme that gives preference to the claims of policyholders.¹⁷²

The wording of the federal priority statute is precise: "A claim of the United States Government shall be paid first when a[n insurer] indebted

169. See generally Darr, *supra* note 29, at 619-23 (addressing consumer protection in the wake of insurance insolvencies).

170. *Id.*

171. See UNIF. INSURERS LIQUIDATION ACT §§ 2-8 (1939), 13 U.L.A. 321, 322-51 (1986 & Supp. 1993). Twenty-five states, Puerto Rico, and the Virgin Islands, have adopted the Act in whole or in part. ALA. CODE §§ 27-32-1 to -41 (1986); ALASKA STAT. §§ 21.78.200-.330 (1993); ARIZ. REV. STAT. ANN. §§ 20-611 to -648 (1990 & Supp. 1993); ARK. CODE ANN. §§ 23-68-101 to -132 (Michie 1987 & Supp. 1993); CAL. INS. CODE §§ 1064.1-12 (West 1993); DEL. CODE ANN. tit. 18, §§ 5901(2)-(13), 5902, 5903, 5913-5920 (1989); FLA. STAT. ANN. §§ 631.011, .031, .041, .141-.201 (West Supp. 1993); IDAHO CODE §§ 41-3301 to -3360 (1991); ILL. ANN. STAT. ch. 215, para. 5/221.1-.13 (Smith-Hurd 1993); KY. REV. STAT. ANN. §§ 304.33-010 to -440 (Michie/Bobbs-Merrill Supp. 1992); LA. REV. STAT. ANN. §§ 22:757-.763 (West 1978 & Supp. 1993); MD. ANN. CODE art. 48A, §§ 132, 132A, 145-148, 150-52 (1991 & Supp. 1993); MASS. GEN. LAWS ANN. ch. 175, §§ 180A-180L (West 1987 & Supp. 1993); MO. ANN. STAT. §§ 375.950-990 (Vernon 1991 & Supp. 1993); NEV. REV. STAT. ANN. §§ 696B.030-.180, 696B.280, 696B.290-.340 (Michie 1986 & Supp. 1991); N.J. STAT. ANN. §§ 17:30C-1 to -31 (West 1985 & Supp. 1993); N.M. STAT. ANN. §§ 59A-41-3 to -23 (Michie 1992); N.Y. INS. LAW §§ 7408-7415 (McKinney 1985 & Supp. 1994); OKLA. STAT. ANN. tit. 36, §§ 1901-1936 (West 1990 & Supp. 1994); OR. REV. STAT. §§ 734.014-.440 (1993); R.I. GEN. LAWS §§ 27-14-1 to -23 (1989 & Supp. 1993); WASH. REV. CODE ANN. §§ 48.31.110-.180 (West 1984 & Supp. 1993); W. VA. CODE §§ 33-10-1 to -39 (1992 & Supp. 1993); WIS. STAT. ANN. §§ 645.03, 645.81-.90 (West 1980 & Supp. 1993); WYO. STAT. §§ 26-28-101 to -131 (1991); P.R. LAWS ANN. tit. 26, §§ 4007-4014 (1977 & Supp. 1990); V.I. CODE ANN. tit. 22, §§ 1261-1268 (1993).

172. See *infra* notes 174-99 and accompanying text.

to the Government is insolvent.”¹⁷³ But the language of section 1012(b) of the McCarran-Ferguson Act is also clear: No congressional act shall supersede any state law that regulates the business of insurance. Several federal appellate courts have tried to harmonize these two arguably irreconcilable statutes. Their efforts, however, have produced strained, inconsistent, and less than intelligible rulings.

In *Gordon v. United States Department of Treasury*,¹⁷⁴ the United States District Court for the District of Maryland found that the federal priority statute preempted Maryland’s insurance liquidation priority statute.¹⁷⁵ The United States Court of Appeals for the Fourth Circuit adopted the district court holding,¹⁷⁶ but the Fourth Circuit’s reasoning was exceptionally strained. The court reviewed the Supreme Court’s *Pireno/Royal Drug* tests¹⁷⁷ and agreed with the district court’s conclusion that “liquidation of an insolvent insurance company and the determination of the priority of payment of claims against the insolvent [insurer] do not constitute the ‘business of insurance’ within the meaning of the McCarran-Ferguson Act.”¹⁷⁸ Therefore, under the federal priority statute, the federal government could assert and satisfy its “superpriority” claim circumventing Maryland’s insurance liquidation priority statute without violating section 1012(b) of the McCarran-Ferguson Act.¹⁷⁹

The Court of Appeals for the Ninth Circuit has addressed the applicability of the federal priority statute as well. In *Idaho ex rel. Soward v. United States*,¹⁸⁰ the IRS challenged the district court’s determination that an Idaho insurance liquidation priority statute regulated the business of insurance within the meaning of the McCarran-Ferguson Act, claiming that the state’s priority statute superseded the priority rule under the federal priority statute.¹⁸¹

173. 31 U.S.C. § 3713(a)(1) (1988) (emphasis added).

174. 668 F. Supp. 483 (D. Md. 1987).

175. *Id.* at 491. In *Gordon*, the Special Deputy State Insurance Commissioner of Maryland was appointed receiver for an insolvent insurance company. *Id.* at 485. The U.S. Department of Treasury, citing the federal priority statute, asserted that federal claims should be given superpriority under the federal statute. *Id.* The insurance commissioner filed a complaint in the federal district court alleging that the federal government’s assertion of top priority was illegal because it preempted the Maryland Insurance Code which regulated the business of insurance. *Id.* Maryland’s Insurance Commissioner sought a declaratory judgment that the Department of Treasury’s assertion of superpriority violated section 1012(b) of the McCarran-Ferguson Act. *Id.*

176. 846 F.2d 272, 273 (4th Cir.), *cert. denied*, 488 U.S. 954 (1988).

177. *See supra* notes 67-75 and accompanying text.

178. *Gordon*, 846 F.2d at 273.

179. *Id.*

180. 858 F.2d 445 (9th Cir. 1988), *cert. denied*, 490 U.S. 1065 (1989).

181. *Id.* at 446. The factual background is uncomplicated:

The Ninth Circuit adopted a position similar to the Fourth Circuit's, holding that the federal priority statute did preempt the state's insurance insolvency statute.¹⁸² Unlike the Fourth Circuit, however, the Ninth Circuit acknowledged, but did not apply, the Supreme Court's *Pireno/Royal Drug* analyses to justify its holding.¹⁸³ Instead, the Ninth Circuit cited the Supreme Court's business of insurance test outlined in *SEC v. National Securities, Inc.*,¹⁸⁴ and concluded that an insolvent Idaho insurance company was no longer in the business of insurance.¹⁸⁵ Therefore, it held

Pacific Insurance Administrators Agency, Inc., and Pacific Insurance Administrators, Inc., formerly engaged in the insurance business in Idaho. After encountering financial problems, the companies [became insolvent and surrendered their assets to the Director of the Idaho Department of Insurance]

During the liquidation process, the Internal Revenue Service . . . submitted claims for federal taxes, including penalties and interest Amended claims stated that Pacific Insurance Administrators Agency, Inc., owed the United States \$25,514.20, and that Pacific Insurance Administrators, Inc. owed the United States \$88,482.26.

. . . Section 41-3342 of the Idaho Insurance Code establishes the priority of distribution among claims against the estate of a liquidated insurer, setting forth eight classes of claimants in descending order of priority. Class 5 of the priority scheme includes claims of "the federal or any state or local government."

. . . .

The United States disputed the priority assigned to its claims, asserting that it was entitled to payment ahead of Class 4 claims under the Federal Insolvency Statute.

Id. at 446-47 (citations and footnotes omitted).

182. *Id.* at 452.

183. *Id.* at 453-55.

184. 393 U.S. 453 (1969). The *National Securities* Court observed:

The [McCarran-Ferguson Act] did not purport to make the States supreme in regulating all the activities of insurance *companies*; its language refers not to the persons or companies who are subject to state regulation, but to laws "regulating the *business* of insurance." Insurance companies may do many things which are subject to paramount federal regulation; only when they are engaged in the "business of insurance" does the statute apply. . . . The relationship between insurer and insured, the type of policy which could be issued, its reliability, interpretation, and enforcement . . . [form] the core of the "business of insurance."

Id. at 459-60.

185. *Soward*, 858 F.2d at 452. The Ninth Circuit stated:

Application of the holding and reasoning of *National Securities* to this case leads to the conclusion that Idaho Insurance Code § 41-3342 is *not* a law regulating the business of insurance. To begin with, the statute deals with insurance companies that no longer are in the business of insurance. The only "business" being conducted is the liquidation of a corporation which happens to have been an insurance company. Hence, the scope of the net cast by the statute is wholly unrelated to the relationship between insurer and insured. The insurer has ceased to exist. The only relationship is between the insureds and the government official charged with overseeing the liquidation of the insolvents. Whereas the court in *National Securities* found that in legislating the McCarran-Ferguson Act Congress focused on the relationship between insurer and insured, the Idaho statute speaks to an

that section 1012(b) of the McCarran-Ferguson Act did not bar the application of the federal priority statute in the insolvency proceedings.¹⁸⁶

The Court of Appeals for the Sixth Circuit addressed the superpriority question and reached an entirely different conclusion. In *Fabe v. United States Department of Treasury*,¹⁸⁷ an Ohio court declared the insurance company insolvent, ordered the company's liquidation, and appointed the Ohio Superintendent of Insurance to serve as liquidator.¹⁸⁸ Federal claims were filed in the state liquidation proceedings in which the Department of the Treasury cited the federal priority statute and argued that federal claims should receive top priority.¹⁸⁹ To resolve the conflict, the superintendent of insurance commenced a declaratory action in a federal district court, arguing that Ohio's insurance liquidation laws preempted the application of the superpriority statute.¹⁹⁰ The district court disagreed, however, ruling in favor of the federal government.¹⁹¹ On appeal, the Sixth Circuit reversed the lower court's decision and held that Ohio's liquidation statute "protect[ed] the interests of the insured" and

entirely different concern in this context: the relationship between debtor and creditor. The relationship regulated by [the Idaho statute] . . . is between the liquidated assets of corporations and the claims of various creditors.

Id. at 452 (citations omitted).

186. *Id.* at 455. One district court in the Tenth Circuit also reached a similar conclusion. See *Phillips v. Lincoln Nat'l Health & Casualty Ins. Co.*, 774 F. Supp. 1297, 1299 (D. Colo. 1991). The court recognized that "Colorado . . . enacted an encompassing regulatory scheme for the liquidation of insolvent insurance companies in [Colorado's] Uniform Insurers Liquidation Act." *Id.* The court stressed that "Colorado [did] not have a law . . . establish[ing] . . . the liquidation of insurance companies [as] the 'business of insurance.'" *Id.* Therefore, the district court held that "the relevant caselaw . . . dictates that the liquidation of an insolvent insurance company is not the 'business of insurance' as that term is used in the McCarran-Ferguson Act." *Id.*

187. No. C-2-88-778, 1990 U.S. Dist. LEXIS 17761 (S.D. Ohio Mar. 15, 1990), *rev'd*, 939 F.2d 341 (6th Cir. 1991), *aff'd in part and rev'd in part*, 113 S. Ct. 2202 (1993).

188. *Id.*

189. *Id.* at *1-2.

190. *Id.* at *4. The court noted that the Ohio Commissioner of Insurance "argue[d] that to apply 31 U.S.C. § 3713 and give the claims of the United States first priority in this instance would impair the laws of the state of Ohio enacted to govern the business of insurance." *Id.*

191. *Id.* at *20. The district court stated:

[T]he United States Supreme Court appears to have adopted a somewhat limited definition of the "business of insurance" as that term is used in section 2(b) of the McCarran-Ferguson Act. Under the Supreme Court's analysis the scope of the term "business of insurance" is limited to those activities directly or indirectly affecting the risk transfer indicative of the insured-insurer relationship. . . . [T]he liquidation of insolvent insurance companies and the concomitant prioritization of claims do not affect the transfer or spreading of risk. Accordingly, this court concludes that Ohio Rev. Code § 3903.42 is not a state law regulating the "business of insurance" within the meaning of 15 U.S.C. § 1012(b).

Id. at *19-20.

“regulat[ed] the ‘business of insurance.’”¹⁹² Therefore, the statute was protected from federal preemption.¹⁹³

When one considers that thousands of policyholders are adversely affected after health and property insurance carriers fail, the Fourth and Sixth Circuits’ conflicting holdings are truly disturbing. Both circuits cited the Supreme Court’s business of insurance explanations outlined in *Royal Drug* and *Pireno*.¹⁹⁴ The Fourth Circuit, however, ruled that policyholders’ claims are inferior to federal claims because insolvent carriers no longer engage in the business of insurance.¹⁹⁵ Yet the Sixth Circuit disagreed.¹⁹⁶

The Sixth Circuit argued that the views of the federal government in *Fabe*, which mirror those of the Fourth Circuit, “misunderstand the nature of an insolvent insurer.”¹⁹⁷ The Sixth Circuit stressed that “[o]nce an insurer is placed in receivership, only the sale of new policies is suspended during liquidation; the actual adjustment of claims and the payment of existing claims continue.”¹⁹⁸ Therefore, policyholders’ reasonable expectations and claims must be honored before satisfying the claims of the federal government.¹⁹⁹ Such intracircuit conflicts and quib-

192. *Fabe v. United States Dep’t of Treasury*, 939 F.2d 341, 350-51 (6th Cir. 1991), *aff’d in part and rev’d in part*, 113 S. Ct. 2202 (1993).

193. *Id.* The court found the Ohio insurance liquidation priority scheme “to be a regulation of the ‘business of insurance’ within the meaning of the McCarran-Ferguson Act and thus subject solely to the provisions of state law absent explicitly conflicting federal legislation.” *Id.* at 343 (citation omitted). The Supreme Court partially supported the Sixth Circuit’s holding in *United States Department of Treasury v. Fabe*, 113 S. Ct. 2202 (1993), stating that “the Ohio priority statute, to the extent that it regulates policyholders, is a law enacted for the purpose of regulating the business of insurance.” *Id.* at 2212. But the Court truly exacerbated the conflict among the federal circuits and muddled this body of insurance law when it held that “[t]o the extent that [Ohio’s priority statute] is designed to further the interests of other creditors, . . . it is not a law enacted for the purpose of regulating the business of insurance.” *Id.*; *see also* *Garcia v. Island Program Designer, Inc.*, 791 F. Supp. 338, 342 (D.P.R. 1992) (adopting the Sixth Circuit’s position in *Fabe* and holding that the federal priority statute does not preempt Puerto Rico’s insurance liquidation priority statute), *rev’d*, 4 F.3d 57 (1st Cir. 1993).

194. Compare cases cited *supra* notes 76-79, 155 with *Fabe*, 939 F.2d at 348. The *Fabe* court stated:

We cannot agree with the . . . argument, that any regulation of insurance liquidation is *per se* not a regulation of the “business of insurance.” Rather, we find the better approach to be an independent assessment as to whether each facet of a challenged plan regulates the “business of insurance” under the *Pireno/Royal Drug/National Securities* trilogy.

Id.

195. *See supra* notes 174-78.

196. *See supra* notes 187-93.

197. *Fabe*, 939 F.2d at 351.

198. *Id.*

199. *Id.*

bling are excellent reasons for preventing federal courts from deciding all insurance-related and business of insurance cases.

VI. A CASE STUDY: AN EMPIRICAL ANALYSIS OF JUDICIAL
OUTCOMES IN FEDERAL COURTS AMONG CASES INVOLVING
THE McCARRAN-FERGUSON ACT, THE SHERMAN
ACT, AND OTHER FEDERAL STATUTES—
1941-1993

Federal courts play a prominent role in the area of insurance regulation. These tribunals, however, unwittingly discriminate against consumers, insurers and state insurance commissioners when deciding procedural and substantive questions under the McCarran-Ferguson Act. In particular, federal courts permit immaterial factors to influence the outcome of McCarran-Ferguson cases where the following insurance-regulation questions are presented: whether the definition of business of insurance is broad or narrow; whether the definition of boycott is broad or narrow; and whether federal antitrust, arbitration, and insolvency laws preempt state statutes that regulate the business of insurance.

Should extralegal factors—such as region of country, gender, ethnicity, geographic origin, or types of federal circuits—singularly influence or determine the outcome of a legal action? Should such variables be relevant if an action concerns a civil or a criminal matter, or if a case is decided procedurally or on the merits? Moreover, if—after controlling for other relevant variables or issues—one's religious affiliation or one's race determines the disposition of federal-court decisions, should it be cause for concern? And, should we experience anger if—after controlling for all other material factors—federal courts are significantly more likely to dismiss Asian-initiated rather than Hispanic-initiated suits on procedural grounds?

The answer to each question is a reverberating "yes." Actually, under either condition, *outrage* would be more appropriate because there is little, if any, relevant case law to support or to cause one to anticipate such questionable outcomes. Yet several extralegal factors—those having no purposeful connection with the merits of McCarran-Ferguson cases—are systematically influencing the disposition of such cases in federal courts.

This section examines the astonishing results of an empirical examination of federal lawsuits involving the McCarran-Ferguson Act, federal antitrust laws and other federal statutes. The study concludes that the likelihood of complainants—insurance consumers, state insurance commissioners, and insurers—winning on the merits or receiving a favorable outcome on procedural grounds is shaped significantly by variables that

have little to do with the legal questions and theories outlined in the pleadings. The outcome instead is determined by factors over which litigants exercise little or no control. More important, such Supreme Court and federal courts of appeals decisions have continued since the inception of the McCarran-Ferguson Act.

A. *Source of Data, Sampling Procedures, and Demographic Characteristics of Litigants*

Research activities involved finding, reading, and coding every reported McCarran-Ferguson case decided in federal courts and between 1941 and 1993. Using both WESTLAW and LEXIS computer research systems, the investigation uncovered 175 Supreme Court and appellate court decisions.²⁰⁰ Each case involved the regulation of insurance and a dispute over at least one or more of the following issues: the definition of business of insurance, the definition of boycott, and the federal preemption of state insurance statutes.

For purposes explained below,²⁰¹ an additional sample of 100 Federal Trade Commission cases were randomly selected, analyzed and included in the study.²⁰² These latter decisions also involved one or more of the issues stated above. Therefore, the total sample population for this empirical study comprises 275 procedural and substantive rulings.²⁰³

Table 1 illustrates some selected demographic characteristics of litigants. First, a comparison of appellate and Supreme Court cases reveals a startling finding: complainants are more likely to lose in the court of appeals, but are more likely to win in the Supreme Court. The percentages are 60.0% and 65.2%, respectively. This finding is rather perplexing when we consider that no statistically significant difference exists between appellate and Supreme Court complainants and between Supreme Court and appellate court defendants. A careful review of the percentages reported for each court supports this finding.

When viewing the types of procedural issues presented before the Supreme Court and the courts of appeals, however, we uncover another statistically significant result: Supreme Court litigants were significantly more likely to complain about the federal preemption of state insurance

200. Search of LEXIS, Genfed Library, COURTS File (June 16, 1993); search of WESTLAW, SCT and CTA databases (June 21, 1993).

201. See *infra* notes 213-17 and accompanying text.

202. Search of LEXIS, Trade library, FTC file (July 2, 1993); Search of WESTLAW, FATC-FTC database (June 21, 1993).

203. Willy E. Rice, *Empirical Analysis of Judicial Outcomes in Federal Courts Among Cases Involving the McCarran-Ferguson Act, the Sherman Act, and Other Federal Statutes, 1941-1993* (1993) (on file with the *Catholic University Law Review*).

statutes, while court of appeals litigants were less likely to complain about this type of federal preemption. The percentages are 34.8% and 11.2%, respectively.

In addition, among appellate court litigants, disability and health insurance contracts were significantly more likely to be involved in the legal disputes. The percentages are 12.5% and 31.6%, respectively. But, among the Supreme Court cases, life insurance contracts (30.4%) were more likely to be the focus of the conflicts.

Table 1 also reveals that litigants who commenced their actions in the court of appeals and in the Supreme Court resided in very different regions of the country. For example, appellate court suits were more likely to originate in the East,²⁰⁴ Midwest,²⁰⁵ and Southwest²⁰⁶—17.1%, 28.3%, and 13.8% respectively. On the other hand, the actions filed in the Supreme Court were more likely to commence in the West²⁰⁷—26.1%. Nearly an equal number of appellate and Supreme Court cases started in the South²⁰⁸—12.5% and 13.0%, respectively.

One hundred Federal Trade Commission cases also appear in the study. Therefore, Table 1 illustrates some selected characteristics of these administrative actions that involve a combination of antitrust and insurance-related (McCarran-Ferguson) issues. Among the findings, four are outstanding: 1) FTC lawyers (complainants), who represent insurance consumers' interests, were more likely to prevail (67.0%) in these cases; 2) health insurance contracts and policies were associated with the overwhelming majority (64.0%) of FTC cases; and 3) the majority of actions involved the scope of the "business of insurance"—63.0%.

Finally, a majority of both appellate and Supreme Court actions concerned antitrust issues and violations under the Sherman Act. The percentages are 44.7% and 30.4%, respectively. Among the federal courts of appeals cases, however, a significantly higher percentage (20.4%) of suits involving the Clayton Act appear.

204. The East includes the following jurisdictions: Connecticut, Delaware, District of Columbia, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island, and Vermont. *Id.*

205. The Midwest includes the following jurisdictions: Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Ohio, South Dakota, West Virginia, and Wisconsin. *Id.*

206. The Southwest includes the following jurisdictions: Arkansas, Louisiana, Oklahoma, and Texas. *Id.*

207. The West includes the following jurisdictions: Alaska, Arizona, California, Colorado, Hawaii, Idaho, Montana, Nevada, New Mexico, Oregon, Utah, Washington, and Wyoming. *Id.*

208. The South includes the following jurisdictions: Alabama, Georgia, Florida, Mississippi, Kentucky, North Carolina, South Carolina, Tennessee, and Virginia. *Id.*

B. The Disposition of McCarran-Ferguson Actions by Types of Procedural (Regulatory) Questions and by Types of Insurance Contracts

Table 2 presents the relationship between *the types of procedural (regulatory) questions* presented on appeal and the disposition of the actions. First, it is important to note that *these cases were decided in the federal courts of appeals*. Second, the reported Chi-square coefficient (7.8769) is statistically significant at a probability level²⁰⁹ of $p=0.02$.

Simply expressed, Table 2 reveals the following: complainants are significantly more likely to lose (77.5%) when the regulatory (procedural) question concerns whether federal laws—the Sherman Act, the Federal Arbitration Act, and the federal insolvency statute—preempt state insurance statutes and the McCarran-Ferguson Act. Also, complainants are significantly more likely to lose (61.5%) when the procedural question concerns whether the definition of boycott is broad or narrow. However, appellants are likely to win and lose an equal number of suits (49.0% versus 51.0%) when the regulatory question concerns the definition of business of insurance.

Certainly, the findings reported in Table 2 are interesting and statistically meaningful, but viewed from a legal perspective, they are not astounding. Nothing material appears in the relevant caselaw to suggest that complainants should win all, some, or none of these actions. However, the results reported in the next table are more disquieting from a legal perspective.

What is so unique about disability-insurance contracts that would cause federal courts to decide systematically in favor of or against the owners of such contracts? Stated differently, do health-insurance policies include some exceedingly uncommon terms and conditions that compel otherwise impartial federal courts to issue unwarranted and disparate decisions? Of course, the answer to each question is “no.” A careful examination of settled principles of contract law and of the Sherman Antitrust Act, the Federal Insolvency Statute, the Federal Arbitration Act, and the McCarran Act failed to uncover a single justification for attaching any legal significance to a particular type of insurance contract.

Yet, an equally cautious examination of the percentages reported in Table 3 reveals that the Supreme Court and federal courts of appeals are

209. With a legal audience in mind, the author has outlined previously an exceptionally simple law-related illustration of a Chi-square computation, along with a brief explanation of the “level of statistical significance.” See Willy E. Rice, *Judicial Enforcement of Fair Housing Laws: An Analysis of Some Unexamined Problems that the Fair Housing Amendments Act of 1983 Would Eliminate*, 27 How. L.J. 227, 253-55 nn.161-62 (1984).

unwittingly permitting types of insurance contracts to influence their decisions.

Table 3 illustrates the statistically significant relationship between the disposition of cases and types of insurance contracts. These findings appear only among those cases where the “business of insurance” and “federal preemption” questions were presented. The results are compelling: complainants were more likely to win in federal court if the regulatory disputes involved health- and disability-insurance contracts; the percentages are 55.0% and 66.7%, respectively. Conversely, complainants were significantly more likely to lose if the “business of insurance” or “preemption” questions concerned life-insurance and other types of insurance contracts—80.0% and 76.9%, respectively.

Of course, if the evidence in Table 3 does not establish conclusively that federal courts are permitting unwarranted, extralegal factors to influence insurance-related regulatory actions, perhaps the findings reported in Tables 4 and 5 are more convincing.

Table 4 shows the relationship between region of the country—complainants’ residences or places of business—and the disposition of McCarran-Ferguson actions. Only federal appellate-court cases are represented in Table 4. The effects of region of country on the disposition of claims, however, are measured at two time periods: 1) before the Supreme Court’s business of insurance decision in *Royal Drug*,²¹⁰ and 2) after the Court decided *Royal Drug*.

Among the cases decided after *Royal Drug*, the findings indicate that no statistically significant association between region of country and outcome materialized: complainants from the Midwest, West, and other regions of the country were likely to win or lose an equal number of McCarran-Ferguson actions in the courts of appeals.

Among the suits resolved before *Royal Drug*, however, the findings are quite different. First, complainants from the western region of the country were significantly more likely to win (71.4%) in the federal appellate courts. But complainants who resided in other regions of the nation—barring the Midwest—were significantly more likely to lose (78.9%) McCarran-Ferguson disputes in federal courts.

The pattern of the findings appearing in Table 5 is similar to that portrayed in the preceding table. Table 5, however, illustrates the association between types of complainants—insured individuals, insured businesses, and reinsurers—the disposition of McCarran-Ferguson conflicts. Here, the effects of types of complainants on the outcome of regulatory dis-

210. *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205 (1979); see also *supra* notes 67-70, 76-93 and accompanying text.

putes in the courts of appeals are assessed at two intervals: 1) before the Supreme Court presented its definition of boycott decision in *St. Paul*,²¹¹ and 2) after the Court decided *St. Paul*.

Among the cases decided after *St. Paul*, the reported likelihood ratio²¹² (2.074) is not statistically significant. This simply means that the courts of appeals did not permit a complainant's legal status to influence whether that person was successful or unsuccessful on appeal. Among the actions decided before *St. Paul*, however, the likelihood ratio (3.5548) is statistically significant at $p=0.05$. The interpretation is clear: where the regulatory question concerned the definition of boycott, individual policyholders were significantly more likely to win in the courts of appeals. Conversely, other types of complainants were significantly more likely to lose. The reported percentages are 75.0% and 83.3%, respectively.

Tables 4 and 5 both clearly show that federal courts of appeals are less likely to allow impermissible variables to influence their business of insurance and boycott decisions after the Supreme Court resolved the intercircuit conflicts in *Royal Drug* and in *St. Paul*. Undeniably, these two findings are extremely encouraging.

Nevertheless, as outlined in Parts II, III and IV, there are many other intra and intercircuit conflicts that the Supreme Court has not settled. Arguably, many of those disagreements and inconsistencies have developed and will continue to develop because federal judges permit extralegal factors to influence the manner in which business of insurance and other regulatory questions are decided in the federal courts of appeals.

C. *A Multivariate Probit Two-Stage Analysis of the Disposition of McCarran-Ferguson Cases in Federal Courts, 1946-1993*

Are federal courts truly biased against complainants whose claims involve life-insurance contracts and less sympathetic toward those whose actions concern health-insurance contracts? Are federal appellate courts biased in favor of complainants from the West and against those from other regions of the country? Or, are state insurance commissioners more likely to win in federal court than insurance consumers?

211. *St. Paul Fire & Marine Ins. Co. v. Barry*, 438 U.S. 531 (1978); *see also supra* notes 135-46 and accompanying text.

212. *See, e.g.*, WILLIAM L. HAYS, STATISTICS FOR THE SOCIAL SCIENCES 736-40 (2d ed. 1973) (discussing likelihood ratio tests for categorical data). The likelihood ratio test and the Chi-squared test are very similar. Also, the latter test is extremely easy to compute and understand. However, the likelihood ration test should be applied where the sample size is fairly small and the observed number of cases in a table cell is five or less. *Id.* A review of Table 5 shows that these conditions are present.

Apparently, the Supreme Court and the federal courts of appeals are biased and are intentionally or unintentionally permitting extralegal factors to influence the outcome of McCarran-Ferguson actions. This certainly is a reasonable conclusion based on the statistical evidence appearing in Tables 3-5.

Yet conceivably, a less obvious statistical aberration could be producing what appears to be judicial bias. Or perhaps the presumably significant extralegal variables may be masking the influence of an even more obscure, significant legal factor—one that has not been measured and assessed in this study. Stated another way, some other underlying, material legal factor—which is highly correlated with these impermissible variables—may be generating what appears to be unusual statistical findings.

For example, Table 2 presents the statistically significant relationship between the disposition of claims and types of procedural questions presented on appeal. The results show that complainants are likely to win or lose, depending on the type of question raised. Therefore, a series of important statistical questions must be answered: which are the “true” predictors of judicial outcomes in federal courts? Are the significant extralegal variables reported in Tables 3-5 more important? Or is the legal variable—types of procedural questions—more relevant? A definitive answer cannot be presented unless we perform an additional analysis.

Also, a phenomenon called “self-selectivity bias”²¹³ may be causing what appears to be judicial bias. Such bias often arises in samples because of the differences between those who decide to commence insurance-related antitrust actions and those who decide not to initiate such actions. Expressed differently, an otherwise fairly random sample of McCarran-Ferguson decisions may be comprised primarily of aggrieved complainants who decided to file suits in federal district courts and who decided to appeal adverse district-court rulings to a federal court of appeals or to the Supreme Court.

213. See, e.g., G.S. MADDALA, LIMITED-DEPENDENT AND QUALITATIVE VARIABLES IN ECONOMETRICS 257-71 (Econometric Society Monograph No. 3, 1983). For examples of and tests for self-selectivity bias from a legal perspective, see Willy E. Rice, *Judicial Bias, the Insurance Industry and Consumer Protection: An Empirical Analysis of State Supreme Courts' Bad-Faith, Breach-of-Contract, Breach-of-Covenant-of-Good-Faith and Excess-Judgment Decisions, 1900-1991*, 41 CATH. U. L. REV. 325, 371-75 (1992) [hereinafter Rice, *Judicial Bias*]; Will E. Rice, *Judicial and Administrative Enforcement of Individual Rights Under the National Labor Relations Act and Under the Labor-Management Relations Act Between 1935 and 1990—An Historical and Empirical Analysis of Unsettled Intercircuit and Intracircuit Conflicts*, 40 DEPAUL L. REV. 653, 730-34 (1991) [hereinafter Rice, *Enforcement of Individual Rights*]; Willy E. Rice, *Judicial and Administrative Enforcement of Title VI, Title IX and Section 504: A Pre- and Post-Grove City Analysis*, 5 REV. LITIG. 219, 279-82 (1986) [hereinafter Rice, *Grove City Analysis*].

Furthermore, self-selection bias might appear in another form.²¹⁴ Complainants who received favorable outcomes in the district courts and who decided not to appeal their actions to a federal court of appeals would not appear in a sample. Those successful litigants therefore would have removed themselves from the original pool of complainants. Under either situation, an otherwise fairly random sample of McCarran-Ferguson cases would be extremely biased. Under such conditions, it would be highly improper to conclude that judicial bias is producing the unwarranted discrimination among complainants. A “selectivity bias” test is thus necessary to determine whether the sample population is fairly representative of the various types of appellants.

Table 6 displays the findings of a multivariate probit two-stage analysis.²¹⁵ This statistical procedure answers two important questions: (1) whether a statistically significant amount of self-selectivity bias appears in the sample; and (2) whether the concurrent and multiple impacts of both extralegal and legal factors—on the disposition of McCarran-Ferguson actions—are statistically meaningful, if selectivity bias is absent.

Before addressing these questions, some initial remarks are warranted. First, several predictor variables appear in the extreme left column in Table 6. A few of these statistically significant predictors were discussed earlier and are illustrated in Tables 2 and 5. We evaluate these predictors at this point to evaluate their simultaneous effects on the disposition of insurance-related, regulatory actions. Second, 275 complainants appear in the sample: 100 Federal Trade Commission (administrative) cases and 175 cases that were commenced in a federal district court. This latter group of litigants decided to obtain additional judicial review in either a federal court of appeals or the Supreme Court. The Federal Trade Commission, however, reviewed and resolved the 100 administrative actions involving the McCarran-Ferguson Act, but none of those administrative cases were appealed. The FTC complainants decided not to go to a fed-

214. See Rice, *Enforcement of Individual Rights*, *supra* note 213, at 733.

Additionally, the difference between litigants' financial resources is often another source of selectivity bias because a positive relationship exists [sic] between the level of one's financial resources and one's ability to purchase good legal representation. Therefore, a finding that [complainants are more or less likely to win in state supreme courts] could be a reflection of differential access to adequate resources rather than a reflection of judicial bias.

Id.

215. See Appendix, Table 6; see also Rice, *Grove City Analysis*, *supra* note 213, at 286-87; Rice, *Enforcement of Individual Rights*, *supra* note 213, at 733 & n.491.

eral court for further review, therefore, they do not appear among either the appellate court or the Supreme Court cases.²¹⁶

The multivariate probit coefficients appearing in the “decision-to-initiate” column answer a relevant methodological question: Do any of the selected predictors explain who is more likely to initiate an insurance-related action in federal court? The answer is “yes.” There are some meaningful differences between those who decided to pursue their causes in a federal court and those who did not. First, the statistically significant negative -2.5376 coefficient suggests that complainants are less likely to initiate a federal suit, if the regulatory question concerns the preemption of federal antitrust laws. Also, the statistically meaningful negative -1.2525 coefficient implies that aggrieveds are less likely to initiate an action in a district court, if the regulatory conflict involves the preemption of state insurance laws.

Do these two significant predictors influence the disposition of cases in federal courts? An examination of the lambda terms under the two “Disposition of McCarran-Ferguson Claims” columns in Table 6 suggests that they do not. First, the statistically insignificant lambda terms—2.3476 and 2.9574—indicate that self-selectivity bias is absent from the sample. The lambda coefficients also mean that judicial outcomes are less likely to be influenced by some distinctive attributes of complainants who decided to seek appellate review in the federal courts.

Consider the three statistically significant probit coefficients illustrated under the heading, “Disposition of McCarran-Ferguson Claims in Federal Courts of Appeals.” They are easily interpreted: 1) The 2.8711 probit coefficient means that state insurance commissioners were significantly more likely to win in the courts of appeals than any other type of complainant; 2) The 1.7222 probit term indicates that complainants were significantly more likely to win in the courts of appeals if their procedural question concerned the scope of the boycott definition; and 3) complainants were significantly more likely to win in the appellate courts if they commenced any type of McCarran-related action in a federal court before the Supreme Court decided *Royal Drug*. The corresponding probit coefficient is 1.7317.

Although the boycott finding is intellectually interesting, it certainly is not spectacular from a legal perspective. In short, there is no compelling reason for complainants’ winning either all, a few, or any actions involv-

216. The Federal Trade Commission also appeared as complainant and defendant in a few of the federal court cases. There was, however, no overlap between FTC administrative cases and federal court cases in which the Federal Trade Commission appealed as a litigant. See Appendix, Table 1.

ing the definition of boycott. Also, there is little cause for alarm upon learning that federal appellate courts were significantly more likely to rule in favor of complainants, especially when plaintiffs were state insurance commissioners. In fact, this finding is quite compatible with what we know or would expect. Under the McCarran-Ferguson Act, state legislatures may enact a variety of insurance-related statutes and allow insurance commissioners to exercise a considerable amount of authority under such statutes.²¹⁷ Similarly, federal courts are less likely to question state insurance commissioners' statutory interpretations or regulatory activities unless the commissioners abuse their powers.

Additionally, complainants were more likely to win in the appellate courts if their actions were decided before *Royal Drug* and were less likely to win if their causes were resolved after *Royal Drug*.²¹⁸ This finding clearly illustrates the influence of Supreme Court decisions on the disposition of cases in the lower federal courts. More important, the disclosure is disturbing because the disposition of insurance-related disputes in the court of appeals should not depend on the timing of unrelated or peripheral Supreme Court decisions. We must remember that the primary question in *Royal Drug* was whether the definition of business of insurance was broad or narrow.²¹⁹ Yet, *Royal Drug* influenced whether complainants won or lost any type of controversy before or after *Royal Drug* was decided. Clearly, this type of phenomenon should not be occurring in the federal courts of appeals.

Finally, the two columns which appear at the far right in Table 6 also support the proposition that federal courts unwittingly or intentionally permit unwarranted and impermissible factors to influence the outcome of insurance-related disputes. Here, only one statistically significant factor appears; and note that the test for self-selectivity bias is insignificant. The statistically significant 3.7100 coefficient reconfirms an earlier discovery: state insurance commissioners were significantly more likely to win than any other type of complainant. Unlike the previous finding, however, this statistic is particularly vexatious because it appears only among complainants who filed their complaints in midwestern states. Once more, the following point must be underscored: Neither the McCarran-Ferguson Act, the Sherman Act, the Federal Arbitration Act, nor the federal insolvency statute supports or causes one to expect such an improbable outcome in the federal courts.

217. See *supra* note 42 and accompanying text.

218. See Appendix, Table 4.

219. See *supra* notes 57-70 and accompanying text.

VII. CONCLUSION

In light of the legal analysis and empirical findings reported in this paper, the movement to reform the McCarran-Ferguson Act is clearly misplaced. Instead, federal courts should be prevented from deciding any question or controversy involving the business of insurance or the insurance industry in general. The Supreme Court and the federal courts of appeals exercise a considerable amount of control over the massive insurance industry. Yet, these courts simply are not performing as well as they should.

Federal courts continue to allow immaterial factors that have little to do with regulatory or with business-of-insurance questions to influence the outcome of litigation. Congress did not expect federal courts to play such an important role because the McCarran-Ferguson Act does not explicitly allocate any regulatory authority to the federal courts of appeals or to the Supreme Court. Moreover, Congress certainly did not intend for federal courts to consider extralegal variables when deciding an insurance-related issue involving the McCarran-Ferguson Act, the Sherman Act, the Federal Insolvency Statute, and the Federal Arbitration Act.

In recent years, several members of the United States Senate and House of Representatives have introduced bills that would address some of the problems outlined in this Article.²²⁰ Specifically, S. 719, the proposed Insurance Competition Improvement Act of 1989, would have created a federal insurance-regulatory commission to draft universal regulations,²²¹ and H.R. 1257, the proposed Federal Insurance Administration Act, would establish a federal insurance commission.²²² The commission would be an independent executive agency, whose mission would

220. See H.R. 1257, 103d Cong., 1st Sess. (1993) (seeking primarily to reconstitute the Federal Insurance Administration as an independent executive-branch agency); S. 719, 101st Cong., 1st Sess. (1989) (proposing limitation of the antitrust exemption for insurance under the McCarran-Ferguson Act); H.R. 1093, 101st Cong., 1st Sess. (1989) (proposing the prohibition of insurers' practices of sharing information on premium rates, conditioning the sale of insurance on the purchase of another product or impairing the availability or affordability of insurance); see also *supra* note 28.

221. See S. 719; see also S. 1644, 102d Cong., 1st Sess. (1991) (establishing an insurance regulatory commission to conduct investigations, assess insurers and reinsurers to pay the commission's expenses, certify state insurance departments, and examine interstate insurers); Anne Saker, *Momentum Grows for Federal Regulation*, USA TODAY, Oct. 8, 1991, at 10B ("Sen. Howard Metzenbaum, D-Ohio, has introduced a bill [S. 1644] that would create an insurance-regulatory commission to draft standard regulations and would lift the anti-trust exemption. States would be required to enact the standards and retain hands-on oversight of companies.").

222. H.R. 1257.

be to "improve[] the safety and fairness of [the] insurance system."²²³ S. 719 was never enacted by the Senate, and as of this writing, H.R. 1257 has not been enacted.

To help correct the judicially created problems described in this Article, Congress should create a federal department of insurance and give that body the authority to regulate the business of insurance within and across state boundaries. The proposed department would not necessarily set premium rates, design universal insurance forms, or oversee the daily activities of insurance companies within the respective states. The agency, however, should be given the authority to establish several regional offices and to hear and resolve all insurance-related conflicts involving the insurance industry and consumers.

As two commentators have observed, "[i]nsurance transactions and institutions are often subject to judicial scrutiny" and those decisions frequently and significantly affect "the character of insurance transactions and institutions."²²⁴ Moreover, the effects of judicial decisions have "sometimes been considerably more significant than the enforcement of regulatory measures by the commissioner of insurance."²²⁵ Judicial decisions, however, are "relatively imprecise" and "provide little guidance"²²⁶ for both consumers and insurers who want to resolve substantive and procedural conflicts in a timely and fair manner.

Until Congress recognizes the severity of this problem and implements corrective measures, federal courts will continue to issue conflicting and poorly reasoned insurance-related decisions. Meanwhile, insurance consumers, insurers, and the insurance industry will remain the victims of such judicial rulings.

223. See 139 CONG. REC. E580 (daily ed. Mar. 10, 1993) (statement of Rep. Joseph P. Kennedy, II). The bill establishes standards by which the agency would certify direct insurers, H.R. 1257 § 203, and reinsurers. *Id.* § 204.

224. KEETON & WIDISS, *supra* note 30, § 8.1(c), at 938.

225. *Id.*

226. *Id.* § 8.3(2), at 943 n.1.

VIII. APPENDIX

TABLE 1. SOME SELECTED DEMOGRAPHIC CHARACTERISTICS OF ADMINISTRATIVE AND JUDICIAL DECISIONS SURROUNDING THE McCARRAN-FERGUSON ACT, 1946-1993 (N=275)

Selected Demographic Characteristics	Federal Trade Commission Decisions (N=100)	Federal Appellate Court Decisions (N=152)	U.S. Supreme Court Decisions (N=23)
	Percent	Percent	Percent
Disposition of Cases from Complainants' Perspective			
• Favorable	67.0	40.0	65.2**
• Unfavorable	33.0	60.0**	34.8
Types of Complainants:			
• Insured Individuals	—	32.2	30.4
• Insured Corporations	—	19.1	17.4
• Health-Care Providers	—	9.2	—
• Insurers	—	22.4	17.4
• State Insurance Commissioners	—	7.9	13.0
• Federal Trade Commission	100.0	—	—
Types of Defendants:			
• Health-Care Providers	49.0	11.2	8.7
• Insurers	51.0	50.0	56.5
• Federal Trade Commissioner & Justice Department	—	11.8	8.7
• State Insurance Commissioners	—	21.7	17.4
Procedural Issues Involving The McCarran-Ferguson Act:			
• Preemption & Other Federal Statutes	—	46.1	39.1
• Preemption & Various State Laws	—	11.2****	34.8****
• Scope—"Business of Insurance"	63.0	69.7	78.3
• Scope—"Boycott"	31.0	17.1	8.7
Types of Insurance Contracts:			
• Automobile	4.0	10.5	4.3
• Disability	—	12.5*	—
• Health	64.0**	31.6*	30.4*
• Life	8.0	13.2**	30.4**
• Other	24.0	32.2	34.9
Region of Country:			
• East	28.0	17.1	8.7
• Midwest	27.0	28.3*	8.7*
• South	11.0	12.5	13.0
• Southwest	14.0	13.8	8.7
• West	11.0	16.4	26.1
Federal Circuits			
• Second	19.0	8.6	8.7
• Fifth	12.0	19.1	8.7
• Seventh	16.0	9.9	4.3
• Eighth	9.0	11.2	4.3
• Ninth	10.0	13.8	17.4
• District of Columbia	—	5.9****	26.1****
Applicability of Selected Federal Statutes			
• Clayton Act	8.0	20.4*	4.3*
• Sherman Act	5.0	44.7	30.4
• ERISA	—	14.5	4.3
• Federal Trade Act	100.0	3.4	1.7

Levels of Statistical Significance for Phi Coefficients in a 2 x 2 table:

**** p < .001

*** p < .01

** p < .02

* p < .05

TABLE 2. DISPOSITION OF McCARRAN-FERGUSON ACTIONS BY VARIOUS TYPES OF PROCEDURAL QUESTIONS, AMONG CASES DECIDED IN THE FEDERAL COURTS OF APPEALS, 1946-1993 (N=152)

Disposition of Claims	"Primary" Procedural Questions Before the Courts		
	Whether Federal Antitrust Arbitration, Insolvency & Various Other Laws Preempt State Insurance Laws & McCarran-Ferguson Act	Whether the Definition of "Business of Insurance" is Restrictive	Whether the Definition of "Boycott" is Broad or Narrow
Favorable Outcomes for Complaints	9 (22.5)	42 (49.0)	10 (38.5)
Unfavorable Outcomes for Complainants	31 (77.5)	44 (51.0)	16 (61.5)
TOTAL	40 (100.0)	86 (100.0)	26 (100.0)

Chi square=7.8769; df=2

Level of statistical significance: $p = 0.02$

TABLE 3. DISPOSITION OF McCARRAN-FERGUSON ACTIONS BY TYPES OF INSURANCE CONTRACTS, AMONG CASES INVOLVING BOTH "BUSINESS OF INSURANCE" AND "PREEMPTION" ISSUES, 1946-1993 (N=79)

Disposition of Claims	Types of Insurance Contracts			
	Health Insurance	Life Insurance	Disability Insurance	Other Types of Insurance
Favorable Outcomes for Complainants	22 (55.0)	2 (20.0)	2 (66.7)	6 (23.1)
Unfavorable Outcomes for Complainants	18 (45.0)	8 (80.0)	1 (33.3)	20 (76.9)
TOTAL	40 (100.0)	10 (100.0)	3 (100.0)	26 (100.0)

Chi square=9.3611; df=3

Level of statistical significance: p=0.02

TABLE 4. DISPOSITION OF McCARRAN-FERGUSON ACTIONS BY TYPES OF INSURANCE CONTRACTS, AMONG CASES INVOLVING BOTH "BUSINESS OF INSURANCE" AND "PREEMPTION" ISSUES, 1946-1993 (N=114)

Disposition of Claims	McCarran-Ferguson Actions Decided in Federal Courts Before the Supreme Court's <i>Royal Drug Company</i> Decision (1946-1978) (N=38)			McCarran-Ferguson Actions Decided in Federal Courts After the Supreme Court's <i>Royal Drug Company</i> Decision (1980-1991) (N=76)		
	Complainants from Midwestern States	Complainants from Western States	Complainants from Other States	Complainants from Midwestern States	Complainants from Western States	Complainants from Other States
Favorable Outcomes for Complainants	6 (50.0)	5 (71.4)	4 (21.1)	9 (45.0)	10 (52.6)	19 (51.4)
Unfavorable Outcomes for Complainants	6 (50.0)	2 (28.6)	15 (78.9)	11 (55.0)	9 (47.4)	18 (48.6)
TOTAL	12 (100.0)	7 (100.0)	19 (100.0)	20 (100.0)	19 (100.0)	37 (100.0)

Chi square=6.2468; df=2
p=0.05

Chi square=0.2797; df=2; p=0.86
(not statistically significant)

TABLE 5. DISPOSITION OF McCARRAN-FERGUSON ACTIONS BY TYPES OF COMPLAINANTS, AMONG CASES DECIDED BEFORE AND AFTER THE SUPREME COURT'S "DEFINITION OF 'BOYCOTT'" DECISION, *St. Paul Fire & Marine Insurance Co. v. Barry* (N=26)

Disposition of Claims	McCarran-Ferguson Actions Decided in Federal Appellate Courts Before the Supreme Court's <i>St. Paul Fire & Marine</i> Decision (1971-1977) (N=10)		McCarran-Ferguson Actions Decided in Federal Appellate Courts After the Supreme Court's <i>St. Paul Fire & Marine</i> Decision (1979-1991) (N=16)	
	Individual Complainants	Other Types of Complainants	Individual Complainants	Other Types of Complainants
Favorable Outcomes for Complainants	3 (75.0)	1 (16.7)	2 (22.2)	4 (57.1)
Unfavorable Outcomes for Complainants	1 (25.0)	5 (83.3)	7 (77.8)	3 (42.9)
TOTAL	4 (100.0)	6 (100.0)	9 (100.0)	7 (100.0)

Likelihood Ratio=3.5548; df=1
p=0.05

Likelihood Ratio=2.074; df=1
p=0.14 (not statistically significant)

TABLE 6. EFFECTS OF SELECTED PREDICTOR VARIABLES ON THE DECISION TO COMMENCE A FEDERAL CAUSE OF ACTION AND ON THE DISPOSITION OF THE McCARRAN-FERGUSON CLAIMS IN FEDERAL COURTS, 1946-1993 (N=275)

Selected Predictor Variables	Decision to Initiate a Cause of Action in Federal Court (N=175)		Disposition of McCarran-Ferguson Claims in Federal Courts of Appeals (N=152)		Disposition of McCarran-Ferguson Claims in Federal Courts Among Complainants from Midwestern States (N=175)	
	Probit Coefficients (Standard Errors)	Absolute Values of t-Statistics	Probit Coefficients (Standard Errors)	Absolute Values of t-Statistics	Probit Coefficient (Standard Errors)	Absolute Values of t-Statistics
Complainants:						
• State Commissioners of Insurance	0.6377 (0.4316)	1.477	2.8711 (0.5309)	5.407****	3.7100 (0.7179)	5.167****
Defendants:						
• Health-Care Providers	-0.5481 (0.2897)	1.892	-1.0178 (0.4381)	2.323	-0.6798 (0.6760)	1.005
• Insurers	-0.0928 (0.2931)	0.316	-0.4537 (0.4158)	1.091	-0.0698 (0.4347)	0.160
Procedural Questions:						
• Preemption & Federal Antitrust Laws	-2.5376 (0.2473)	10.262****	-1.6823 (1.0663)	1.577	-1.9191 (0.8654)	2.217
• Preemption & Various State Laws	-1.2525 (0.2621)	4.778****	-0.4859 (0.8943)	0.543	-1.3772 (0.6860)	2.007
• Scope—“Boycott”	0.1791 (0.2140)	0.837	1.7222 (0.4502)	3.825**	0.8026 (0.6736)	2.675
Whether the Action Commenced Before or After the Supreme Court's <i>Royal Drug Company</i> Decision	0.5601 (0.2218)	2.524	1.7317 (0.4637)	3.734**	0.7447 (0.4692)	1.587
LAMBDA Term (“Self-Selectivity” Bias)	—	—	2.3476 (1.0889)	2.155	2.9574 (1.0345)	2.858
CONSTANT	2.6813 (0.3386)	7.917****	-0.3567 (0.5911)	0.603	-0.9053 (0.5017)	1.804

Levels of Statistical Significance: **** p < 0.0001 *** p < 0.001 ** p < 0.01 * p < 0.05

