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The applicability of anti-trust statutes to the business of insurance

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BOSTON UNIVERSITY

College of Business Administration

THESIS

The Applicability of Anti-Trust Statutes To The Business of Insurance

by

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(LL.M. Boston University 1950)
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Submitted in partial fulfillment of
the requirements for the degree of

MASTER OF BUSINESS ADMINISTRATION

1952

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THE APPLICABILITY OF ANTI-TRUST STATUTES TO THE BUSINESS OF INSURANCE

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James E. Shaw

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I. INTRODUCTION: PAUL v. VIRGINIA DECISION

On August 5, 1943, Judge Marvin E. Underwood of the United States District Court of Georgia quashed an indictment in the case of the United States of America v. South-Eastern Underwriters Association.* The defendants, consisting of one hundred ninety-eight corporations and twenty-seven individuals, were charged with conspiring to fix and maintain arbitrary and non-competitive rates on fire insurance sold by them in various souther states, in violation of the Sherman Anti-Trust Act.** They were further indicted on a charge of conspiring to monopolize trade and commerce in fire insurance in these states in violation of section 2 of the act.

The defendant demurred and challenged the sufficiency of the indictment upon the grounds that:

(a) it charged no offense against the United States, and

(b) that the business of fire insurance is not commerce, and

(c) that the interpretation of the act insisted upon by the government would be a violation of the Fifth, Sixth, and Tenth Amendments of the Constitution, and

(d) that the court is without jurisdiction of the subject matter.

* 56, p.712.
** 69, sec. 1.

The entire case turned, as the court put it, "upon the question as to whether or not the business of insurance is interstate trade or commerce."

In sustaining the demurrer and holding that the business of insurance does not constitute commerce the court relied upon a series of decisions of the United States Supreme Court.* The first of this group was Paul v. Virginia decided seventy-five years ago in which Mr. Justice Field, writing the opinion, said:

> ". . .Issuing a policy of insurance is not a transaction in commerce. . .Such contracts are not inter-state transactions, though the parties be domiciled in different States."**

Paul was appointed agent in Virginia for several insurance companies incorporated in New York. He applied for a license to act as such agent within Virginia. An act of that state required insurance companies not incorporated therein before carrying on any business within that state to obtain a license for such purpose. As a prerequisite to obtaining the license it was required to deposit with the state treasurer bonds of a specified character varying in amount from $30,000 to $50,000, depending upon the amount of capital employed. Another act prohibited, under penalty, any person without a license to act as agent for any foreign insurance

* 51, p.168
**51, p.183

company

Paul offered to comply with the provisions of the law save that requiring the deposit of the bonds. Although a license was refused him, he undertook to act for the companies and issued a policy to a resident of Virginia. He was indicted and convicted. The conviction was affirmed by the Virginia Supreme Court of Appeals and a writ of error was granted by the United States Court.

The second objection urged to the validity of the statute was based upon the commerce clause.* Justice Field, after concluding that commerce may be carried on by corporations, said:

"There is, therefore, nothing in the fact that the insurance companies of New York are corporations to impair the force of the argument of counsel. The defect of the argument lies in the character of their business. Issuing a policy of insurance is not a transaction of commerce. The policies are simple contracts of indemnity against loss by fire, entered into between the corporations and the assured, for a consideration paid by the latter. These contracts are not articles of commerce in any proper meaning of the word. They are not subjects of trade and barter offered in the market as something having an existence and value independent

*70, Art.1,s.8,c.3.

of the parties to them. They are not commodities to be shipped or forwarded from one State to another, and then put up for sale. They are like other personal contracts between parties which are completed by their signature and the transfer of the consideration. Such contracts are not inter-state transactions, though the parties may be domiciled in different States. The policies do not take effect---are not executed contracts ---until delivered by the agent in Virgihia. They are, then, local transactions, and are governed by the local law. They do not constitute a part of the commerce between the States any more than a contract for the purchase and sale of goods in Virginia by a citizen of New York whilst in Virginia would constitute a portion of such commerce."

The foregoing pronouncement by the Court was urged by the government's cousel in the South-Eastern Underwriters case, supra, to be dictum. Underwood brushed this contention aside, stating:

"In all of the above cited cases, the ruling was essential to the case and the reasoning of the court showed most careful analysis and full consideration of the questions now raised. . ."

A careful reading of the Paul decision impels agreement with the Court that the ruling was not merely dicta. It does not appear that the case could have been decided on the first issue alone which was whether the statute was in conflict with Article IV of the Constitution. It was urged that the statute discriminated between Virginia corporations and corporations of other states. The Court found against this contention, holding that corporations have no absolute right of recognition in other states, but depend for such recognition and the enforcement of their contracts upon the assent of such other states and that such assent may be granted upon such terms and conditions as those states may think proper to impose. This finding clearly could not determine the case in the light of the defendant's objection to the validity of the statute on the ground that it invaded the realm of interstate commerce which was solely a matter under the supervision of Congress. If Paul's contention in this respect was upheld the statute would be invalid and his conviction accordingly set aside. The issue, therefore, of whether insurance was interstate commerce was material to the determination of the case. The Court's finding that the business of insurance was not commerce, although a sweeping one and subject to considerable

doubt and criticism, has been rigidly adhered to by the Court in a number of cases subsequently decided by it.

In Hooper v. California*, Hooper was convicted of violating a section of the California Penal Code in procuring insurance for a resident of that state from an insurance company not incorporated therein, without having filed the bond required by a section of the Political Code. The majority opinion, written by Mr. Justice White, in answer to the claim that the contract being one for marine insurance was a matter of interstate commerce and as such beyond the reach of state authority, held:

> ". . . This proposition involved an erroneous conception of what constitutes interstate commerce. That the business of insurance does not generically appertain to such commerce has been settled since the case of Paul V. Virginia, /supra./
>
> "Whilst it is true that in Paul v. Virginia, and in most of the cases in which it has been followed, the particular contract under consideration was for insurance against fire, the principle upon which these cases were decided involved the question of whether a contract of insurance of any kind, constituted interstate commerce."**

*44, p.155
**44, p.653

The Court in commenting upon the general rule that the right of a foreign corporation to engage in business within a state other than that of its creation depends solely upon the will of such other state and the exceptions to this rule in so far as it relates to corporations which have become an instrumentality of interstate commerce or their business constitutes such commerce, stated:

> ". . . If the power to regulate interstate commerce applied to all the incidents to which such commerce might give rise and to all contracts which might be made in the course of its transaction, that power would embrace the entire sphere of mercantile activity in any way connected with trade between the States; and would exclude state control over many contracts purely domestic in their nature.
>
> ". . .The business of insurance is not commerce. The contract of insurance is not an instrumentality of commerce. The making of such a contract is a mere incident of commercial intercourse, and in this respect there is no difference whatever between insurance against fire and insurance against 'the perils of the sea.'"*

This holding was again reiterated in the case of

* 44, p.655

Liverpool and London Life and Fire Insurance Company v. Oliver*, in which a corporation organized under the laws of the Kingdom of Great Britain and doing business within the United States challenged the right of the State of Massachusetts to collect a tax on premiums from business obtained by the company in that state. This was the first case in which a company was directly involved. The previous decisions concerned company agents only.

The next case in which the Court had occasion to maintain its position, albeit dicta, was New York Life Insurance Company v. Cravens.** Here again a company was involved.

One of the more important cases on this question to come before the Supreme Court was New York Life Insurance Company v. Deer Lodge County.*** It was there asserted that a tax levied by a Montana county on certain assets of the company was "illegal, unlawful and void for that said defendant was without jurisdiction to levy or collect said tax, and the levy and collection thereof was and is a burden upon interstate commerce contrary to section 8, Article I of the Constitution of the United States." Counsel for the company, which included the illustrious Dean Pound of Harvard Law School, in an endeavor to swing the Court away

*47, p.566
**49, p.178
***50, p.231

from the Paul case, argued that since all decisions pertaining to the company's business were rendered in New York, the authority of its Montana representative was strictly limited and that applications for insurance were received solely for the purpose of transmission to the home office and the use of the United States mails was essential to practically every step in the transaction of its business.

The majority opinion of the Court, written by Mr. Justice McKenna, adverting to the earlier decisions on the point, stated:

> "If we consider these cases numerically, the deliberation of their reasoning, and the time they cover, they constitute a formidable body of authority and strongly invoke the sanction of the rule of stare decisis. This we especially emphasize, for all of the cases concerned, as the case at bar does, the validity of state legislation, and under varying circumstances the same principle was applied in all of them. For over forty-five years they have been the legal justification for such legislation. To reverse the cases, therefore, would require us to promulgate a new rule of constitutional inhibition upon the States and which would compel a change of their policy and a readjustment of their laws. Such result necessarily urges against

a change of decision."*

The majority were of the opinion that the rationale of Paul v. Virginia was exhaustive of the general principle and that "it would rack ingenuity to attempt to vary its expression or more aptly illustrate it." The volume of business and the geographical extent thereof did not appear to impress Justice McKenna and those of his colleagues who joined with him for: "Nor does the character of the contracts change by their numbers or the residence of the parties."

Neither did the company's argument that the use of the mails in connection with its business constituted a "current of commerce among the states" move the Court to alter its established view. In answer to this the Court said:

> ". . .This use of the mails is necessary, it may be, to the centralization of the control and supervision of the details of the business; it is not essential to its character."**

Mr. Justice Brandeis in Bothwell v. Buckbee, Mears Co.,*** held a contract of insurance made by a foreign corporation with a citizen of Minnesota was not interstate commerce. The Court, in that case, did not go as far as it

*50, p.502
**50, p.509
***41, p.275

did in the Paul and Hooper cases and hold that the business of insurance was not commerce at all.

In a comparatively recent case, Western Live Stock v. Bureau of Revenue*, Mr. Justice Stone, citing the Paul, Hooper, and Deer Lodge County cases, supra, stated:

> "That the mere formation of a contract between persons in different states is not within the protection of the commerce clause, at least in the absence of Congressional action, unless the performance is within its protection, is a proposition no longer open to question."

In order to determine whether or not the business of insurance is commerce it is necessary to ascertain just what commerce is as defined by the Supreme Court.

After a careful delineation of the concept of commerce under the federal constitution, it is the intent of the writer, then to examine in detail the application of this concept to the business of Insurance under the various anti-trust statutes in effect as of the date of this paper. We shall then consider present and possible future legislative trends in this particular area of endeavor.

*57, p.303

II. WHAT IS COMMERCE?

In order to determine whether or not the business of insurance is commerce it is necessary to ascertain just what commerce is as defined by the Supreme Court.

The first attempt by the Supreme Court to define the term "commerce" was made in Gibbons v. Ogden, in which the Constitution's most distinguished interpreter, Chief Justice Marshall, said:

> ". . .Commerce undoubtedly is traffic, but it is something more; it is intercourse. It describes the commercial intercourse between nations, and parts of nations, in all its branches. . . .
>
> ". . .It has, we believe, been universally admitted that these words (of the commerce clause) comprehend every species of commercial intercourse between the United States and foreign nations."*

This broad and general interpretation has permitted the courts to expand the concept of commerce to include many things which were unknown to and not contemplated by the framers of the Constitution.

By-passing many of the intervening years to Chief Justice Marshall's definition and to expand thereon, we arrive at the important case of Pensacola Telegraph Co. v.

*43, p.188

Western Union Telegraph Co*, in which the court, seemingly in an effort to demonstrate that is was keeping abrest of the times and the advance of civilization with its attendant developments, investions, and complications arising out of an expanding economy and a growing country, said:

> "The powers thus granted are not confined to the instrumentalities of commerce, or the postal system known or in use when the Constitution was adopted, but they keep pace with the progress of the country, and adapt themselves to the new developments of time and circumstances. They extend from the horse with its rider to the stage-coach, from the sailing-vessel to the steamboat, from the coach and the steamboat to the railroad, and from the railroad to the telegraph, as these new agencies are successively brought into use to meet the demands of increasing population and wealth."

In International Textbook Co. v. Pigg**, the plaintiff, a Pennsylvania corporation, sued on a contract providing for installment payments for a course of instruction by correspondence in commercial law. The contract was entered into in Kansas with a citizen of that state through a solicitor of plaintiff. The solicitor not only solicited

*52, p.96
**45, p.217

students to take the various correspondence courses offered by plaintiff but also collected the installment payments. He maintained an office in Kansas at his own expense. The company had no office of its own in that state. He would remit the collections to the company by mail and it would send its course of instruction to the enrollee through the mail.

Here was a case which involved a private contract of a local nature, yet the Court held that the plaintiff was engaged in interstate commerce. In holding that a Kansas statute which required foreign corporations to perform certain conditions precendent to doing business within that state directly burdened the interstate business of plaintiff, Mr. Justice Harlan speaking for the majority, said:

> "It is true that the business in which the International Textbook Company is engaged is of a somewhat exceptional character, but, in our judgment, it was, in its essential characteristics, commerce among the states within the meaning of the Constitution of the United States. It involved, as already suggested, regular and, practically, continuous intercourse between the Textbook Company, located in Pennsylvania, and its scholars and agents in Kansas and other States.

> That intercourse was conducted by means of correspondence through the mails with such agents and scholars . . . this mode--looking at the contracts between the Textbook Company and its Scholars--involved the transportation from the State where the school is located to the State in which the scholar resides, of books, apparatus and papers, useful or necessary in the particular course of study the scholar is pursuing. . . Intercourse of that kind, between parties in different States--particularly when it is in execution of a valid contract between them--is as much intercourse, in the constitutional sense, as intercourse by means of the telegraph--'a new species of commerce'. . . ." *

One would rightfully assume on the basis of the sweeping language in the foregoing opinion that the Court was drawing away from its views in the Paul case and was ready, when confronted with the issue, to recognize the business of insurance as commerce. However, the Court, when put to the test, found itself ineluctably bound to its views in the Paul case, and reiterated what it there said in the Deer Lodge County and Bothwell cases, previously discussed herein. Both of these cases were before the Court after it had decided the International Textbook and Pensacola

*45, p.106

Telegraph cases.

In the Deer Lodge County case cousel for the insurance company directed the Court's attention to its decision in the International textbook case. The Court, however, sought to distinguish its holding in the latter on the ground that there the transaction involved transportation of property and not "mere personal contracts" such as insurance which is not commerce "at all." The answer to such a tenuous distinction is found in the facts in the International Textbook case. The transaction involved therein, a contract for a course of study in commercial law, required nothing more in the way of transportation of property than is involved in a transaction whereby a policy of insurance is purchased at an agreed price (premium) from a company located in another state. The purchase of a policy also involves the transportation of property over state lines--the mailing of the policy and future correspondence relating to the policy which is the contract between the parties. To place the distinction upon the basis which the Court did is to overlook the development and growth of the modern insurance corporation, its part and force in the nation's economic life and to cloister oneself against realities.

In a case involving the Fair Labor Standards Act,*

*63, sec. 201

Kirchbaum Co. v. Walling, it was held that employees of a building owner who did the work of maintaining and operating the building in which the tenants were principally engaged in the production of goods for interstate commerce were engaged in an "occupation necessary to the production"* of goods in interstate commerce. The rationale of the Court was that without light, heat and power the tenants could not engage in the production of goods for interstate commerce. Of course it could be said, as did the Court, that since the act included persons engaged "in any process or occupation necessary to the production" and because the persons engaged in maintaining a building were engaged in a process or occupation necessary to enable the actual producers to produce the goods to be used for interstate commerce, such persons were within the ambit of the act. It is to be noted that such reasoning was applied in a situation where the persons employed for such purposes were the employees not of the producers of the goods but of the owner of the building in which the producers rented space.

The validity of the Court's rationale and conclusion has been questioned.** In fact, these maintenance and service employees were engaged in keeping the building habitable and were performing certain services which are

*46, p.524
**25, p.103

essential in order for a landlord to acquire and retain tenants. Such maintenance and services while beneficial to the tenants would appear to be merely incidental to their use of the space occupied by them. However, what is important, in connection with the consideration of the subject of this paper, is the fact that the opinion revealed the Court's broad thinking on the subject of interstate commerce and its willingness to expand the commerce concept to take in activities of a local nature which indirectly and remotely contribute to making it possible to carry on an activity interstate in character.

Further evidence of such willingness on the part of the Court is found in the case of Wickard, Secretary of Agriculture v. Filburn.* In that case a small wheat grower who grew wheat for consumption on his own farm was held liable to the marketing penalty under the Agricultural Adjustment Act of 1938. The Court, Mr. Justice Jackson speaking, held that a local activity, though not regarded as commerce, "may still, whatever its nature, be reached by Congress if it exerts a substantial economic effect on interstate commerce, and this irrespective of whether such effect is what might at some earlier time have been defined as 'direct' or 'indirect'."

*58, p.317

In a somewhat recent case, National Labor Relations Board v. J. L. Hudson Co., the Sixth Circuit Court of Appeals considered the question of whether the National Labor Relations Act* was applicable to a retail department store located in Detroit, Michigan.

It was established that in 1942 the store purchased merchandise of the cost of $43,864,289 and that over eighty percent thereof was shipped to it from outside the state. A comparatively insignificant amount, $300,000 in value, was shipped to it from foreign countries. Only one and six-tenths percent of its total sales were sold and shipped to customers outside the state. In shipping such out of state sales, the store used the parcel post, the railway express, trains and interstate truck lines. One-sixth of its advertising costs through the various media was expended for circulation in states other than Michigan.

Upon the basis of these facts, the Court found that the activities of the store although "intrastate in character when considered separately," were "so closely and substantially related to interstate commerce that their control is essential or appropriate for the protection of interstate commerce from burden or obstruction."**

*66, sec. 151
**48, p.382

III. THE SOUTHEASTERN UNDERWRITERS CASE

With this background came the Sherman Act indictment against the Southeastern Underwriters Association. Many of the acts charged, quite aside from rate agreements, were obvious restraints of competition and an attempt to monopolize. Mr. Justice Black, in what is called the opinion of the Court, says without denial by dissenters that "Appellees have not argued otherwise."* The District Court sustained a demurrer to the indictment.** The Government went straight to the Supreme Court under the Criminal Appeals Act. The three who join with Mr. Justice Black are Justices Douglas, Murphy, and Rutledge. There are separate dissents by the Chief Justice and by Justices Frankfurter and Jackson. Mr. Justice Frankfurter joins briefly with the Chief Justice. Mr. Justice Jackson takes a somewhat different line and presents his views in a form resembling that of an independent essay. Since he obviously would not fully sustain the demurrer to the indictment, he is announced by the reporter as "dissenting in part." So he is, in ideas, both from the majority and from the Chief Justice.

The Chief Justice and Mr. Justice Black have a difference of opinion as to what is before the Court under the restrictions of the Criminal Appeals Act. The contro-

*56, p.1165
**56, p.712

versy is somewhat involved and it is not certain that the opposing gears completely mesh. Mr. Justice Black does not indicate disagreement with the statement of the Chief Justice that under the Criminal Appeals Act "the only questions open for decision here are whether the District Court's constructions of the commerce clause and of the Sherman Act, on which it rested its decision, are the correct ones." He insists, however, that the indictment applied to and that the District Court passed upon "the total activities complained of as constituting the business of insurance"* including "not only the execution of insurance contracts and the innumerable transactions necessary to performance of the contracts." He twice guards against any notion that nothing was involved but the making of "local" contracts, and he rejects an argument "suggested in this Court" that "the indictment charges nothing more than restraint and monopoly in the"mere formation of an insurance contract."

One interpretation of the effort here might be that Mr. Justice Black is merely wishing to insist that the interstate features of the insurance business are clearly involved, and thus to get away from the old notion that an insurance contract is a local transaction though negotiations and shipment straddle state lines. The Chief Justice,

*56, p.1165

however, who was in a preferred position to know, evidently thinks that something more was intended. He quotes the District Court to the effect that "It is not a question here of whether the defendants participated in some incidental way in interstate commerce or used in some instances the facilities of interstate commerce, but is rather whether the activities complained of as constituting the business of insurance would themselves constitute interstate trade or commerce." Thus, he seems to be interpreting the majority statement of the issue as designed to make use of the fact of interstate communication and transmission not merely to establish that the business is interstate but also that it is commerce. It is not so clear that Mr. Justice Black is doing this when he is concerned with the indictment as when later he parades all the interstate features while turning the insurance business into commerce. At any rate at this point he does not seem to be regarding the insurance companies as carriers even if he may be seeking to tint them with the complexion of shippers.

This will be pursued further when we come to Mr. Justice Black's section on constitutional issues. There he certainly jumbles issues of various kinds and by no means confines himself to obligations of endemnity.

The Chief Justice may be directing himself at this quite as much as at the scope of the indictment. He certainly does not take the ancient Field view that there is nothing interstate about insurance. He plants himself on the well-established postulate that the business of writing insurance contracts is not commerce, and that the incidents of using interstate communication and transportation in this non-commerce business do not turn it into commerce. So far as the scope of the indictment and of the decision of the district court and of review under the Criminal Appeals Act are concerned, the quarrel here, whatever it may be, is not of enduring importance. A new indictment could be framed to cover every conceivable activity of the insurance combination in the most specific terms and could charge the use of the mails and of express and of train travel of officers as crucial elements in the crime of suppressing competition. There would still remain the question whether contracting and contracting across state lines and keeping others from contracting across state lines constitute restraints of trade or commerce or merely of something else like borrowing or lending money or giving advice or some other service not amounting to a transfer of property.

So much for the adjective. Now for the substantive.

In his opening introductory paragraph Mr. Justice Black states the result of the decisions which have sanctioned state power over insurance.* He does not, however, at this point report the legal reasons for those decisions. This omission may lead those unfamiliar with past developments to assume more than is warranted from the statement that for the first time there is squarely presented the question whether Congress has power under the commerce clause "to regulate insurance transactions stretching across state lines." This conveys no intimation that there is not complete novelty in the problem. Nor can it be said that in later paragraphs there is anything approaching adequate recognition of the principles underlying the many judicial declarations of the constitutional nature of the insurance business. If after such recognition those principles were found no longer acceptable and were rejected on the basis of changed conditions and of new light known to new judges, there would be a directness of approach which would leave for possible criticism only the questions of the wisdom of the practical judgment and the wisdom of making it the basis for the particular decree. Such an approach would guard itself against the danger of possible deception to the unwary.

While it is true that earlier cases have not

*56, p.1164

involved an Act of Congress which required the Court to pass on the national commerce power over the insurance business, it by no means follows that in the case at bar "that issue is squarely presented and must be decided."* The indictment before the Court was for an alleged violation of the Sherman Act. The constitutional issue is not presented unless the Sherman Act presents it. The interpretation of that statute would therefore seem to be the primary problem to consider. There is a familiar canon that a statute should if reasonably possible be so interpreted as to avoid raising a grave constitutional issue. True enough, the canon has sometimes seemed to have been honored in the observance for the purpose of unwarrantably drawing the fangs from a statute. Contrition for such sins, however, should warn only against warping a statute to save it or to keep it from applying. It need not militate against the wisdom and propriety of first discovering as objectively as possible whether the statute properly interpreted does apply to the case. Instead of this, Mr. Justice Black first discusses the commerce power of Congress somewhat at large without confining the discussion to power over insurance or to the particular exercise of the commerce power upon which decision depends. Granted that Congress might in various other ways apply its

*56, p.1164

commerce power to the insurance business, it does not follow that it has sought to do so in this particular way or that it may do so in this particular way.

IV. RATE FIXING

We proceed, now, to the charge of rate fixing--the gravamen of the indictment in this case. It is settled law, established by repeated Supreme Court decisions, that if a group of owners or manufacturers of similar articles of personal property agree that no one of them will sell such articles below a stated scale of prices, this agreement violates the anti-trust laws, regardless of whether the prices are or are not reasonable in themselves.* It was the stated purpose of the South-Eastern Underwriters indictment to apply this doctrine to the marketing of insurance contracts. If now we consider the consequences of this attempt, we may get light, not only on why the attempt was not made sooner, but on many aspects both of the insurance business and of the anti-trust laws.

The original Sherman Act of 1890 defined two distinct offenses; contracting to restrain trade or commerce, and monopolizing, or attempting to monopolize, any part of the trade or commerce between the states. In line with these provisions of the statute, the South-Eastern underwriters indictment charges the 193 insurance companies with two offenses--that of conspiring to restrain interstate trade in fire insurance contracts in the southeastern area, and that of attempting to monopolize this trade.

*55, p.316

A moment's reflection, of course, will demonstrate that neither of these alleged criminal enterprises could be successful unless there were some artificial limitation on the supply of fire insurance contracts in the southeastern states. If a group of citizens were to meet in Atlantic, Georgia, for the purpose of breaking the defendants' alleged monopoly by organizing a new insurance company to compete with them, there would be no natural upper limit to the number of fire insurance policies which they might issue, and no natural lower limit to the premiums which they might charge. If it were merely a question of writing insurance contracts at lower premiums, the defendants' alleged monopoly could be broken and their power to restrain trade destroyed in a few months. But the problem is not to provide the southeastern states with cheap insurance policies; it is to provide them with policies which will insure. A contract of fire insurance is of no value unless it expresses the obligation of an organization which can be relied on to discharge the responsibilities it has assumed. State statutes have, therefore, provided for more than half a century that no one may engage in the business of writing insurance contracts except a corporation or other organi- created for that purpose which has submitted to some state

official satisfactory evidence that its plan of operations is a sound one, and that its promises will be made good.* The opportunity to restrain this branch of interstate trade and commerce and to monopolize its product does not, therefore, result from the niggardliness of nature. That opportunity was created, and is maintained, by the explicit provisions of state law.

It will now be readily apparent why the federal anti-trust laws were not applied to the insurance business from the start. The Supreme Court sustained the validity of the system of state regulation, as applied to out-of-state insurance companies, as early as 1868 in the Paul case, but the effort to establish it on a secure and scientific basis lasted a generation longer and involved a persistent struggle with the ideas of free enterprise and free contract, which were supposed to authorize anybody to enter this field on his own terms. The Anti-Trust Act of 1890--which was intended to preserve free enterprise in merchandising, mining, and manufacture from the real or supposed depredations of financial pirates--was not well-designed, and could hardly have been intended, to interfere with the simultaneous effort to bring free enterprise in writing insurance contracts under legislative control. This conclusion is confirmed by the later anti-trust legislation,

*42,p.217

which refers repeatedly to "commodities," "goods, wares, or merchandise," "products and commodities," and "sale, or contract to sell" as the subjects of the commerce under discussion--words which are not apt to describe insurance contracts, and which are not commonly so used.

Let us return to our gathering of citizens in Atlanta, Georgia, assembled to break the alleged monopoly which the South-Eastern indictment describes. They are now resolved to provide not merely cheap insurance but sound insurance, and to organize their enterprise in full compliance with the statutes of the six southeastern states. Their discussion will obviously revolve about the allegation in the indictment that "the premium received by all stock fire insurance companies for the sale of fire insurance in the States of Alabama, Florida, Georgia, North Carolina, South Carolina, and Virginia. . . .[for] the ten-year period 1931-1940, inclusive. . .amounted to more than $436,000,000. Losses paid by such companies during. . .the ten year period 1931-1940, inclusive, [amounted] to approximately $197,000,000." Their object will be to save the difference--$239,000,000.--to the property owners in their territory who need insurance, or at least to capture it for southeastern investors, southeastern insurance salesmen, southeastern insurance executives, and southeastern clerks.

Let us suppose that the assembly has no figures or statistics before it except those which appear in the indictment itself. The distribution of the $239,000,000. must then be assumed. The assembly would seem to be warranted in assuming that this sum was divided into five principal portions, applied to the following five purposes: (I) profits to stockholders; (2) taxes; (3) salesmen's commissions; (4) clerk hire; (5) management salaries. In order to break the defendants' monopoly by offering the southeastern states lower premiums, some part of these expenses would have to be saved. The profits to stockholders could be saved if fire insurance were organized on a mutual basis. The assembly votes, therefore, that a new mutual fire insurance corporation be formed. Whether the new mutual company could save anything on taxes depends on the pertinent state and federal statutes, which cannot here be explored. It seems unlikely that very much could be saved in salesmen's commissions. Most of the commissions paid by the defendants doubtless go to men in the southeastern states. It will take a substantial sales effort to get the new enterprise going. The same or equivalent sales skill cannot well be attracted unless the same commissions are paid. Nor can the clerk hire well be reduced by reducing wages. This would hurt the much needed-good will

of the new enterprise and might encounter union resistence. In any case the clerk will, no doubt, all be subject to the FLSA.* The clerk hire, then, must be reduced, if at all, by reducing the volume of clerical labor. Whether or not this is possible the assembly cannot decide. Persumably, it can be done only by first-rate management, and the first-rate management will have to be paid first-rate salaries. The total management cost can, therefore, be made smaller only if the size of the total management staff is reduced. In upshot, it seems that the assembly has a chance to reduce the cost of fire insurance in the Southeast if it succeeds in organizing a large mutual company, and in employing an adequate number of executives, administrators, and statisticians as good as the best. How much the reduction might be--whether large or trifling--is a question which no one can answer from the South-Eastern indictment alone.

Our assembly has now got some help from the allegations of the indictment. These allegations have given it a rough idea of the problem and the target at which to aim. It has got some help, also, from the Supreme Court's sustaining of the boycotting charge. It knows that a new mutual company will have a legal grievance if cut off from facilities for reinsurance, or if the defendants conspire

*63, sec.201

to withhold their own insurance from property owners and brokers who venture also to take insurance from the new mutual. But, thus far, our assembly has in no way benefited from the Supreme Court's sustaining of the rate-fixing charge in the indictment. Every problem which has been considered up to this point would be just as easy, and just as difficult, if the rate-fixing charge had been overruled instead of sustained.

The difficulties of the situation, however, are still far from exhausted. The major problem which will confront the management of the new mutual company has still to be approached and solved. This is the problem of determining the rate to be quoted on each individual risk. Probably, it would not be too difficult to obtain the rates currently quoted on most classes of fire risks in each of the counties and municipalities of the six southeastern states. Having obtained them, it would be possible for the new company to quote rates, say, five per cent lower, and to hold out to policyholders the hope of receiving dividends on their policies, too. But at this point the battle would only be begun. The defendants might counter by cutting ten per cent off all of their rates. The ensuing rate war would have no tendency to reduce either of the contestant's

expenses; on the contrary, these expenses might very soon be increased. It would not be long before the pressure would become irresistible to reduce the reserves set aside to pay fire losses, to assume that the fires of the past were more destructive than those of the future, to indulge the tempting opinion that one is a better judge than one's competitor of the likelihood of fire losses in a particular factory or a particular town. Businessmen with large risks to distribute among competing underwriters would start beating premiums down. The tendency would be to beat down the premiums on large risks more than on **smaller ones and thus jeopardize the entire rate schedule or structure.**

V. CONTROLLING LEGISLATION

The South-Eastern underwriters decision startled the bar by the apparent novelty of its doctrine. It disturbed the insurance profession more deeply because the federal anti-trust laws, as the Supreme Court construed them, forbade all price fixing agreements between business competitors, and thus seemed to threaten a return of the evils of unrestrained competition in premiums for fire insurance, which it was thought had been exorcised a generation before. The insurance profession thus found itself confronted with the necessity of meeting an old issue in a new forum, and on a nationwide scale. The situation was further complicated by anxiety less the decision that insurance was interstate commerce have the effect of invalidating the system of state regulation and supervision already built up.

When the 79th Congress assembled to act on the problem presented by this decision, it had to consider an array of legislation, which as a result of the decision, became applicable to the insurance industry. The array of federal statutes to be considered in connection with this matter were as follows:

1. The Sherman Act.
2. The Clayton Act.

3. The Robinson-Patman Act.
4. The Federal Trade Commission Act
5. The Merchant Marine Act
6. The National Labor Relations Act
7. The Fair Labor Standards Act

The first four of these, as has already been pointed out, are generally classified as the anti-trust laws of the nation. The Sherman Act, the principal anti-trust statute, has already been discussed in no little detail in the previous section. It is now our intent to consider briefly the applicability of the other pertinent federal statutes as set out above.

The Clayton Act

The purpose of the Clayton Act was to supplement and strengthen the Sherman Act by limiting or prohibiting certain business practices which tend to destroy competition or to create monopoly. For instance, Section 14 of the Clayton Act prohibits "Tying Contracts," i.e., agreements of sale or lease:

> ". . .on the condition that the lessee or purchaser shall not use or deal in the goods, wares, merchandise, machinery, supplies or other commodities of a competitor where the effect of such condition may be to substantially lessen competition or tend to create a monopoly."

Other sections of the act impose limitations upon

corporations purchasing stock of other corporations engaged in interstate commerce; upon interlocking directorates and officials which may influence competition adversely; upon price discrimination, and upon brokerage fees or other commissions in effecting contracts.

Should insurance be construed to be "goods" or "other commodities" within the meaning of the Clayton Act, changes would presumably be required in the practices of rating organizations, and insurance brokerage and agency systems, and in the investment policies and the joint management of some insurance companies.

The Robinson-Patman Act

Like the Clayton Act, the Robinson-Patman Act's applicability to insurance depends upon the inclusion of insurance as "good" or "commodities", now that insurance has been held to be commerce. This Act supplements the Clayton Act by prohibiting price discrimination in excess of differences in the cost of selling or manufacturing:

> "The Robinson-Patman Antidiscrimination Act makes unlawful sales that discriminate against the competitors of the purchaser; sales at prices lower than those charged to others for the purpose of destroying competition or eliminating competitors. The sales must

be in commerce and must be sales of 'goods'."*
If applied to insurance the Robinson-Patman Act would presumably replace the standards now followed by state authorities in determining whether premiums are unduly discriminatory.

The Federal Trade Commission Act

The Federal Trade Commission Act established a Commission with powers to investigate, and to restrain unfair trade practices. Unfair trade practices are business practices which tend to restrain competition or to create monopoly. The restraining powers of the Commission are based on its authority to issue "cease and desist orders" with regard to such practices. The Commission is authorized to use both its investigating and its restraining powers to enforce the other anti-trust laws.

Other Federal Laws

Pending further Congressional action, the powers of the Federal Trade Commission and of the United States Attorney General, to apply the anti-trust laws to insurance, overlapped and conflicted with the powers previously exercised by the state regulatory authorities. It was for Congress to determine how this duplication of authority was to be coordinated or eliminated. In making this determina-

*14, p.60

tion Congress had an opportunity to review other Federal legislation relating to insurance regulation.

This other legislation consisted principally of the Merchant Marine Act, which specifically exempted marine insurance from the anti-trust laws, and two labor acts the National Labor Relations (Wagner) Act and Fair Labor Standards (Wage and Hour) Act which, according to the Polish National Alliance decision, were applicable to insurance. The question was how this legislation was to be fitted in with any new legislation affecting the regulation of insurance.

The Merchant Marine Act

Under the Merchant Marine Act Congress adopted, with regard to marine insurance and reinsurance, the same policy adopted by the Webb-Pomerene Act with regard to foreign trade in general. It had been argued in both cases that foreign competitors would have an unfair advantage over American competitors, if the latter were subject to anti-trust legislation. For this reason Congress, through the Merchant Marine Act, authorized marine insurers to engage in combinations for rate-making purposes, which under the anti-trust laws would be illegal.

The Labor Acts

In the Polish National Alliance v. National Labor

Relations Board,* the National Labor Relations Act was held to be applicable to insurance employees. The reasoning followed in that case seems to apply with equal force to the Fair Labor Standards Act. These laws, like the anti-trust laws, were therefore to be part of the overall system of insurance regulation unless Congress should provide otherwise.

VI. New Legislation

(A) Public Law 15

The Congress, following the decision in the SEUA case, was therefore faced with a difficult problem. State regulation had been established over a period of some 75 years and had been applied to the insurance industry with varying degrees of success. Many legal and administrative problems had been resolved by trial and error, by cooperation among the states, and by work of the NAIC in conjunction with the insurance industry. The layman can not help feeling that insurance has always been, by its very nature, commerce, and if not interstate commerce, at least an industry that did affect interstate commerce. Legally, the position taken by the Department of Justice in the SEUA case (that the case of Paul v. Virginia had been misconstrued, and that the dictum in the case had borne considerable

*53, p.322

legal weight) seems defensible. At any rate, the SEUA case did not, like previous cases, involve the validity of a state statute, but rather involved the application of a Federal anti-trust law. So the question was squarely put before the Court--and the Court held that insurance was commerce, that when conducted across state lines it was interstate commerce, and that the Sherman Act did apply to the industry.

Subsequent to the SEUA decision and prior to Congressional action clarifying their position under the existing structure of state regulation, insurance companies were in a difficult legal position. If they complied with the state laws then in existence (1944), in an attempt to avoid liability under those laws, their acts of compliance would in many cases be in direct violation of the Federal anti-trust laws. The companies could therefore be prosecuted by the United States Attorney General if they complied with the state laws and prosecuted by the Attorney Generals of the several states if they did not comply with them. In fact, some state laws, like those of Wisconsin and New York, required or encouraged insurance companies to belong to rating bureaus and in general to follow a cooperative rate-making procedure, similar to the procedure condemned in the

SEAU case as a violation of the Sherman Act.

In view of this conflict of laws of the importance of the insurance industry, and of the obvious problems involved in adjusting insurance operations and procedures to meet the provisions of Federal laws applying to commerce, the Congress proceeded to hold hearings and to listen to both sides of the story. It is important for us to consider some of the problems brought out by these hearings, keeping in mind the provisions of the Commissioners Bill, quoted at pg. 66 hereinafter, so that we may understand the intent of the legislature when it passed the statute growing out of the SEUA decision and the investigation following the decision.

As previously noted, while the appeal in the SEUA case was pending before the Supreme Court, Senators Bailey and Van Nuys introduced a bill* which was discussed before the subcommittees of the Committees on the Judiciary, Congress of the United States, in Joint Hearing. This bill provided that:

". . . Nothing contained in the Act of July 2, 1890, as amended, known as the Sherman Act, or the Act of October 15, 1914, as amended, known as the Clayton Act, shall be construed to apply to the business of insur-

*67, sec.1362

ance or to acts in the conduct of that business or in any wise to impair the regulation of that business by the several States."

Many men imbued with the spirit of states' rights supported this bill with the idea that the states, through their police power, could adequately regulate the insurance business in the interest of the public. Also they felt that insurance did not fall within the commerce clause, and were opposed to any infractions upon the sphere of states' rights.

United States Attorney General Biddle, in appearing before the Joint Committee, made the statement that insurance companies had fought state regulation in Paul v. Virginia and that now the companies were fighting Federal regulation. He declared that:

"What the insurance companies want is no regulation, they want a no man's land in which neither law is applicable."*

The Attorney General went on to point out that he was not advocating Federal regulation, but that his position was that the Federal anti-trust laws did apply to the insurance business. He pointed out that:

"State regulation of rates, where it exists, has much the same objective as the Sherman Act, but such

*39, p.25

local regulation, while salutary as far as it goes, is powerless to deal effectively with restraints of trade in operations concerning more than one State and in interstate commerce.

"Since 90% of fire insurance companies are engaged in conducting an interstate business and the States are plainly without power to reach these activities which extend beyond State lines, the passage of this proposed legislation would create a no-man's land--as I have already said--in which neither State nor Federal government could function.

"Thus it becomes patent that the claim of interference with the prerogatives of the States is no more than a cloak surrounding the real purpose of the proposed legislation, and that such legislation would only aid in placing the insurance companies above and beyond the power of the law. Its passage would generally absolve the insurance companies from any effective governmental control whatsoever."*

During the course of these hearings Mr. A.V. Gruhn of the American Mutual Alliance, pointed out that there were other Federal laws that would apply to insurance in addition to the Sherman and Clayton Acts. In particular he was

*39, p.61

concerned over the application of the Federal Trade Commission Act. The Committee felt that this of such importance that Mr. Gruhn was asked to submit his material in written form to the Committee. The importance of this work is evident in that it apparently had some effect upon the ultimate congressional action.

Representatives of organized labor were opposed to the Bailey-Van Nuys Bill because they felt that it was not in the best interests of the National Labor Relations Act and the Fair Labor Standards Act. Labor pointed out that the application of the anti-trust laws to the insurance business was a far cry from saying that the Federal government should regulate insurance companies.

After much testimony and many meetings, the trend toward the ultimate answer became apparent. The answer was first indicated by Senator O'Mahoney and Senator Hatch. They both pointed out that the industry should not have approached Congress for a blanket exemption from the anti-trust laws; it should instead have advanced some specific legislation for possible temporary exemption, or have listed such exemptions as were absolutely necessary. This had been done in the marine insurance field in the early 1920's, and it could be done again. This would provide a period of

adjustment and investigation to determine exact needs and to develop a system of operation for the rate-making process without destroying the effectiveness of either the anti-trust laws or state regulation in the interests of the public.

The Text of the Law

It is interesting to note that about this time the SEUA decision was handed down. Shortly thereafter, H. R. 1326 passed the House by a large majority, but the bill never passed the Senate. The weight of time then went to work, and efforts to resolve the problem resulted in a compromise measure, presented to the 79th Congress. This measure was the McCarran Act, called Public Law 15, 79th Congress, the text of which is as follows:

(Public Law 15--79th Congress)
(Chapter 20--1st Session)
(S. 340)

AN ACT

TO EXPRESS THE INTENT OF THE CONGRESS WITH REFERENCE TO THE REGULATION OF THE BUSINESS OF INSURANCE

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, that the Congress hereby 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.

Sec. 2. (a) The business of insurance, and every

person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.

(b) No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically related to the business of insurance: Provided, that after January 1, 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.

Sec. 3. (a) Until January 1, 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, 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 Act shall render the said Sherman Act inapplicable to any agreement to boycott, coerce, or intimidate, or act of boycott, coercion, or intimidation.

Section 4. Nothing contained in this Act 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.

Section 5. As used in this Act, the term "State" includes the several States, Alaska, Hawaii, Puerto Rico, and the District of Columbia.

> Section 6. If any provision of this Act, or the application of such provision to any person or circumstances, shall be held invalid, the remainder of the Act, and the application of such provision to persons or circumstances other than those as to which it is held invalid, shall not be affected.
>
> Approved March 9, 1945.

The McCarran Act (Public Law 15) is obviously based upon the bill submitted to the Congress by the NAIC, although the two are not identical.

Impact of the Law

Contrary to the wishes of some branches of the industry, Public Law 15 did not grant blanket exemption of the industry from the provisions of the anti-trust laws. Essentially, the Act established a moratorium period for the industry, during which time, however, Section 3b provided:

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

The apparent intent of the moratorium period was to allow time for the industry to make the necessary internal adjustments to fit its new legal position as an industry engaged in interstate commerce, and to provide the states with an opportunity to review their existing statutes, amend

or clarify them, or pass additional statutes. This is necessary to cope with the somewhat ambiguous Section 3b of the Act, which provides that the Federal anti-trust laws shall be applicable after the moratorium to the insurance business "to the extent that such business is not regulated by State Law."

Legal theorists and students of legislative law could write many pages at this point dealing with an analysis of the legislative intent in connection with this Act and the legal meaning of such words as agreement, coercion, boycott, regulate, and of the phrase "to the extent that such business is not regulated by State Law," as such meaning has evolved from court cases, normal daily usage, legislative usage, etc. For our purposes certain brief assumptions will be made without an attempt to justify them legally or to annotate them.

The title states that the Act is an expression of the intent of the Congress with reference to the regulation of the business of insurance. If we look back at some of the testimony at the public hearings, at the proposed bill to exempt the insurance industry completely from the impact of the Federal anti-trust laws, and at the SEUA decision, as well as the expressed opinion of the Attorney General and

the President of the United States, it is logical to deduce that Congress wanted to remove obstacles to continued state regulation of the industry. That is the express purpose of the Act. As a guide to what the Congress meant when phrasing the Act, there is nothing to indicate that any of the words used in the Act were meant to be viewed in a more liberal or in a more restricted way than has been the practice by the courts in the past. It was said that:

> "A narrow legalistic approach to the interpretation of the McCarran Act will defeat its own ends. Insurance companies are not thereby to be permitted to make contracts and agreements in restraint of trade, to monopolize interstate commerce, or otherwise to engage in restrictive practices.
>
> "The states have the opportunity to re-examine and reconstitute their regulatory laws for the orderly correction of abuses which have existed in the insurance business. Fairness, efficiency and the preservation of competitive opportunity should be the criteria. If the attempt fails, the answer must lie with the Congress and the courts." *

The Act does not say to the states, "You must pass acts regulating insurance," but it does say that to the extent

*35

that the states do not act, or to the extent that the states do act, or to the extent that state action is not sufficient, or is not in fact affirmative regulation, Congress may act or the courts may apply existing Federal regulation.

It was not the intent that states should be permitted to erect "islands of safety" by passing legislation that was not in fact regulatory. As pointed out by Senator Barkley,*

> ". . .I wish it to be understood that in voting for the approval of the Conference Report, I am accepting the interpretation placed upon it by the conferees, namely, that if any state, through its legislature, undertakes to go through the form of regulation merely in order to put insurance companies within the state on an island of safety from Congressional regulation, that effort will be futile. And not only can Congress deal with any phase of the insurance business not dealt with by a state legislature, but even in a case in which a state legislature deals with any phase of it, but does not deal with it adequately in the opinion of Congress. Congress is not in any way barred by the Conference Report from dealing with that subject and with the phase of it which Congress deems

*36, p.1558

to have been inadequately dealt with by the states: so that hereafter we can enact such legislation as we may deem proper and wise to have enacted in connection with the regulation of this business, which clearly is inter-state commerce."

Senator Ferguson discussed the areas of permissible affirmative state regulation and the intent of Public Law 15 as follows:

". . .If a state passes an act regulating insurance, or taxing insurance, and that regulation is contrary to the Sherman Act, or the Clayton Act, with three exceptions, then the state law would be the law. Here are the exceptions: Nothing contained in this Act shall render the said Sherman Act inapplicable to any agreement to boycott, coerce, or intimidate, the acts of boycott, intimidation or coercion. In other words, under the terms of the bill, there are six things on which a state could not legislate. They are boycott, coercion or intimidation, or agreements to boycott, coerce or intimidate. . . With respect to anything else, if the states were to specifically legislate upon a particular point and that legislation were contrary to the Sherman Act, Clayton Act, or the

Federal Trade Commission Act, then the state law would be binding. That is exactly what we attempted to do in the bill. It is clear what we attempted to do. After a conference with the House, we believe that the states should regulate insurance, and taxation on insurance business. But we spelled out certain things on which we thought Congress should not allow states to legislate. Those are the things I have mentioned. As to the others, the state has full power to act by legislation--not by agreement, but by legislative act." *

The Act grew out of the SEUA decision followed by a careful study of all sides of the problem, discussed openly and freely in the Joint Hearings, and by a careful weighing of bills presented for consideration. The needs of the industry, as well as its existing structure as developed under state regulation were carefully analyzed. The intent was to develop and promote regulation of the industry in the best interests of the public, providing for the necessary adjustments to be made at some future time. As pointed out by the American Mutual Alliance, weight was given to certain practical considerations:

"Here is a business which has grown and become

*36, p.1551

very useful under state regulation. The Anti-Trust Laws were the only Federal laws which the Government had ready when insurance was declared interstate commerce. The result was action in Congress to leave regulation with the states except for certain expressly spelled out qualifications. Congress knows that business must get done--would it have required the business to subject itself to state law in Section 2(a) and then put it under the duty in 2 (b) to obey such law at its peril? Certainly this is not a reasonable result.

"It is submitted that the conflict otherwise existing between Section 2 (a) and 2 (b) may be resolved and the reconciliation of Congress' plea to exercise good faith with the language in 2 (b) may be accomplished, by paraphrasing thus:

> 'In the event that any state fails to regulate with respect to the insurance business. . ."

The phrase in Public Law 15 thus appears to be quantitative rather than qualitative. It has the effect of holding over the insurance business a threat that if the state does not regulate, the Federal Government will and will regulate with the only weapon presently

at hand--the Anti-Trust Laws.

"In other words, Congress has not said to the states: 'You must so regulate the business of insurance that no restraints of trade or monopolies exist.' Rather, it has said: 'We are, for the present, convinced that combinations and activities otherwise perhaps vulnerable to the Anti-Trust Laws are necessary to the public interest in this particular business and provided that such otherwise vulnerable activities are regulated by you, we are willing to wait and see'."*

The Moratorium period was extended from January 1, 1948, to June 30, 1948, to allow the Congress time to study the effect of action taken by the states during the interim, and also to accommodate some states whose legislatures met during the extension time. If the states had established effective regulation by the expiration time of the moratorium, and that regulation was actually in operation, it became apparent that the forces favoring a perpetuation of state regulation would have taken a major step toward the further exclusion of Federal legislative action.

(b) THE NAIC AND THE AIC

The National Association of Insurance Commissioners,

*34, p.72

operating through its established Federal Legislation Committee and its Rates and Rating Organizations Committee, conducted many meetings and hearings to help determine the course of action to be followed by the states.

> "It (the NAIC) invited participation of the industry which designated an all-industry committee composed of representatives of every segment of the insurance industry. The membership of this all-industry committee was organized in May, 1945 by representatives of the insurance business to aid in the formulation of a legislative program to strengthen existing state laws for the purpose of meeting Public Law 15."*

The All-Industry Committee was composed of delegates of organizations that were representative of the companies, agents, executives and underwriters participating in the Industry.

The Committee's objective was to develop standard rating laws to be adopted by the states, or to serve as valid guides to the states in amending their own rating laws, in compliance with the Congressional intent behind Public Law 15. Mr. Dineen, New York State Superintendent of Insurance, pointed out in an address delivered in 1947 before the National Association of Independent Insurers that:

*23, p.13

"No legislation in the history of the insurance business had the background of the model rating bills. These bills have been drafted pursuant to a Congressional invitation in which the intent of Congress may be plainly ascertained from the Congressional debate and reports. They have been drafted by committees whose reasoning on every detail of the bills is embodied in a document distributed from coast to coast, and preserved in the permanent records of the National Association of Insurance Commissioners. Furthermore, every Commissioner knows that Congress now has the power, at least insofar as the field of interstate commerce is concerned, to take over the regulation of the insurance business and that state regulation must prove its mettle. This collection of circumstances should furnish the most potent of arguments for reasonable and proper interpretation of these model rating bills if they are enacted into law, and should guarantee a high degree of fidelity in their enforcement. For these reasons I have been persuaded that the isolated instances of improper or arbitrary interpretation of other statutues by insurance Commissioners over the years furnish no precedent as to what may be

expected in the administration of these bills.

The bills which Mr. Dineen refers to were developed as result of aggressive and affirmative action taken by the NAIC in cooperation with the All-Industry Committee. Many meetings were held, guided by men who possessed legislative construction experience, legal experience and practical experience in the industry itself, and men who had seen how the machinery of regulation is actually administered from their own supervisory experience. It was an impressive array of talent that went to work in the interests of the public to create these model bills.

While these committees were working, members of the Congress were carefully following the state legislative developments, and were interested in what steps the industry was taking during the moratorium period. In September, 1946, Senator Pat McCarran inquired into the progress made by the industry under the moratorium toward compliance with Public Law 15. The letter in answer to his inquiry, written by Mr. Henry Wood, Secretary of the All-Industry Committee, very well described the progress made up to that time.

> "The All-Industry Committee was organized in May, 1945, at a joint meeting of the Committee on Federal Legislation of the National Association of Insurance Commissioners and representatives of the insurance industry and, as presently constituted, is composed of nineteen national insurance organizations repre-

senting all branches of the insurance business (Life, Fire, Marine, Accident and Health, Casualty and Surety, Stock, Mutual, Reciprocal and Fraternal; Bureau and Independent companies, Agents and Brokers.)

"Since its organization, the All-Industry Committee has held ten meetings (as of September 6, 1946--other meetings have since been held). These meetings have consumed twenty-three days, exclusive of time spent in research and study. In addition, there have been numerous meetings of the Committee's several sub-committees. All of these meetings have been open to any interested company representatives and many such representatives attended the meetings. Several meetings were joint meetings with committees of the National Association of Insurance Commissioners and all other meetings were attended by representatives of that organization.

"Because of the scope and great importance of the problem, the Committee decided that rate regulatory legislation should be the first matter for consideration. Careful study and consideration developed the view that, with respect to fire, inland marine, casualty and surety insurance, the important objectives of safeguarding insurance company solvency and ensuring fair and equitable practices in the public interest could most certainly be secured under a state regulatory system which permitted cooperative activity in rate making to be conducted under adequate and affirmative regulatory safeguards. It was recognized that such activities might, in the absence of state regulation, be violative of the Sherman Act and thus that state regulation of the sort which would make the Sherman Act inapplicable was essential. It was also believed that the preservation of competitive opportunity in the insurance business was likewise essential and that this objective should likewise be secured, to as great an extent as was possible without defeating the paramount objectives.

"Our efforts and those of the National Association of Insurance Commissioners have been directed not only toward developing rate regulatory bills under which these objectives would be secured but at attaining a

proper balance among them. Divergent and sometimes conflicting views had to be reconciled, not only among various branches of the industry but also among insurance commissioners and between insurance commissioners and the industry.

"As a result of this cooperative work of the Committee and the National Association of Insurance Commissioners, two rate regulatory bills have been developed which, we believe, fulfill the stated objectives. One bill pertains to fire and marine insurance and the other to casualty and surety insurance. These bills were reported to the National Association of Insurance Commissioners' Committee on Rates and Rating Organizations by the Committee's sub-committee in June, 1946. The sub-committee's report observed that 'the science of rate making is a progressive one and as time passes changes and improvements will, no doubt, suggest themselves. However, in the light of present day thinking and for those states which subscribe to the principles set forth in the bills, the Committee recommends their use at this time', and requested the Committee on Rates and Rating Organizations to submit the bills to the National Association of Insurance Commissioners with a recommendation that the bills and the report be approved and adopted by the Association. The sub-committee's report was considered and unanimously adopted at a joint meeting of the Rates and Rating Organizations Committee and the Federal Legislation Committee and thereafter by the National Association of Insurance Commissioners at the Portland meeting in June, 1946.

". . .A vast amount of work has been done not only in connection with rate regulatory legislation but also in connection with the other problems presented by the imminence of the applicability to insurance of the Sherman Act, the Federal Trade Commission Act, the Clayton Act and possibly the Robinson-Patman Act, and much remains to be done, and it will be done. Many will share in it, including the many legislative commissions and committees, the National Association of Insurance Commissioners and the insurance All-Industry Committee. . ."*

*33

The expression "many will share in it" used above, recalls to mind the list of members in the All-Industry Committee. One can't help feeling that the weight of various backgrounds led to some degree of "conciliation and mediation" during the process of developing the legislation. Certainly the members represented a number of different states, and represented companies or organizations doing business in more than just one state. Consequently, thoughts and ideas, must have come into conflict and old antagonisms must have been revived. That an idea or practice is old does not of necessity make it obsolete, nor are new ideas radical simply because they are new. By a process of attrition and compromise the so-called model bills were born, and the labor pains were probably most acutely felt by those who favored bills that "might" meet the requirements of Public Law 15, or who were not advocates of regulation of rates in such a strict sense as prevailed in the state of New York. It would seem that strict regulation as evidenced by the New York pattern was perhaps the guiding pattern for the All-Industry Bills(hereafter referred to as the AIC bills).

Senator Pat McCarran, Chairman of the Senate Committee on the Judiciary, at the time he asked the industry, in 1946, to report its actions to date to comply

with Public Law 15, made the following general remarks about the conflicting views in the industry.*

"From many sources, I learned of the conflict of various interests within the industry. In fact, I was in receipt of charges of various kinds, and I was on the listening end of various arguments pro and con this point or that. I am, therefore, not unaware of the struggle and conflict that resulted in the so-called all-industry model bills.

"Of course, I know that matters of personal interest and advantage naturally tend to magnify themselves to the group or groups concerned; and I also realize that such interests, so magnified, sometimes have a tendency to obscure the ultimate goal.

"I think that the drafting of the so-called all-industry bill is significant. It indicates that to the industry, at least, the emphasis since the enactment of Public Law 15 has been on the rating problem. This is further borne out by the fact that 4 or 5 different versions of legislation, treating this problem according to the various concepts by groups which disagree with the tenets of the all-industry bill, also were drafted and have been urged upon the various

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state legislatures.

". . .For the welfare and progress of the insurance industry as a whole, quarrels between segments of the industry must be settled and differences and disagreements between factions must be ironed out. It will not do to say: 'We can't get together.' Congress will find a way to put you together if you do not accomplish the result for yourselves; and the bed which Congress will prepare for you, in that eventuality, might not be so comfortable as if you made your own."

Although this address was made after the AIC bills were drafted, undoubtedly the drafters realized they were "making their own bed." By the force of democracy at work within the committees concerned, four model bills were developed, designed along the lines of "strengthening existing state insurance regulatory laws."

(c) THE AIC MODEL BILLS

In the Section to follow one of the AIC model bills will be examined in detail For our immediate purpose the following brief summary of the four model bills will suffice:

1. Casualty and Surety Rate Regulatory Bill.
2. Fire, Marine and Inland Marine Rate Regulatory Bill.

Both of these proposed bills provide for state supervision of the rating activities which have been found necessary for various types of property, casualty and surety insurance. They provide that rates must conform to prescribed standards and that they shall not be excessive, inadequate or unfairly discriminatory; that rate manuals and plans shall be filed with the Insurance Commissioner who is directed to review such filings as soon as reasonably possible; that such rates may not be used for a waiting period of fifteen days, or, if extended by the Commissioner, of thirty days; and that if not disapproved within such waiting period, such filings are deemed to meet the requirements of the Act.

3. Bill relating to Unfair Methods of Competition and Unfair and Deceptive Practices in the Business of Insurance.

This bill prohibits any unfair method of competition or unfair or deceptive act or practice in the business of insurance in about the same language as used in the Federal Trade Commission Act. But, unlike that Act, it lists in Section 4 certain unfair acts and practices (such as false advertising, defamation of competitors, rebates, etc.) and as to them empowers the Insurance Commissioner, after prescribed notice and hearings, to issue orders to cease and desist from the violations found. As to any other acts or practices which are not specifically defined as unfair in Section 4 but which the Commissioner finds, after hearing, to be unfair or deceptive he is empowered to report to the Attorney General who can institute court proceedings to enjoin and restrain their continuance.

4. Accident and Health Insurance Bill.

This bill requires the filing of accident and health policy forms, applications, riders, endorcements, classifications of risks and premium rates with the Commissioner of Insurance, provides that no policy, application, rider or endorsement forms may be issued until 30 days after filing unless previously approved, and provides for the disapproval, or withdrawal of approval, by the Commissioner of such forms if they

> contain benefits unreasonable in relation to premiums or contain provisions which are unjust, unfair, inequitable, misleading, deceptive or encourage misrepresentation. Hearings on disapprovals would be granted on written request and decisions and orders of the Commissioner would be subject to review by appeal.
>
> The All-Industry Committee also recommended that each state consider, as part of its legislative program, statutory language to permit specifically the payments of commissions to brokers, and to provide for licensing brokers, if such provisions are not in the existing statutes. (Many states already had such laws.) The purpose of this was to meet any possible application to insurance of the Robinson-Patman Act, which act prohibits discrimination in commodity transactions and might prohibit payment of commissions to insurance brokers under certain circumstances.*

The AIC bills as drafted were submitted for approval in June, 1946, at Portland, Oregon, and were accepted by the majority of the NAIC and the AIC. Needless to say, in the light of the internal conflicts referred to above there was some dissent; nevertheless the bills are outstanding examples of cooperative effort to meet a challenge. Some definite affirmative action was necessary if the states were to continue in their status as regulators of the insurance industry. Apparently no one claims that the bills are infallible, or that when subjected to the test of time, they will not require some amendment.

The bills are "model". There is nothing to indicate that the bills must or should be adopted in the several states in the exact form adopted by the NAIC and the

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AIC. They are far from compulsory in that sense. However, in view of the legislative, legal and administrative talents combined in drafting these model bills, and of the opportunity given to conflicting parties of interest to express their views before the bills were put in final form, they do serve as useful guides for state action. Looking at the dates when the various state legislatures were due to convene, it was apparent that little time for indecision existed. It would therefore seem that, even for the opponents of some provisions of the bills, the adoption of the model bills in the states held fewer disadvantages than did no action whatsoever, which would lead to Federal regulation under the provisions of Public Law 15. There is evidence that the men who drafted this model legislation, gave careful consideration to the SEUA decision (the holding as well as the majority and minority opinions and dicta), to existing Federal Laws that were applicable, and to the constitutional limitations on state and Federal levels and problems growing out of dual control over interstate commerce. Generally, it is reasonable and defensible to say that the model bills are neither the minimum nor the maximum legislation permissible under this background and under Public Law 15. In short, they are a happy medium.

Before entering upon a discussion and explanation of the model bills in an attempt to understand how they apply to meet the historical reasons for rate regulation, and the test of "effective" state regulation, we should look at two cases dated June 3, 1946, as they are pertinent to the problems confronting the states legislatively in considering the AIC bills.

(d) APPLICABLE COURT DECISIONS

The first case, Robertson v. California, sets forth the constitutional rule governing state regulation prior to the passage of Public Law 15, based on the test of whether, in the absence of Federal action, the state law in question discriminates against or unduly hinders interstate commerce. The second case, Prudential Company v. Benjamin, is based upon the broader rule which permits even laws discriminating against interstate commerce when sustained by the coordinated action of the state and Federal governments. This second case takes on added significance because of the fact that state taxing powers were before the Court, and the Court held that Public Law 15 had restored these powers to the full extent since it made limitations on state taxing power, designed to preserve Federal power over interstate commerce, inoperative.

Because of the importance of this change in the constitutional law governing state regulation of insurance, each of the two cases will be reviewed briefly.

Robertson v. California

The case of Robertson v. the People of the State of California* developed prior to the passage of Public Law 15, but it is quite pertinent to the present topic. Mr. F. O. Robertson had allegedly violated two of California's statutes. In the first instance he had functioned as an agent for an Arizona company that had not been admitted to do business within the State of California, and, in the second instance, he had performed as such agent without authority from the State of California in that he had not procured a license from that state. Robertson had defended upon the premise that as an insurance agent, he was engaged in interstate commerce transactions, which would place him outside the authority of state regulation by California.

Robertson was convicted by the trial court, conviction being affirmed by the United States Supreme Court. The Court did not involve Public Law 15 in reaching its decision, because the facts predated that law. They did, recognize the SEUA decision and pointed toward its impact upon state regulation:

*59, p.1040

"That appellant's activities were of a kind which vitally affect the welfare and security of the local community, the state, and their residents could not be denied. Cf. Hooperston v. Cullen, 318 U.S. 313, 316 ff. They had in fact a highly 'special interest' in his localized pursuit of this phase of the comprehensive process of conducting an interstate insurance business. Cf. Union Brokerage Co. v. Jensen, supra, at 212. Here, as in each of the instances cited, appellant's activities were concentrated in the regulating state, although affecting or constituting interstate commerce. Moreover, the licensing provision of Sec. 1642 is regulatory, not exclusory in character; is not discriminatory; is not in conflict with any policy or action of Congress but rather accords with its expressed views in so far as the McCarran Act may be taken to be applicable; and is designed appropriately to secure the public from those evils of uncontrolled insurance solicitation to which it is directed. In view of these facts the regulation 'neither discriminates against nor substantially obstructs the commerce.' California v. Thompson, supra, at 114.

"The South-Eastern decision . . . did not wipe out the experience of the states in the regulation of the business of insurance or its effects for the continued validity of that regulation. . ."

Consequently, licensing and reserve requirements as a phase of regulation on a state level were regarded as reasonable in the light of the public interest, and not outside the area of a state's police power.

In summing up its decision the Court declared:

"Here California's reserve requirements for securing authority to do business can not be held, either on the fact of the statute, or by any showing that has been made, to be excessive for the protection of the local interest affected; or designed or effective either to discriminate against foreign or interstate insurers or to forbid or exclude their activities. (The licensing provisions permit the conduct of business) by all who are able and willing to maintain reasonable minimum reserve standards for the protection of policy holders. Exclusion there is, but it is exclusion of what the state had the power to keep out, until Congress speaks otherwise." (Italics ours.)

This decision is certainly of some comfort to

those favoring the continued existence of state regulation. Of interest is the similarity of the issue and the decision in this case and in that of Paul v. Virginia previously referred to, both of which upheld the right of the state to regulate the business of insurance as conducted within the state borders, in the interest of the people within the state, even though one was decided many years before the now famous SEUA case. Thus, in 1868 and again in 1946, we find that state regulatory laws pertaining to insurance were upheld.

The effects of the SEUA case, and the difference between the 1868 and 1946 decisions is evident, however, in the emphasis which the 1946 Court put on three points: that the state law before it was not excessive for the protection of local interests, that it did not discriminate against interstate commerce, and that it was not inconsistent with any policy or action of Congress.

The Prudential Case

The plaintiff in the case of the Prudential Insurance Company of America v. L. George Benjamin* was a New Jersey Corporation. It transacted business in the State of South Carolina. This State had a law that provided for a 3% tax on premiums collected by plaintiff or other non-

*54, p.1411

resident insurance companies, on business transacted within South Carolina. South Carolina corporations did not have to pay the tax, or any tax comparable to it. In view of these facts, the plaintiff charged discrimination against its operations as a business engaged in interstate commerce. Plaintiff contends that under Public Law 15, though the Act specifically states the right of states to tax and regulate, it was not intended to controvert the Commerce Clause, which prevents discriminatory state taxation or other forms of discrimination, which are "implied prohibitions."

The United States Supreme Court affirmed the decision of the trial court for the defendant. It held that actually Congress may not only permit, but also may prohibit interstate commerce; it possesses "supreme authority over that commerce," and therefore Congress may:

> ". . .Confine it loosely or closely. . . This broad authority Congress may exercise along. . . or in conjunction with coordinated action by the states, in which case limitations imposed for the preservation of their powers become inoperative and only those designed to forbid action altogether by any power or combination of powers in our governmental system remain effective. Here both Congress and South

Carolina have acted, and in complete coordination, to sustain the tax. It is therefore reinforced by the exercise of all the power of government residing in our scheme."

It should be noted that the state power upheld in this case was upheld on the ground that it had been authorized by Congress. It would seem that the Court has construed the McCarran Act to protect the rights of a state to regulate and tax the business of insurance, in the interest of the public. Certainly there is nothing in the Act to compel any form of uniformity between the states' regulation and taxation requirements.

These two cases, decided just a few days before the AIC bills were presented in Portland, Oregon for consideration and approval by the NAIC and the AIC, helped the respective organization, and the states, to understand how the Supreme Court regarded state regulatory and tax laws in the light of the SEUA decision and Public Law 15 (McCarran Act). These cases were cited in several other subsequent cases which upheld retaliatory state tax laws and regular premium tax laws.* It becomes even more evident that when the moratorium period expires, in the light of the above cases, the anti-trust statutes definitely will apply to

*25, p/ 105

interstate commerce transactions in insurance, in the event that the states do not take action to round out affirmative and adequate state regulation. Of the AIC bills the framers have said:

> "It is confidently believed that under (these bills) effective state regulation can be achieved and maintained and also that such regulation will have the effect of making the Sherman Act inapplicable to insurance rate making." *

VII. THE STATES ANSWER THE CHALLENGE OF PUBLIC LAW 15

The states found themselves in a position where a review of their legislation pertaining to the regulation of the insurance industry became necessary. The Congress had authorized continued state regulation of insurance on the condition that regulation at the state level should prove an effective and affirmative means of attaining the objectives of the Federal anti-trust laws. The NAIC and the AIC had indicated the type of state legislation required to meet this condition. It now remained for insurance officials and supervising officials in each state to reach a meeting of minds as to the legislative action to be recommended in their state. The job cut out for them seemed to be:

*18, p.23

"To help erect a supervisory and administrative system which would conform to each state's laws but at the same time recognize that 'interrelationship, interdependence and integration of activities in all the states in which they operate are practical aspects of the companies' methods of doing business.'

"Insurance supervisory authorities, much to their credit, have likewise been thoroughly aware of the necessity for implementing state rate regulatory statutes, for coordinating supervisory activities under various rating laws, and for uniform interpretation of the standard of rate making."*

States have realized that competition is an important element in the insurance industry, and that it may be just as necessary in the interests of the public as is stability within the industry. Even considerably prior to the SEUA decision, some states had taken definite affirmative steps to regulate the industry, having in mind at all times the benefit of the public; however, other states had taken little or no action that touched upon some of the current problems. Consequently, the approach to a solution of the problem had to vary with the pattern previously established.

*22, p.1-Forward

With these conditions in mind, the states could analytically approach the AIC bills submitted for consideration by their legislatures. What do those bills seek to accomplish?

> "Broadly, they seek to preserve state regulation of insurance through adequate regulatory legislation in various fields covered by the Federal Anti-Trust Acts. In passing the rate regulatory bills the states would be taking advantage of the opportunity given by Public Law 15 to oust the Federal Acts to the extent the states regulate in their fields under state law. The bills provide methods to meet the challenge of the Congress to the states to pass effective and affirmative state legislation which will prevent the impact of the Federal anti-trust laws. If that impact is not avoided by the states, through adequate legislation, the end of exclusive state supervision will be in sight. There can be no doubt of that."*

The possibility of eventual Federal regulation of insurance had not been unforeseen. As previously noted, it had long been predicted by members of the bar and of the judiciary and by state supervisory officials. After the passage of Public Law 15, the vast array of industry, super-

* 33, p.83

visory, and legal talent had gone to work, in a democratic manner, to draft model bills designed to implement the intent of Congress and to protect the public interest within the framework of state regulation. To understand how these bills proposed to accomplish this purpose, an analysis of some of their provisions is in order.

Some of these provisions such as those pertaining to unfair practices, modeled after the Federal Trade Commission procedure, follow the pattern of fairly well-established administrative procedures. It is in the provision pertaining to rate-making and filing procedures, extended in the case of health and accident insurance to the filing of forms, riders, and endorsements, that the most important and the most controversial procedures are found. Although the three bills containing rate-filing procedures differ in numerous details, according to the differing requirements of the three fields of insurance covered (casualty and surety, fire and marine, and health and accident insurance), all three bills are designed on the same basic pattern. This pattern provides:

1. That rates be made in accordance with certain stipulated standards and in accordance with stipulated procedures as to the part, if any, to be played by rating bureaus.

2. That rates (or forms) be filed with the proper authorities in such a manner as to permit them to be reviewed or examined.

3. That there be a stipulated waiting period after the filing date, before the rate (or form), if not previously questioned, becomes effective.

4. That the regulatory authorities shall have the power, subject to a designated procedure for its exercise, to disapprove of filings either before or after they become effective.

In the following pages a detailed examination of the Casualty and Surety Rate Regulatory Bill will be presented as an illustration of how the basis plan of the AIC model bill operates and as an example of the way in which the model bills proposed to reconcile the requirements of Public Law 15 with the various practical needs of the insurance industry and of the regulatory officials.

(a) THE CASUALTY AND SURETY BILL

Sec. 1. Purpose of Act.

The purpose of this Act is to promote the public welfare by regulating insurance rates to the end that they shall not be excessive, inadequate or unfairly discriminatory, and to authorize and regulate cooperative action among insurers in rate making and in other matters within the scope of this Act. Nothing in this Act is intended (1) to prohibit or discourage reasonable competition, or (2) to prohibit, or encourage

except to the extent necessary to accomplish the aforementioned purpose, uniformity in insurance rates, rating systems, rating plans or practices. This Act shall be liberally interpreted to carry into effect the provisions of this Section.

This section places the Act within the area of legislative intent of the Congress in passing Public Law 15, and serves as guide to state supervisors administering the law, by setting forth the general standards in accordance with which both rates and cooperative rate-making procedures are to be regulated so as to protect the public interests.

Sec. 2. Scope of Act.

This Act applies to casualty insurance, including fidelity, surety and guaranty bonds, and to all other forms of motor vehicle insurance, on risks or operations in this state, except:

(a) reinsurance, other than joint reinsurance to the extent stated in Section 11;

(b) accident and health insurance;

(c) insurance against loss of or damage to aircraft or against liability, other than workmen's compensation and employers' liability, arising out of the ownership, maintenance or use of aircraft;

(d) insurance against (here list any other kinds of casualty insurance to which this Act does not apply).

If any kind of insurance, subdivision or combination thereof, or type of coverage, subject to this Act, is also subject to regulation by another rate regulatory act of this state, an insurer to which both acts are otherwise applicable shall file with the (commissioner of insurance), hereinafter referred to as (commissioner), a designation as to which rate regulatory act shall be applicable to it with respect to such kind of insurance, subdivision or combination thereof, or type of coverage.

At the time of drafting there was conflict as to how the accident and health business should be regulated, so it was specifically excluded here, to save time, and eventually was covered in a separate bill.

Rather than run into a conflict between regulatory bills of overlapping coverages, the power of election was inserted, leaving the election up to the companies, where it properly belongs.

Sec. 3. Making of Rates

(a) All rates shall be made in accordance with the following provisions:

1. Due consideration shall be given to past and prospective loss experience within and outside this state, to catastrophe hazards, if any, to a reasonable margin for profit and contingencies, to dividends, savings or unabsorbed premium deposits allowed or returned by insurers to their policyholders, members or subscribers, to past and prospective expenses both countrywide and those specially applicable to this state, and to all other relevant factors within and outside this state;

2. The systems of expense provisions included in the rates for use by any insurer or group of insurers may differ from those of other insurers or groups of insurers to reflect the requirements of the operating methods of any such insurer or group with respect to any kind of insurance, or with respect to any subdivisions or combination thereof for which subdivision or combination separate expense provisions are applicable;

3. Risks may be grouped by classifications for the establishment of rates and minimum premiums. Classification rates may be modified to produce rates for individual risks in accordance with rating plans

which establish standards for measuring variations in hazards or expense provisions, or both. Such standards may measure any differences among risks that can be demonstrated to have a probable effect upon losses or expenses:

4. Rates shall not be excessive, inadequate or unfairly discriminatory.

(b) Except to the extent necessary to meet the provisions of subdivision 4 of subsection (a) of this Section, uniformity among insurers in any matters within the scope of this Section is neither required nor prohibited.

This section recognizes the importance of the Law of Large Numbers in the business of insurance, and the fact that as applied to different phases of the industry in different parts of the country, rates will vary. Changes in experience and administrative procedures take place, so an area of flexibility has been provided. The establishment of standards that rates shall not be excessive, inadequate, or unfairly discriminatory reflects a tendency toward a uniformity in the interests of practicable regulation, qualified by a desire to perpetuate reasonable competition in the interests of the public. The Congress had emphasized

through the Judiciary Committee that they did not intend nor desire

> ". . .to require or encourage the several states to enact legislation that would make it compulsory for an insurance company to become a member of rating bureaus or charge uniform rates. It is the opinion of Congress that competitive rates on a sound financial basis are in the public interest."

It is clear that this section of the bill contributes towards an accomplishment of the objectives that seem desirable to Congress. It is obvious, however, that much depends upon the reasonable application of the general factors by both the rate makers and the officials supervising those rates; the term "due consideration" must be properly weighted for each situation to prevent any unreasonable skewness right or left. In rate making, the expenses of operation are recognized as a major consideration, along with the loss experiences of the organization submitting the rates for approval, and whether a company is a bureau member or not, provision is made for adjustments in its rates to reflect its individual expense experience. Any requirement as to a floor or ceiling on expense levels would tend to make for maladjustments in fair competition.

To get away from what may appear outwardly to be unfair discrimination in rates charged the "corner grocer" and the "large chain store" half way up the block, provision is made for rate adjustments on individual risks through valid rating plans; however, such adjustments must be of a nature subject to proof.

This entire section implies that much trust and faith is placed in the ability and integrity of the supervisory officials. Not only must those officials apply the law as the legislature intended it to be applied, but they must also apply it the same way for all insurers or groups of insurers. It is one thing to say that rates shall not be "excessive, inadequate or unfairly discriminatory," and it is another thing to apply these standards with a clear and uniform idea in mind as to what they mean for all insurers and insureds. The standards also must be flexible enough to reflect changes in general conditions from time to time, not only in one state, but in all the states. These standards incorporated into the AIC bills were not just dreamed up overnight. They are standards developed as a result of past regulatory experience in many lines of businesses affected with a public interest. Their meaning can be traced through the case law that contributed

to their legal and legislative implications.

Sec. 4. Rate Filings

(a) Every insurer shall file with the (commissioner) every manual of classifications, rules and rates, every rating plan and every modification of any of the foregoing which it proposes to use. Every such filing shall state the proposed effective date thereof, and shall indicate the character and extent of the coverage contemplated. When a filing is not accompanied by the information upon which the insurer supports such filing, and the (commissioner) does not have sufficient information to determine whether such filing meets the requirements of the Act, he shall require such insurer to furnish the information upon which it supports such filing and in such event the waiting period shall commence as of the date such information is furnished. The information furnished in support of a filing may include (1) the experience or judgment of the insurer or rating organization making the filing, (2) its interpretation of any statistical data it relies upon, (3) the experience of other insurers or rating organizations, or (4) any other relevant factors. A filing and any supporting information shall be open to public inspection after the filing becomes effective.

(b) An insurer may satisfy its obligation to make such filings by becoming a member of, or a subscriber to, a licensed rating organization which makes such filings, and by authorizing the (commissioner) to accept such filings on its behalf; provided, that nothing contained in this Act shall be construed as requiring any insurer to become a member of or a subscriber to any rating organization.

(c) The (commissioner) shall review filings as soon as reasonably possible after they have been made in order to determine whether they meet the requirements of this Act.

(d) Subject to the exception specified in subsection (e) of this Section, each filing shall be on file for a waiting period of fifteen days before it becomes effective, which period may be extended by the

(commissioner) for an additional period not to exceed fifteen days if he gives written notice within such waiting period to the insurer or rating organization which made the filing that he needs such additional time for the consideration of such filing. Upon written application by such insurer or rating organization, the (commissioner) may authorize a filing which he has reviewed to become effective before the expiration of the waiting period or any extension thereof. A filing shall be deemed to meet the requirements of this Act unless disapproved by the (commissioner) within the waiting period or any extension thereof.

(e) Any special filing with respect to a surety or guaranty bond required by law or by court or executive order or by order, rule or regulation of a public body, not covered by a previous filing, shall become effective when filed and shall be deemed to meet the requirements of this Act until such time as the (commissioner) reviews the filing and so long thereafter as the filing remains in effect.

(f) Under such rules and regulations as he shall adopt the (Commissioner) may, by written order, suspend or modify the requirement of filing as to suspend or modify the requirement of filing as to any kind of insurance, subdivision or combination thereof, or as to classes of risks, the rates for which cannot practicable be filed before they are used. Such orders, rules and regulations shall be made known to insurers and rating organizations affected thereby. The (Commissioner) may make such examination as he may deem advisable to ascertain whether any rates affected by such order meet the standards set forth in subdivision 4 of subsection (a) of Section 3.

(g) Upon the written application of the insured, stating his reasons therefor, filed with and approved by the (commissioner), a rate in excess of that provided by a filing otherwise applicable may be used on any specific risk.

(h) Beginning ninety days after the effective date of this Act no insurer shall make or issue a contract or policy except in accordance with filings which are

> in effect for said insurer as provided in this Act or in accordance with subsections (f) or (g) of this Section.

It is not sufficient simply to file a rate with the commissioner; that rate must be substantiated with supporting data that is material. Not only does this provision help the commissioner in analyzing the rates in the interests of the public, but it greatly facilitates any further requests for information or subsequent investigations he feels are in order. Approved rating organizations may function and rates may be fixed in concert through them, subject, of course, to supervision by the insurance commissioner. The provision for a waiting period is important as it allows time for the commissioner to study the rate and its supporting data; also, it tends to lessen the probability of rates that may later prove to be unfairly discriminatory. If the rate went into effect without this waiting period, and did prove to be unfairly discriminatory and had to be recalled, an extremely unhealthy situation would be created involving a genuine misuse of the public's interest and bad publicity for the industry, not to mention the task of refunding the excesses charged, or working out some system whereby no refund would be made but a lowered premium would be provided as to the time the initial rate

was declared unfair. Such a situation certainly would not create good will, would not be approved by the public, and would not enhance the status of the industry.

The waiting period established is not a limitation to rates becoming effective sooner, within the discretion of the commissioner. Also, no affirmative approval is necessary--if the commissioner does nothing toward disapproving the rate filed, the rate becomes effective at the expiration of the waiting period.

The drafters of this bill realized that the public has been and may be confused over how their insurance rates are determined. Provisions were included to provide a means for the public to learn not only what they were paying but how the rate charge was determined. One of the outstanding state insurance commissioners comments:

> "There is a provision in the bills, which, in my judgment represents the acme of good public relations, namely, a proviso that every filing, in addition to indicating the character and extent of the coverage contemplated, shall be accompanied by the information upon which the insurer supports the filings and that the filing and supporting information shall be open to public inspection. One of the greatest and, in many

instances, one of the most valid complaints against the insurance business is the injection of unnecessary mystery into rate making. The public is entitled to know how a carrier arrived at a rate which the public is called upon to pay. There are, of course, cases in which the element of judgment in the formulation of a rate plays an important role and where statistical information standing alone would not justify the rate, but I can think of no reason which prevents a carrier from stating that fact in the memorandum supporting the filing. We surely should be approaching the day when a serious effort is made to minimize those instances where only God knows how the rate was determined.*

Sec. 5. Disapproval of Filings

(a) If within the waiting period or any extension thereof as provided in subsection (d) of Section 4, the (commissioner) finds that a filing does not meet the requirements of this Act, he shall send to the insurer or rating organization which made such filing written notice of disapproval of such filing specifying therein in what respects he finds such filing fails to meet the requirements of this Act and stating that such filing shall not become effective.

(b) If within thirty days after a special surety or guaranty filing subject to subsections (e) of Section 4 has become effective, the (commissioner) finds that such filing does not meet the requirements of this Act, he shall send to the insurer or rating organization

* 33, p.12

which made such filing written notice of disapproval of such filing specifying therein in what respects he finds that such filing fails to meet the requirements of this Act and stating when, within a reasonable period thereafter, such filing shall be deemed no longer effective. Said disapproval shall not affect any contract made or issued prior to the expiration of the period set forth in said notice.

(c) If at any time subsequent to the applicable review period provided for in subsection (a) or (b) of this Section, the (commissioner) finds that a filing does not meet the requirements of this Act, he shall after a hearing held upon not less then ten days' written notice, specifying the matters to be considered at such hearing, to every insurer and rating organization which made such filing, issue an order specifying in what respects he finds that such filing fails to meet the requirements of this Act, and stating when, within a reasonable period thereafter, such filings shall be deemed no longer effective. Copies of said order shall be sent to every such insurer and rating organization. Said order shall not affect any contract or policy made or issued prior to the expiration of the period set forth in said order.

(d) Any person or organization aggrieved with respect to any filing which is in effect may make written application to the (commissioner) for a hearing thereon, provided, however, that the insurer or rating organization that made the filing shall not be authorized to proceed under this subsection. Such application shall specify the grounds to be relied upon by the applicant. If the (commissioner) shall find that the application is made in good faith, that the applicant would be so aggrieved if his grounds are established, and that such grounds otherwise justify holding such a hearing, he shall, within thirty days after receipt of such application, hold a hearing upon less than ten days' written notice to the applicant and to every insurer and rating organization which made such filing.

If, after such hearing, the (commissioner) finds that the filing does not meet the requirements of this Act, he shall issue an order specifying in what respects he finds that such filing fails to meet the requirements of this Act, and stating when, within a reasonable

> period thereafter, such filing shall be deemed no longer effective. Copies of said order shall be sent to the applicant and to every such insurer and rating organization. Said order shall not affect any contract or policy made or issued prior to the expiration of the period set forth in said order.
>
> (e) No manual of classifications, rules, rating plan or any modification of any of the foregoing which establishes standards for measuring variations in hazards or expense provisions, or both, and which has been filed pursuant to the requirements of Section 4 of this Act, shall be disapproved if the rates thereby produced meet the requirements of this Act.

The language of this section seems to be clear. Not only is the public protected by the system of rate approval, but any member of the public who is "aggrieved" under that system of rate approval has a right to review.

The commissioner must state his reasons for disapproving a rate, just as the companies must show why they feel a rate is justified. Needless to say, the opponents of the bill point out that even the provisions of this section may not obviate some of the abuses possible if a commissioner does not properly administer the law. Superintendent Dineen's remarks on this subject are to the point:

> "Some critics, when confronted with the guarantees of freedom of action set forth in the bills, say these guarantees are illusory in the sense that they have no

assurance that the Commissioner will follow the plain mandate of the statute. They rely, and I shall speak frankly in this respect, upon unhappy experiences with Commissioners in one state or another under laws. Of course, if we are going to proceed upon the premise that Insurance Commissioners are not going to obey the law or administer it properly, we might as well write off state regulation right now. Indeed, a question is prompted: what assurance has the industry that a Federal administrator acting under a similar law would follow it any more conscientiously or any less arbitrarily than a state administrator? . . . Such a course of conduct is not peculiar to men entrusted with the administration of insurance laws; it happens to administrators in every regulatory field. . . Rarely will one find a regulatory statute in which there is more complete provision for relief by judicial review than is contained in the AIC bills. After there have been a few adjudications on the subject and a pattern has been established, it seems unlikely that any major difficulties should arise." *

Because the company is in a position to justify its requests with regard to the rate application, the burden

* 33, p.13.

has correctly been placed on them to justify with supporting data, rather than upon the Commissioner to rebut, perhaps without full knowledge of the company's case. Also, the provisions for affirmative action subsequent to rate approvals prevents tying the hands of the commissioner.

Sec. 6. Rating Organizations

(a) A corporation, an unincorporated association, a partnership or an individual, whether located within or outside this state, may make application to the (commissioner) for license as a rating organization for such kinds of insurance or subdivisions thereof as are specified in its application and shall file therewith (1) a copy of its constitution, its articles of agreement or association or its certificate or incorporation, and of its by-laws, rules and regulations governing the conduct of its business, (2) a list of its members and subscribers, (3) the name and address of a resident of this state upon whom notices or orders of the (commissioner) or process affecting such rating organization may be served and (4) a statement of its qualifications as a rating organization. If the (commissioner) finds that the applicant is competent, trustworthy and otherwise qualified to act as a rating organization and that its constitution, articles of agreement or association or certificate of incorporation, and its by-laws, rules and regulations governing the conduct of its business conform to the requirements of law, he shall issue a license specifying the kinds of insurance or subdivisions thereof for which the applicant is authorized to act as a rating organization. Every such application shall be granted or denied in whole or in part by the (commissioner) within sixty days of the date of its filing with him. Licenses issued pursuant to this Section shall remain in affect for three years unless sooner suspended or revoked by the (commissioner). The fee for said license shall be twenty-five dollars. Licenses issued pursuant to this Section may be suspended or revoked by the (commissioner), after hearing upon notice, in the event

the rating organization ceases to meet the requirements of this subsection. Every rating organization shall notify the (commissioner) promptly of every change in (1) its constitution, its articles of agreement or association or its certificate of incorporation, and its by-laws, rules and regulations governing the conduct of its business, (2) its list of members and subscribers and (3) the name and address of the resident of this state designated by it upon whom notices or orders of the (commissioner) or process affecting such rating organization may be served.

(b) Subject to rules and regulations which have been approved by the (commissioner) as reasonable, each rating organization shall permit any insurer, not a member, to be a subscriber to its rating services for any kind of insurance or subdivision thereof for which it is authorized to act as a rating organization. Notice of proposed changes in such rules and regulations shall be given to subscribers. Each rating organization shall furnish its rating services without discrimination to its members and subscribers. The reasonableness of any rule or regulation in its application to subscribers, or the refusal of any rating organization to admit an insurer as a subscriber, shall, at the request of any subscriber or any such insurer, be reviewed by the (commissioner) at a hearing held upon at least ten days' written notice to such rating organization and to such subscriber or insurer. If the (commissioner) finds that such rule or regulation is unreasonable in its application to subscribers, he shall order that such rule or regulation shall not be applicable to subscribers. If the rating organization fails to grant or reject an insurer's application for subscribership within thirty days after it was made, the insurer may request a review by the (commissioner) as if the application had been rejected. If the (commissioner) finds that the insurer has been refused admittance to the rating organization as a subscriber without justification, he shall order the rating organization to admit the insurer as a subscriber. If he finds that the action of the rating organization was justified, he shall make an order affirming its action.

(c) No rating organization shall adopt any rule the effect of which would be to prohibit or regulate the payment of dividends, savings or unabsorbed premium deposits allowed or returned by insurers to their policyholders, members or subscribers.

(d) Cooperation among rating organizations or among rating organizations and insurers in rate making or in other matters within the scope of this Act is hereby authorized, provided the filings resulting from such cooperation are subject to all the provisions of this Act which are applicable to filings generally. The (commissioner) may review such cooperative activities and practices and if, after a hearing, he finds that any such activity or practice is unfair or unreasonable or otherwise inconsistent with the provisions of this Act, he may issue a written order specifying in what respects such activity or practice is unfair or unreasonable or otherwise inconsistent with the provisions of this Act, and requiring the discontinuance of such activity or practice.

This section recognizes not only that rating organizations contribute to the stability of the industry by pooling information, but also that for such organizations to be regulated in the affirmative sense of the word, the commissioner must have some way of controlling their practices. If this were not accomplished, the effectiveness of rate regulation would indeed by questionable. If all the commissioner is supposed to do is put a stamp of approval on a rate or upon the practices of a rating organization without any quasi-judicial powers whatsoever, then states would certainly be setting up the so-called "island of immunity or safety" --the very thing that the Judiciary

Committee pointed out would not be approved by the Congress.

Properly regulated rating bureaus, legally co-operating because of the unique nature of the insurance business, marshall technical facilities to combine and coordinate business and statistical experience which, if intelligently used, makes for more accuracy and stability of insurance rates. Congress recognized that such a process is definitely in the interests of the public. The bills establish the principles upon which such cooperation may take place, and the techniques may vary so long as the interests of the public are protected.

Sec. 7. Deviations

> Every member of or subscriber to a rating organization shall adhere to the filings made on its behalf by such organization except that any such insurer may make written application to the (commissioner) for permission to file a uniform percentage decrease or increase to be applied to the premiums produced by the rating system so filed for a kind of insurance, or for a class of insurance which is found by the (commissioner) to be a proper rating unit for the application of such uniform percentage decrease or increase, or for a subdivision of a kind of insurance (1) comprised of a group of manual classifications which is treated as a separate unit for rate making purposes, or (2) for which separate expense provisions are included in the filings of the rating organization. Such application shall specify the basis for the modification and shall be accompanied by the data upon which the applicant relies. A copy of the application and data shall be sent simultaneously to such rating organization. The (commissioner) shall set a time and place for a hearing at which the insurer and such

> rating organization may be heard and shall give them not less that ten days' written notice thereof. In the event the (commissioner) is advised by the rating organization that it does not desire a hearing he may, upon the consent of the applicant, waive such hearing. The (commissioner) shall issue an order permitting the modification for such insurer to be filed if he finds it to be justified and it shall thereupon become effective. He shall issue an order denying such application if he finds that the modification is not justified or that the resulting premiums would be excessive, inadequate or unfairly discriminatory. Each deviation permitted to be filed shall be effective for a period of one year from the date of such permission unless terminated sooner with the approval of the (commissioner).

The word "deviation" as used in this section perhaps needs some clarification. It is not synonymous with any change in or addition to filings of rating organizations by non-members, for instance, who are using the manuals of the rating organization.

> "The term 'deviation' has no relationship whatever to new rates or rating systems filed directly with the supervisory authority by an insurer which is not a member or a subscriber of a rating organization. This is true even though such insurer may use the manuals or experience data of some rating organization as a part of the information and data supporting its filing. When an independent insurer makes such a direct filing of rates which vary uniformly either up

or down from the rates filed by a rating organization whose manual or experience is used to support it still is not a 'deviation' but a direct filing.

"The word 'deviation' is not used to describe or refer to a rate change which an independent insurer files direct or a rate change which a rating organization makes in its own filings. . . The deviation is applied for only by a member or subscriber of a rating organization."*

The All-Industry Committee has pointed out that economical carriers should be allowed to pass on savings to their policy holders, and that deviations are conducive to competition within the membership of rating organizations. The bills make provisions for this. Favorable loss experience can result in savings also for the policy holder, which can and should be passed on to him. Without deviations there may be too much inflexibility in the law; but if the process of deviation is too flexible, the advantages of cooperation in determining those rates within the organiza- will be lost, and this may lead to a condition that would not constitute regulation that could be considered effective.

Sec. 8. Appeal by Minority

Any member of or subscriber to a rating organiza-

*23, p33

> may appeal to the (commissioner) from the action or decision of such rating organization in approving or rejecting any proposed change in or addition to the filings of such rating organization and the (commissioner) shall, after a hearing held upon not less than ten days' written notice to the appellant and to such rating organization, issue an order approving the action or decision of such rating organization or directing it to give further consideration to such proposal, or, if such appeal is from the action or decision of the rating organization in rejecting a proposed addition to its filings, he may, in the event he finds that such action or decision was unreasonable, issue an order directing the rating organization to make an addition to its filings, on behalf of its members and subscribers, in a manner consistent with his findings, within a reasonable time after the issuance of such order.
>
> If such appeal is based upon the failure of the rating organization to make a filing on behalf of such member or subscriber which is based on a system of expense provisions which differs, in accordance with the right granted in subdivision 2 of subsection (2) of Section 3, from the system of expense provisions included in a filing made by the rating organization, the (commissioner) shall, if he grants the appeal, order the rating organization to make the requested filing for use by the appellant. In deciding such appeal the (commissioner) shall apply the standards set forth in Section 3.

There is nothing at all compulsory in the bills pertaining to membership in or affiliated with a rating organization. It may develop that this section will be used by carriers whose membership in a rating organization is about the only reasonable and efficient way they can operate. For carriers not so situated, obvious courses of action are available, over and above this "appeal by minority"; e.g. they can file independently, or join other bureaus.

VIII THE ATTITUDE OF THE INDUSTRY TO THE NEW LEGISLATION

Since the SEUA decision in 1944 and the recommendation of the model bills by the AIC and NAIC, Uniform Rating Laws have been adopted by the vast majority of the various state legislatures. A few states made material changes in the laws before passage but these are definitely in the minority. In Texas, Louisana and Virginia--for example-the state fixes the rates for many lines; in California and Missouri the rates are filed upon demand by the Commissioner. As stated, however, those making such substantial changes in the model bills are relatively few. As the score now stands, rate regulation is now in effect in every state insofar as fire insurance is concerned; it exists everywhere but Idaho for such lines as casualty, fidelity and inland marine insurance.

The unfair trade practices sections of the act have been enacted into law by twenty-six states. This section of the state law is similar to the unfair trade practices section of the federal statute, the Federal Trade Commission Act. Under its provisions, as has been stated above, the Insurance Commissioner may issue cease and desist orders, enforceable by court injunction, for such unscrupulous business practices as false and misleading advertising,

the giving of secret rebates and discriminatory advertising allowances, defamation of competitors, and similar unwholesome devices.

In addition to the above at least ten jurisdictions have passed legislation outlawing inter-locking directorates as such is prohibited under the second of the great anti-trust statutes, namely the Clayton Act to which we have also already referred. Under the state version of the act, as under the federal version, interlocking directorates or the purchase of stock in a competing company is not forbidden unless the same tends to monopoly or to a substantial or unreasonable restraint of trade or elimination of competition.

In the field of Accident and Health insurance, forty-six states now require the filing with, and approval by, the state commissioner of policy forms for such coverage in advance of issuance. Under the usual statutory provision, such forms are denied approval if they contain any deceptive or misleading clauses or provisions. In this particular area, greater uniformity is constantly being sought by the promulgation of Official Guides by the joint action of the AIC and NAIC for use by state authorities in judging such forms as they are submitted for approval.

After this brief resume of the developments since the now celebrated SEUA case was handed down by the Supreme Court, it would be well to pause, for a moment, to consider the attitude of the industry during this period of great change. Immediately after the decision, and for a year or so subsequent to it, the insurance industry--both at the executive as well as the rank and file level--were considerably alarmed at the far reaching results of which the decision was capable. As was recently stated by the Chief Auditor of X Life Company in Boston, one of the leading such companies in the New England area, "It was as though the flood gates restraining pandemonium has suddenly and recklessly been thrown open." Nor was this surprising since state officials as well as insurance executives experienced a similar sensation feeling that the very foundation of state regulation and taxation had been shaken. Newspaper editorials, likewise, were in general "violently opposed to the decision."*

In time however, particularly after the passage of Public Law 15, establishing a moratorium to permit state legislatures to cope with the situation, the insurance industry bent themselves to the task of salvaging the situation with a remarkable energy and proportionate

*27, p.773

commendable results. As has already been stated, the task was not without its difficulties nor was the cooperation of a unanimous nature. There were, as could be expected--human nature being as it is--dissenters, in the industry and without, who blocked and delayed the formulation of the model bills. Despite the resistence, the major obstacles, as we know, were overcome and the model bills were drafted.

Since the SEAU decision several other important changes had materialized, which changes touch the very core of the industry as a whole. Some of the more relevent of these have been described by Franklin J. Marryott, General Counsel of the Liberty Mutual Insurance Company as follows:

1. Promulgation of uniform classifications of expenses.

2. Re-examination of the basis upon which underwriting profit will be allowed.

3. Development of improved classifications of fire occupancy hazards.

4. Development of formulae for adjusting rates more equitably on a class-by-class basis.

5. The introduction of experience rating plans for multiple location risks (contents) as, for example, the Pearl Plan, the Liberty Mutual Plan, the North American

Plan, the Escott Plan and the like--some of which seem to involve special expense treatment for this class and for the larger risks within the class.

6. A study of schedule rating practices and their application to a specific risk.

7. An examination of the justification for discounts for long term policies.

8. Controversy as to whether plans for installment payment of premiums are regulated under state regulatory laws.

9. Introduction of statistical plans for reporting experience upon an "earned premium-incurred losses basis, rather than upon a written-paid off basis.

a. REGULATION 30

Perhaps the most significant single impact felt by the insurance industry was the promulgation and eventual adoption by all states of the well-known Uniform Instructions For Classification of Expenses of Fire and Marine and Casualty and Surety Insurers or, as it is more commonly known, Regulation 30. In that the problem of rate fixing is so intimately associated with the question of company expenses, Commissioner Dineen of the State of New York in 1946 requested, and received, an appropriation from the

state legislature for the purpose of inquiring into the matter and making recommendations for a more uniform classification of expense item. That rate making is directly connected with expense accounting, is generally known. Serious difficulties blocked the path to intelligent rate fixing by the multiple variety of expense item classifications formerly used by the many companies operating under accounting procedures in effect for many decades. After several years of exhaustive research and study--to which members of the industry lent their vast resources of both talent and money--the Commission in 1947 issued the celebrated Regulation Thirty establishing uniform classifications of expense items for accounting purposes. As of January 1, 1949, the adoption of such classifications for those companies doing business in the state of New York--and this of course took in most, if not all, of the leading companies--was optional. Subsequent to January 1, 1950, however, the adoption was mandatory.

Even to a casual observer, the effects of such a regulation would seem to be of cataclysmic proportions. For the industry it meant the delegation to the junk heap of methods and accounting procedures adhered to for over a century. It meant the wholesale re-training of clerical

help, the complete revision of company records, a complete change of accounting methods and procedures, including form and policy revisions. It would be foolhardy to attempt to emphasize the importance of accounting and auditing departments in the insurance industry. Without exaggeration it is the very heart of the organization--the very organ pumping constantly the life blood into the many scattered and far reaching veins of the company. With such a sweeping effect upon such a vital part of the industry, Regulation 30 was truly a tremendous impact upon the industry as a whole

The attitude of the industry as a whole to Regulation 30, despite its troublesome impact, can best be summed up in the simple yet analytical words of Earl C. Fay, Comptrollerfor Liberty Mutual Insurance Company and a leading figure in this field in his own right when he said:

> "Regulation 30 was the best thing that could have happened for the industry. How can rates be fixed on a uniform basis unless it is known how the premium dollar is spent? To do this intelligently, uniformity is the only answer."

These sentiments were similarly voiced in substance by C. H. Brown, Chief Accountant of the Boston Branch of

Hardward Mutual Insurance company as well as Germanus M. Perino, Chief Auditor of the New England Mutual Life Insurance Company, and others in similar positions in other companies with whom the writer had occassion to discuss the problem in the preparation of this paper.

One significant, and in a sense, inexplicable, reaction to the writers query as to the effects of the SEAU decision on accounting procedures was the answer given by not a few of the insurance executives that the writer had occasion to interview while preparing this work. Mr. X, the Chief Auditor of a Life Insurance Company, for example, stated that the SEAU decision had absolutely no change upon the accounting methods and procedures of his company. He stated that he remembered when this particular decision was handed down that "There was a lot of talk about it for a while" but that it shortly died down and sofar as his experience was concerned nothing further was ever done about it. Substantially similar sentiments were voiced by Mr. Y, Chief Accountant of E Mutual Insurance who, for example, stated that not only was he unfamiliar with the SEAU decision but that there was never any doubt but what the matter of insurance was state, rather than federally, regulated. Still another Chief Auditor of C Mutual Company

stated that although Regulation 30 was unknown to him, nevertheless he was sure that it did not pertain in any way to his company on the basis that it was originally issued by the legislature of the state of New York. This divergence of opinion is brought out here, not in criticism of the industry, but merely because it appears to be significant. Of what it is significant, the writer is not sure, but it could very well be significant of the fact that the industry has long since shaken off its fear of the effects of the SEAU decision and has gradually accepted the regulatory inconveniences that such decision has caused as something to be borne as a necessity rather than feared and resisted.

At this point, however, it should be emphasized that the uniform classifications of expenses as required by Regulation 30, which has since been adopted by the legislatures of most, if not all, of the other states, is not a stagnant settled matter. It is constantly undergoing change and revisions for the good and convenience of the industry as well as the state authorities responsible for policing compliance with its requirements. For illustration, the announced agenda for the March 31, 1952 meeting of the Uniform Accounting Subcommittee which is to

be held in the Commodore Hotel, New York City contains the following topics for discussion and subsequent action.

"(1) Functional Distribution of Commissions and Brokerage.

"(2) Definition of the Expense Group--Acquisition, Field Supervision and Collection Expenses -

The following is quoted from the report of the Uniform Accounting Subdivision dated November 7, 1951 --'There is much dissatisfaction with the present definition of acquisition, field supervision and collection expenses. All segments of the industry are urged to seek a more acceptable definition.'

"(3) Other Expense Analyses

In the report of November 7, 1951 the Uniform Accounting Subcommittee it was stated: 'While the industry representatives express themselves as not averse to filing with the Subcommittee information on certain expense analyses, strong and unanimous opposition was voiced against the phraseology in the Subcommittee report. Therefore, that section of the Subcommittee's report dealing with 'Other Expense Analyses' was received and the

Subcommittee is directed to give further study to the subject.'"

The above are but a few of the items on this years agenda confronting the Uniform Accounting Subcommitee. Others are of a similar nature and all serve to illustrate that Regulation 30 and the impact that it proved to have upon the industry is likely to be continuing in its nature for some years to come.

SUMMARY AND CONCLUSION

In the celebrated case Paul v. Virginia, Mr. Justice Field declared that "issuing a policy of insurance is not a transaction in commerce. . . such contracts are not interstate transactions, though the parties be domiciled in different states." These words uttered in 1868 merely indicated the feeling of both the legislature and judiciary to that time to the effect that the business of insurance was not such that was subject to federal regulation but was purely a matter for state control. The Virginia case, and the sentiments voice therein, was regarded as the whole law on the subject by a long line of decisions for about seventy-five years until the decision in the Southeastern Underwriters Association case, in 1944, wherein the Supreme Court of the United States completely repudiated it by

holding that insurance fell within the commerce clause of the Constitution and was therefore subject to regulation by the federal government. The SEAU decision startled the bar by the apparent novelty of its doctrine in the face of such substantial precedent to the contrary. It disturbed the insurance profession more deeply because the federal anti-trust laws, as the Supreme Court construed them, forbade all price fixing agreements between business competitors, and thus seemed to threaten a return of the evils of unrestrained competition in premiums for fire insurance, which it was thought had been exorcised a generation before. The insurance industry thus found itself confronted with the necessity of meeting an old issue in a new form and on a nation wide scale. The situation was further complicated by anxiety less the decision that insurance was interstate commerce would have the effect of invalidating the system of state regulation and supervision already established.

Subsequent to the SEAU decision and prior to Congressional action clarifying their position under the existing structure of state regulation, insurance companies were in a difficult legal position. If they complied with the state laws then in existence (1944), in an attempt to avoid liability under those laws, their acts of compliance

would in many cases be in direct violation of the federal anti-trust laws. The companies could therefore be prosecuted by the United States Attorney General if they complied with the state's laws and by the Attorney Generals of the several states if they did not comply with them. In fact, some state laws like those of Wisconsin and New York required or encouraged insurance companies to belong to rating bureaus and in general to follow cooperative rate-making or rate-fixing procedure, similar to the procedure condemned by the SEAU case as a violation of the Sherman Act, the great anti-trust or anti-monopoly statute.

In view of this conflict of laws and out of consideration for the importance of the insurance industry to the national economy and welfare, the congress immediately instituted hearings to hear both sides of the controversy. In the course of these hearings it was brought out that there were other federal laws which would apply to insurance in addition to the Sherman and Clayton Acts, as for example the National Labor Relations Act and the Fair Labor Standards Act. Representatives of labor felt that since the application of these laws would place in jeopardy the union's status that it was not in the best interests of the public that insurance should be federally

regulated. They insisted that the application of the anti-trust statutes to the insurance business was a far cry from saying that the Federal government should regulate insurance companies.

After much testimony and many meetings, the trend toward the ultimate answer gradually became apparent. The solution was first indicated by Senators Hatch and O'Mahoney. They both pointed out that the industry should not have approached Congress for a blanket exemption from the anti-trust laws: it should have instead advanced some specific legislation for possible temporary exemption, or have listed such exemptions as were absolutely necessary. This would provide a period of adjustment and investigation to determine exact needs and to develop a system of operation for the rate-making process without destroying the effectiveness of either the anti-trust laws or state regulation in the interests of the public. Shortly thereafter the McCarran Act, called Public Law 15 of the 79th Congress was enacted.

Contrary to the then wishes of some branches of the Industry, Public Law 15 did not grant blanket exemption of the business of insurance from the provisions of the anti-trust laws. Essentially the Act established a moratorium period for the industry to allow time for it to make

the necessary internal adjustments and to provide the states with an opportunity to review their existing statutes, amend or clarify them, or pass additional laws. It was then provided that the federal anti-trust laws would be applicable to insurance after the moratorium "to the extent that such business is not regulated by state law." The moratorium was to last until January 1, 1948 but it was later extended to June 30, 1948 to allow Congress time to study the effect of action taken by the states during the interim, and also to accomodate some states whose legislatures met during the extension time.

During the moratorium period sincere efforts were made to establish standard rating laws to be adopted by the states, or to serve as valid guides by the states in amending their own rating laws in compliance with the Congressional intent as evidenced by Public Law 15. These efforts were joint in that they were participated in by the National Association of Insurance Commissioners on the one side, and an All-Industry Committee, composed of delegates and representatives of the various companies, agents, executives and underwriters of the insurance industry as a whole, on the other. The end result of such joint efforts was the drafting of model bills to serve as guides for state

legislatures in their search for compliance with the requirements of the McCarran Act.

The AIC bills as drafted were submitted for approval in June, 1946 at Portland, Oregon, and were accepted by the majority of the NAIC and AIC. Needless to say, in light of the internal conflicts there was some dissent. Nevertheless the bills were outstanding examples of a united effort to meet the challenge. Since that time they have been substantially adopted by most, if not all state legislatures; a bare minority modified the same materially in one particular or another.

The attitude of the vast majority of the industry both before and since the drafting and adoption of the model bills has been most exemplary. For all it meant great inconvenience and change, and at a great sacrifice in money and effort. Nevertheless the challenge was met, and despite the obstacles and difficulties, the goal for the most part was attained.

It would seem to be too early to arrive at any conclusive judgments as to the success or failure of the new rating laws and their administration. Such regulation as is envisioned by these laws, as a natural consequence, will require many further inconveniences and sacrifices,

in effort and money, to the industry as a whole. Insofar as such hardships do not work an increase in the cost of insurance, they will, unfortunately, not constitute matters of too great public concern.

"That is not to say, however," in the words of Henry S. Mosher, General Attorney for Allstate Insurance Company and Chairman of the Section on Insurance Law of the American Bar Association, "that the imposition upon these companies of quite unnecessary inconveniences and burdens will not become a matter of public concern. Such an administration, coupled with its deterring effect on the will to compete, could have a disastrous effect on competition in the insurance business. Since the public interest lies in the maintenance of competition, such an eventuality would make the undertaking of a new approach to the problem inevitable."

It is to be hoped however that such action will be unnecessary. If both the industry and the insurance commissioners will weigh their actions carefully, in the light of the purposes of the rating laws, and be ever conscious of the necessity for fostering competition, there is every probability that the present rate regulatory program will be successful, that state supervision will be preserved, and that the industry may face the future confidant of even greater achievement.

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45. International Textbook v. Pigg, 217 U.S. 91, 30 S.Ct. 481 (1910).
46. Kirchbaum Co. v.Walling,, 316 U.S. 517,62 S.Ct.1116(1942).
47. Liverpool & London Life & Fire Insurance Co. v. Oliver, 10 Wall.(77 U.S.)566 (1871).
48. N.L.R.B. v. J.L.Hudson Co., 135 F.(2d) 380 (1943).
49. New York Life Insurance Co. v. Cravens, 178 U.S. 389, 20 S.Ct. 962 (1900).
50. New York Life Insurance Co. v. Deer Lodge County, 231 U.S. 495, 34 S.Ct. 167 (1913).
51. Paul v. Virginia, 8 Wall.(75 U.S.)168 (1868).
52. Pensacola Telegraph Co. v. Western Union Telegraph Co. 96 U.S. 1 (1877).
53. Polish National Alliance v. N.L.R.B., 322 U.S. 643 (1944).
54. Prudential Co. v. Benjamin,66 S.Ct. 1411 (1946).
55. United States v. Masonite Corp., 316 U.S. 265 (1942).
56. United States v. South-Eastern Underwriters Association, 51 F. Supp. 712,(N.D.,Ga.)/1943/, 64 S.Ct.1164(1944).
57. Western Livestock v. Bureau of Revenue,303 U.S.250(1938).
58. Mcnard, Secretary of Agriculture v. Filburn, 317 U.S. 111, 63 S.Ct. 82 (1942).

VI. Constitutional and Legislative Enactments

59. Agriculture Adjustment Act of 1938, 70 U.S.C. 1340.
60. Association of Insurance Commissioners Model Bill.
61. Clayton Act, 15 U.S. C. 14 (1914).
62. Criminal Appeals Act, 18 U.S.C.682.
63. Fair Labor Standards Act, 29 U.S.C. 201(1940).
64. Federal Trade Commission Act, 15 U.S.C. 45 (1914).
65. Merchant Marine Act,41 Stat. 988 (1920).
66. National Labor Relations Act, 29 U.S.C. 151 (1940).
67. Public Law 15, S.1362, H.R.3269,78 Comg.,1st Session.
68. Robinson-Patman Act, 15 U.S.C. 13(1936).
69. Sherman Act, 15 U.S.C. 1(1890).
70. United States Constitution.

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