

Testimony  
*United States Senate Committee on the Judiciary*  
**The McCarran-Ferguson Act: Implications of Repealing the Insurers' Antitrust Exemption**  
June 20, 2006

**Mr. Donald Klawiter**

Chair, Section of Antitrust Law , American Bar Association

---

STATEMENT OF DONALD C. KLAWITER

Chair, ABA Section of Antitrust Law

On Behalf of the  
AMERICAN BAR ASSOCIATION

Before the  
Senate Judiciary Committee

CONCERNING REPEAL OF THE MCCARRAN-FERGUSON ACT OF 1945

June 20, 2006

Mr. Chairman and Members of the Committee:

I appreciate the opportunity to present the views of the American Bar Association on the subject of the insurance exemption from the antitrust laws, known as the McCarran-Ferguson Act of 1945. My name is Donald C. Klawiter, and I am the Chair of the Section of Antitrust Law of the American Bar Association and a partner in the Washington, DC office of Morgan, Lewis & Bockius LLP. I am appearing on behalf of the American Bar Association and its President, Michael Greco. My testimony today reflects the position of the American Bar Association.

I commend the Committee for its consideration of the repeal of the antitrust exemption for the insurance industry. Industry-specific exemptions from the antitrust laws are rarely justified. The antitrust law, and more specifically, the Sherman Act, has served the nation well for 115 years because it is a simple and very flexible statement of competition policy that is interpreted by the courts based on the facts and circumstances of each particular case. The interpretation of the Sherman Act certainly can apply across many industries with unique issues – and the insurance industry is certainly no exception. The benefits of antitrust exemptions almost never outweigh the potential harm imposed on society by the loss of competition. Such exemptions often are not necessary to eliminate or limit the risk of antitrust liability for procompetitive conduct, and the goals of such protection can be achieved in a manner consistent with established antitrust principles and enforcement policy.

The American Bar Association favors repeal of the McCarran-Ferguson Act, which largely exempts the insurance industry from the antitrust laws. We believe that the law should be replaced by a series of safe harbors to make clear that certain types of conduct by insurers are procompetitive and beneficial to the American economy. Other than the safe harbors, it is our strong position that insurance industry should be subject to the same antitrust rules as other industries. Congress has, in the past, eliminated exemptions for many industries with the demonstrable result that competition increased and flourished after the elimination of the exemption. The American economy, its consumers and the insurance industry will benefit in the long-run from the discipline of free and open

competition among insurers.

Why do we have an antitrust exemption for the insurance industry? I believe a brief historical review is helpful. In the latter half of the 19th century, dramatic growth in the fire insurance industry led to increased interest by the states in the regulation and taxation of insurance companies. In response, insurance companies, seeking to avoid such regulation, challenged the states' authority to regulate the insurance industry, contending that such regulation constituted a violation of the Commerce Clause. However, in *Paul v. Virginia*, 75 U.S. (8 Wall.) 168 (1868), the United States Supreme Court rejected the insurers' position, holding that the Commerce Clause did not preclude the states from regulating insurers.

In the wake of the Paul decision, state regulation of insurance increased significantly. Then, in 1944, the United States Supreme Court, in *United States v. South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1944), effectively overruled Paul, holding that insurance was interstate commerce and should be regulated under the Commerce Clause. In response, the very next year, Congress enacted the McCarran-Ferguson Act, 15 U.S.C. § 1011 et seq.

The Act provides the insurance industry with a limited exemption from the federal antitrust laws. Specifically, the McCarran-Ferguson Act exempts conduct if that conduct (1) constitutes "the business of insurance" (2) is "regulated by State Law" and (3) does not amount to an "agreement to boycott, coerce, or intimidate, or act of boycott, coercion, or intimidation." All three prongs of the McCarran-Ferguson Act must be satisfied for the exemption to attach to an insurer's conduct.

In determining whether conduct qualifies as "the business of insurance" under the McCarran-Ferguson Act's first prong, the courts have considered the following factors: (1) whether the activity has the effect of transferring or spreading a policyholder's risk; (2) whether the activity is an integral part of the policy relationship between insurer and insured; and (3) whether the activity is limited to entities within the insurance industry. See *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982); *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205 (1979). Notably, no single factor is determinative on this issue.

As to the second prong, courts have held that an activity is regulated by state law if the insurer is subject to general state regulatory standards. In addition, the quality of the regulatory scheme, or its enforcement, does not influence the availability of the exemption. *Hartford Fire Ins. Co. v. California*, 509 U.S. 794 (1993).

Finally, with respect to the third prong, the Supreme Court in *Hartford Fire* held that a boycott occurs, thus subjecting insurer conduct to the federal antitrust laws, when a refusal to deal is designed to pursue an objective "collateral" to the terms of the transaction in which the refusal to deal occurs.

The perception is widely held that the McCarran-Ferguson exemption from the antitrust laws permits insurers to manipulate the insurance mechanism and the price of insurance coverage collusively. Many claim that the exemption produces anticompetitive results to the detriment of consumers throughout the country. Specifically, proponents of repeal have claimed that:

- (1) rate service organizations facilitate collusion on prices;
- (2) consumers are often forced to purchase coverage they do not want to obtain the coverage they desire. These tying arrangements can be anticompetitive because they force consumers to pay for less desirable products to get high-demand products, especially when the tying is pervasive on a market-wide basis;

- (3) insurance companies are permitted to control the price at which insurance is offered to consumers, which reduces competition among agents; and
- (4) insurance companies are permitted to engage in market allocations, which control the number of competitors in a market and reduces competition.

Nearly twenty years ago, the American Bar Association formed a commission to study, among other things, the important policy issues associated with the application of the U.S. antitrust laws to the business of insurance. Following two years of discussion and debate, the ABA adopted a resolution recommending the repeal of the McCarran-Ferguson exemption to the antitrust laws, to be replaced by a series of safe harbors defining certain categories of exempt conduct.

The current activities of the Antitrust Modernization Commission, which will issue its report to the Congress in 2007, provide the opportunity and impetus for the antitrust bar generally, and the Section of Antitrust Law specifically, to revisit the issues associated with the McCarran-Ferguson antitrust exemption. The Section of Antitrust Law formed a task force of many of the most respected antitrust practitioners and academics to study various issues being considered by the Antitrust Modernization Commission. The Section, through the work of the task force, prepared a variety of different comments, including comments on the area of exemptions and immunities generally and on the McCarran-Ferguson exemption specifically. Just a week ago, the Section presented a symposium on important issues under consideration by the Antitrust Modernization Commission, and a panel of distinguished practitioners and academics discussed exemptions and gave specific focus to the need to “modernize” the insurance industry exemption. The comments of the Section of Antitrust Law to the Antitrust Modernization Commission on exemptions, and its specific comments on McCarran-Ferguson, restate and reaffirm the ABA’s thinking and recommendations from the late 1980s. The ABA recommendations are attached to this statement for your convenience.

It is the view of the American Bar Association that all conduct that does not fall within the specific safe harbors should be subject to the same antitrust rules that are applied to all other sectors of the American economy. The state action doctrine, which immunizes certain conduct from antitrust liability that arises from government action, should only immunize the conduct of insurance companies to the extent that conduct falls within one or more of the safe-harbors outlined in the attached ABA policy. The safe harbors are not intended to alter existing antitrust policy. They are intended merely to deter private litigation challenging conduct that, in the unique circumstances of the insurance industry, may actually promote competition.

Specifically, the ABA recommendation recognizes the benefits of safe harbors for the following conduct by insurance companies:

- (1) Insurers should be authorized to cooperate in the collection and dissemination of past loss-experience data so long as those activities do not unreasonably restrain competition, but insurers should not be authorized to cooperate in the construction of advisory rates or the projection of loss experience into the future in such a manner as to interfere with competitive pricing.
- (2) Insurers should be authorized to cooperate to develop standardized policy forms to simplify consumer understanding, enhance price competition and support data collection efforts, but state regulators should be given authority to guard against the use of standardized forms to unreasonably limit choices available in the market.
- (3) Insurers should be authorized to participate in voluntary joint-underwriting agreements in connection with such agreements to cooperate with each other in making rates, policy forms, and other essential insurance functions, so long as these activities do not unreasonably restrain competition.
- (4) Insurers participating in residual market mechanisms should be authorized in connection with such

activity to cooperate in making rates, policy forms, and other essential insurance functions so long as the residual market mechanism is approved by and subject to the active supervision of a state regulatory agency.

(5) Insurers should be authorized to engage in any other collective activities that Congress specifically finds do not unreasonably restrain competition in insurance markets.

These safe harbors are intended to protect legitimate procompetitive joint activity by insurers while still subjecting the insurance industry to the antitrust rule of law. While much, if not all, of the safe harbor conduct would be permissible or even encouraged under current antitrust precedent, the idea of the safe harbors is to remove all doubt, and hence to discourage private suits challenging such procompetitive conduct.

The American Bar Association position also makes clear that the states should retain the authority to regulate the business of insurance, except in the unusual circumstances where the regulatory objective can only be accomplished through federal involvement.

While this hearing is considering the broader implications of the antitrust exemption for the business of insurance, I wish to comment briefly on S.1525, which would remove the antitrust exemption in the medical malpractice insurance area. S.1525 is an outstanding first step along the road to a sensible application of the antitrust laws to the insurance industry and seeks to ensure that the same rules of competition apply to the insurance industry as apply to all other aspects of American business. The same concerns and considerations that animate S.1525 apply with equal force to areas of the insurance industry outside of the medical malpractice context. Moreover, Section 3 of S. 1525 provides for what we have referred to as safe harbors for certain procompetitive conduct. We would urge the Congress to spell out those safe harbors more expressly in any legislation.

I would add one word of caution regarding the specific language of S. 1525. Just as the insurance industry should not be subject to an antitrust exemption, it should not be subject to a more rigorous antitrust standard than the rest of American industry, and I do not believe that the bill's intention is to impose more demanding antitrust standards on the insurance industry. The language of the bill, however, could be read to condemn activity that would be permissible under the antitrust laws. Some activities that could be labeled by some as "price fixing" or "market allocation" could have procompetitive justifications that would make them permissible under the antitrust laws. For instance, the antitrust laws generally permit manufacturers to set exclusive territories for their downstream distributors, even though such conduct could be construed as vertical "market allocation." These terms have very specific meanings in the existing case law relating to the Sherman Act and it should clearly not be the intent of this very constructive legislation to place a greater burden on the insurance industry than on other industries.

Thank you for the opportunity to appear before you today to present the views of the American Bar Association. Legislation to repeal the McCarran-Ferguson antitrust exemption and replace it with the safe harbors outlined above promises to serve consumers by promoting competition in the insurance industry. Competition is the hallmark of the American economy. The United States has very successfully spread the gospel of competition to the rest of the world – with remarkable results in international acceptance and enforcement over the past ten years. Special treatment for certain industries makes us look inconsistent or even hypocritical to those we seek to educate and influence in the rest of the world. The American Bar Association believes strongly that competition in the insurance industry can be enhanced, consistent with necessary joint activities, to the benefit of all segments of our society.

I would be happy to answer any questions you may have.

Resolution Adopted By The  
 American Bar Association  
 House of Delegates  
 February 1989

BE IT RESOLVED, That the American Bar Association adopts the following recommendation:

1) The current McCarran-Ferguson exemption to the antitrust laws should be repealed and replaced with legislation containing the following features:

(1) Insurers should be made subject to general antitrust laws but provided with authorization to engage in specified cooperative activity that is shown to not unreasonably restrain competition in the industry.

(2) Insurers should be authorized to cooperate in the collection and dissemination of past loss experience data so long as those activities do not unreasonably restrain competition but should not be authorized to cooperate in the construction of advisory rates or the projection of loss experience into the future in such a manner as to interfere with competitive pricing.

(3) Insurers should be authorized to cooperate to develop standardized policy forms in order to simplify consumer understanding, enhance price competition and support data collection efforts, but state regulators should be given authority to guard against the use of standardized forms to unreasonably limit choices available in the market.

(4) Insurers should be authorized to participate in voluntary joint underwriting agreements and in connection with such agreements to cooperate with each other in making rates, policy forms, and other essential insurance functions so long as these activities do not unreasonably restrain competition.

(5) Insurers participating in residual market mechanisms should be authorized in connection with such activity to cooperate in making rates, policy forms, and other essential insurance functions so long as the residual market mechanism is approved by and subject to the active supervision of a state regulatory agency.

(6) Insurers should be authorized to engage in such other collective activities that Congress specifically finds do not unreasonably restrain competition in insurance markets.

(7) State regulation of insurance rates should not exempt insurers from the antitrust laws under the state action doctrine, except as specified in Recommendation B.1(1) to B.1(6). Other non – rate regulation by a state should not exempt insurers from the antitrust laws unless that regulation satisfies the requirements of the state action doctrine and the regulation is shown to not unreasonably restrain competition.

2) States should retain the authority to regulate the business of insurance. The federal government should defer to state regulation except in those unusual circumstances where the regulatory objective can only be effectively accomplished through federal involvement.