



AMERICAN BAR ASSOCIATION

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**Submitted on behalf of the
AMERICAN BAR ASSOCIATION**

**to the
Committee on the Judiciary
United States Senate**

**CONCERNING S. 1681, “THE HEALTH INSURANCE
INDUSTRY ANTITRUST ENFORCEMENT ACT OF 2009”**

October 20, 2009

Mr. Chairman and Members of the Committee:

On behalf of the American Bar Association (“ABA”), which has almost 400,000 members, I appreciate the opportunity to submit to you the ABA’s views concerning S. 1681, The Health Insurance Industry Antitrust Enforcement Act of 2009. The Antitrust Law Section has frequently noted its opposition to industry-specific exemptions from the antitrust laws, finding them to be rarely justified. Accordingly, the ABA advocates a repeal of the McCarran-Ferguson exemption, rendering the federal antitrust laws applicable to the insurance industry. However, to deter unwarranted private litigation testing the limits of permissible insurer conduct absent an exemption, the current ABA Policy further recommends that a limited number of “safe harbor” exemptions be created for certain demonstrably procompetitive forms of conduct.

1. The ABA’s Views of the McCarran-Ferguson Antitrust Exemption

The ABA believes that the McCarran-Ferguson Act’s antitrust exemption should be repealed for the insurance industry and replaced with a series of “safe harbor” protections for certain forms of collective insurer conduct that are unlikely to cause anticompetitive harm to consumers. The underlying rationale for the American Bar Association’s position is that the Sherman Act has served the nation well for nearly 120 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. This flexibility eliminates, in most cases, the need for industry-specific exemptions. Moreover, the benefits of such exemptions rarely outweigh the potential harm imposed on society by the loss of competition resulting from such exemptions, and often are not necessary to limit the risk of deterring procompetitive conduct. In short, the objectives and goals of the McCarran-Ferguson exemption can be achieved in a manner consistent with established antitrust principles and enforcement policy, thus rendering the

exemption unnecessary, provided “safe harbors” are created, as I explain in more detail in this statement.

Consistent with these general principles, the American Bar Association has supported McCarran-Ferguson reform in the past, most recently in my testimony before the House Judiciary Committee Subcommittee on Courts and Competition Policy that I presented to the Subcommittee on October 8, 2009. In June of 2006, testimony was presented before your Committee by Don Klawiter, the Chair of the Section of Antitrust Law of the ABA at that time. The ABA has consistently expressed the view that the McCarran-Ferguson Act’s antitrust exemption should be repealed for the entire insurance industry – not just with respect to the health insurance and medical malpractice insurance industries, as S. 1681 would do – and replaced with a series of “safe harbor” protections for certain forms of collective insurer conduct that were unlikely to cause anticompetitive harm to consumers. To the extent that S. 1681 constitutes a first step in this direction, by repealing the antitrust exemption for these two types of insurance, the American Bar Association would support legislation along the lines of S. 1681, but only if it were amended to provide safe harbors for certain procompetitive conduct as set forth in our attached ABA policy.

As I just indicated, the American Bar Association position on McCarran is not new; over the last twenty years the ABA has consistently maintained that the McCarran-Ferguson Act should be repealed and replaced with certain “safe harbor” protections that I will outline below. See, e.g., [Comments to the Antitrust Modernization Commission Regarding the McCarran-Ferguson Act](#) (April 10, 2006), available at <http://www.abanet.org/antitrust/at-comments/2006/04-06/CI-AMC-McCarranFerguson.pdf>. The American Bar Association’s position – then and now – is that McCarran should be repealed and replaced by a series of safe

harbor protections for certain insurance industry conduct. For all other conduct, the American Bar Association position is that the insurance industry should be subject to the same antitrust rules as other industries. Before addressing some of the specifics of the proposed bill, I believe that a brief historical review of the origins of the McCarran-Ferguson Act is helpful.

Why do we have an antitrust exemption for the insurance industry? 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 therefore subject to federal regulation. In response, the very next year, Congress enacted the McCarran-Ferguson Act, 15 U.S.C. § 1011 *et seq.*, seeking to ensure that the regulation of the insurance industry remained principally the province of the states.

The Act provides the insurance industry generally –not just health insurers and medical malpractice insurers - 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 (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 held in *Hartford Fire* 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.

With this as background, 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 safe harbors are not intended to alter existing antitrust

policy; rather, they are intended to serve the important objective of deterring private litigation that might, post-exemption, challenge conduct that, in the unique circumstances of the insurance industry, may actually promote competition. The ABA's recommendation, which is attached to this statement for your convenience, 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 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.

(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.

Turning back now to S. 1681, the American Bar Association would support legislation along the lines of S. 1681, but only if it is amended to provide safe harbors for conduct that is procompetitive. The American Bar Association believes that the safe harbor provisions outlined above, that have been included in several other McCarran repeal proposals over the years but are not contained in S. 1681, are necessary amendments to the legislation.

At the same time, repeal of McCarran without the creation of these safe harbors would not be desirable because it would leave a degree of uncertainty regarding the permissible scope of insurer interaction, potentially causing consumer harm. While Assistant Attorney General Varney testified before your Committee that she believed that activities such as the sharing of historical claims data is well recognized as permissible conduct that would likely not be subject to challenge, that is no guarantee against possible litigation. Because there is no case law on the insurance-related issues that would arise, it is not entirely clear what forms of collective action would be allowed if the McCarran-Ferguson exemption was repealed in all respects. Business review letters from the Department of Justice, while often helpful in providing guidance to the business community, take considerable time to process and, faced with such uncertainty, many companies might avoid collective action that could be procompetitive for fear of criminal or civil

penalties. Uncertainty will only be removed after expensive litigation and the reconciliation of potentially conflicting judicial interpretations.

In addition, while the American Bar Association's view is that 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 either. While I do not believe that the bill's intention is to impose more demanding antitrust standards on the insurance industry than other industries, the bill's broad prohibition on "price fixing," "bid rigging" and "market allocations" could potentially be read to condemn activity that would be otherwise permissible under the antitrust laws. Specifically, some activities that might be characterized as "price fixing" or "market allocation" could have procompetitive justifications that would make them permissible under current antitrust doctrine. For example, the antitrust laws generally permit manufacturers to set exclusive territories for their downstream distributors, even though such conduct could be construed as a vertical "market allocation." These terms have very specific meanings in the existing case law interpreting the Sherman Act, and it should clearly not be the intent of this legislation to place a greater burden on the insurance industry than on other industries. Accordingly, the language of Section 3 of the bill could be clarified by adding the bold language as follows:

Notwithstanding any other provision of law, nothing in the Act of March 9, 1945 (15 U.S.C. 1011 et seq., commonly known as the "McCarran-Ferguson Act"), shall be construed to permit health insurance issuers (as defined in section 2791 of the Public Health Service Act (42 U.S.C. 300gg-91) or issuers of medical malpractice insurance to engage in any form of price fixing, bid rigging, or market allocations **that contravenes federal antitrust law** in connection with the conduct of the business of providing health insurance coverage (as defined in such section) or coverage for medical malpractice claims or actions.

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.

Thank you for the opportunity to present the views of the American Bar Association. We would be happy to work with your Committee on the legislation and to answer any questions you might 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.