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Clarification of the McCarran-Ferguson Act's Antitrust Exemption for the Business of Insurance: Group Life & (and) Health Insurance Co. v. Royal Drug Co.

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III. CONCLUSION

In *American Transfer & Storage Co. v. Brown* the Dallas court of civil appeals addressed the issue of whether the Carmack Amendment to the Interstate Commerce Act preempts the DTPA. In holding that the Carmack Amendment does not preempt the DTPA, the court focused its analysis on the divergent purposes of the two statutes, concluding that the DTPA does not obstruct the full purposes and objectives of the Carmack Amendment. To support its preemption analysis, the court looked to the United States Supreme Court's decision in *Huron Portland Cement Co. v. City of Detroit*. Subsequent Supreme Court decisions, however, suggest that a preemption analysis on a comparison of the statutes' purposes is no longer valid. Moreover, *Huron* is of limited precedential value because it addressed a state's deeply rooted interest in regulating local pollution problems.

Judicial precedent suggests that the scope of the Carmack Amendment is broader than that delineated by *Brown*. The Supreme Court has found that transactions incident to the interstate transportation of goods, even though a bill of lading has not been issued, are within the purview of the amendment. The Supreme Court has also declared that the provisions of the Carmack Amendment are broad enough to include all damages resulting from any carrier breach of duty within its transportation function. These authorities require the conclusion that American's representations were within the amendment. Applying the DTPA to Brown's claim obstructed the amendment's declared purpose of providing uniformity for carrier liability for loss of, or damage to, interstate shipments. The effect of the *Brown* decision is again to subject carriers operating in several states to diverse measures of damages.

The *Brown* court was presented with a second issue of whether a consumer may recover damages for mental anguish under the DTPA. The court concluded that the DTPA did not liberalize common law rules relating to recovery for mental anguish. Accordingly, as Brown could not recover for mental anguish under common law, the court concluded that Brown could not recover for mental anguish under the DTPA.

Bill Van Wagner

Clarification of the McCarran-Ferguson Act's Antitrust
Exemption for the Business of Insurance: Group
Life & Health Insurance Co. v. Royal Drug Co.

As part of a state-approved plan to provide group health insurance coverage in Texas, Group Life and Health Insurance Company, also known as Blue Shield of Texas, offered a plan of prescription drug insurance under which the insured would pay two dollars for each prescription drug

purchased from a participating pharmacy. To enlist participant pharmacies Blue Shield offered to enter into a Pharmacy Agreement with each licensed pharmacy in San Antonio.¹ If a policyholder patronized a non-participating pharmacy, he was required to pay the full price for a drug and then was allowed only partial reimbursement from Blue Shield.² Eighteen nonparticipating pharmacies brought an antitrust action against Blue Shield and three participating pharmacies, alleging that the Pharmacy Agreements resulted in price-fixing and a boycott of nonparticipating pharmacies in violation of the Sherman Act.³ The defendants argued that the Pharmacy Agreements were exempt from the antitrust laws under section 2(b) of the McCarran-Ferguson Act⁴ because the agreements were the "business of insurance."⁵ The district court granted summary judgment for the defendants.⁶ On appeal the United States Court of Appeals for the Fifth Circuit reversed, concluding that the Pharmacy Agreements were not part of the "business of insurance" for the purposes of section 2(b) of the McCarran-Ferguson Act and therefore were subject to antitrust scrutiny.⁷ In order to resolve an intercircuit conflict over the meaning of

1. Under the terms of the Pharmacy Agreement Blue Shield agreed to reimburse the pharmacy for the pharmacy's cost of acquiring the drug. Thus, participation in the plan was effectively limited to those pharmacies that could afford to distribute drugs for a \$2 markup.

2. Blue Shield would pay the policyholder 75% of the difference between \$2 and the full price charged by a nonparticipating pharmacy. For example, if the full price for a drug was \$10, the insured would pay the nonparticipating pharmacy \$10 and would receive \$6 from Blue Shield. Six dollars represents 75% of \$8, the difference between the \$10 retail price and \$2. Thus, the insured's net cost is \$4. In contrast, if he purchased the drug at a participating pharmacy his net cost is only \$2. Therefore, the plan encourages insureds to patronize pharmacies participating in the plan.

3. 15 U.S.C. §§ 1-7 (1976). Section 1 provides in part: "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States . . . is declared to be illegal . . ."

4. 15 U.S.C. § 1012(b) (1976).

5. The McCarran-Ferguson Act, 15 U.S.C. §§ 1011-1015 (1976) provides in part: § 1011. Declaration of policy

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.

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

(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, unless such Act specifically relates to the business of insurance . . .

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

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

6. 415 F. Supp. 343 (W.D. Tex. 1976).

7. 556 F.2d 1375 (5th Cir. 1977).

the term "business of insurance,"⁸ the United States Supreme Court granted certiorari. *Held, affirmed*: The Pharmacy Agreements do not constitute the "business of insurance" within the meaning of section 2(b) of the McCarran-Ferguson Act and thus are not exempt from the application of federal antitrust law. *Group Life & Health Insurance Co. v. Royal Drug Co.*, 440 U.S. 205 (1979).

I. THE MCCARRAN-FERGUSON ACT ANTITRUST EXEMPTION

In *United States v. South-Eastern Underwriters Association*⁹ the Supreme Court held that insurance transactions were interstate commerce¹⁰ and subject to federal antitrust laws.¹¹ This decision ended almost a century of exclusive regulation by the states of the insurance industry.¹² The furor¹³ over this decision prompted congressional passage of the McCarran-Ferguson Act¹⁴ one year later.¹⁵

8. The decision of the Fifth Circuit conflicted with previous decisions of the Third Circuit (*Frankford Hospital v. Blue Cross*, 554 F.2d 1253 (3d Cir. 1977)), the Fourth Circuit (*Anderson v. Medical Serv.*, 551 F.2d 304 (4th Cir. 1977)), and the District of Columbia Circuit (*Proctor v. State Farm Mut. Auto. Ins. Co.*, 561 F.2d 262 (D.C. Cir. 1977), *vacated and remanded*, 99 S. Ct. 1417, 58 L. Ed. 2d 631 (1979)).

9. 322 U.S. 533 (1944). The defendants were charged with conspiring to fix insurance rates and commissions. The Court specifically condemned such activities after finding that Congress did not intend that the business of insurance should be exempt from the operation of the Sherman Act. *Id.* at 562. *See generally* Partridge, *States Rights and Insurance—After S.E.U.A.*, 1945 *INS. L.J.* 265.

10. The Court stated that "[n]o commercial enterprise of any kind which conducts its activities across state lines has been held to be wholly beyond the regulatory power of Congress under the Commerce Clause. We cannot make an exception of the business of insurance." 322 U.S. at 553.

11. The Court concluded: "A general application of the [Sherman] Act to all combinations of business and capital organized to suppress commercial competition is in harmony with the spirit and impulses of the times which gave it birth." *Id.* The Court also stated: "By no means [did] . . . the Congress of 1890 specifically [intend] to exempt insurance companies from the all-inclusive scope of the Sherman Act." *Id.* at 560.

12. *Paul v. Virginia*, 75 U.S. (8 Wall.) 168, 183 (1869), the leading case before *South-Eastern Underwriters*, contained a dictum to the effect that the "[i]ssuing [of] a policy of insurance is not a transaction of commerce." It was therefore assumed by many that the federal government had no authority over the insurance industry under the commerce clause. As a result, there was a tradition of exclusive state regulation of insurance transactions. *See, e.g.*, *New York Life Ins. Co. v. Deer Lodge County*, 231 U.S. 495 (1913); *Hooper v. California*, 155 U.S. 648 (1895). *See generally* B. GAVIT, *THE COMMERCE CLAUSE OF THE UNITED STATES CONSTITUTION* (1970); Powell, *Insurance as Commerce in Constitution and Statute*, 57 *HARV. L. REV.* 937 (1944).

13. After the Court's decision segments of the insurance industry argued that application of the antitrust laws to the industry was not feasible and that a total exemption from the federal antitrust laws was necessary for the conduct of business. The insurance industry contended that if rate fixing were eliminated, the resulting price competition would threaten the financial stability of many companies. Further, the vigorous enforcement of the antitrust laws would prevent the industry from pooling loss statistics and thereby hamper their ability to compute premium rates. *See generally* Note, *Federal Regulation of Insurance Companies: The Disappearing McCarren Act Exemption*, 1973 *DUKE L.J.* 1340. Other groups in the industry, as well as state insurance officials, focused on the need to preserve state regulatory and taxing powers. As one commentator wrote after *South-Eastern Underwriters*: "[t]he validity of every state statute, court decision, and departmental ruling relating to regulation or taxation of insurance became immediately questionable." E. SAWYER, *INSURANCE AS INTERSTATE COMMERCE* 51 (1945).

14. *See* note 5 *supra*.

15. *See generally* Note, *A Year of S.E.U.A.*, 23 *CHI.-KENT L. REV.* 317 (1945) (discuss-

The McCarran-Ferguson Act exempts from scrutiny under the federal antitrust laws insurance company conduct that is (a) the "business of insurance," (b) regulated by the state, and (c) not a boycott.¹⁶ To invoke the exemption, all three statutory requirements must be satisfied.¹⁷ Therefore, if the challenged activities do not constitute the business of insurance, the McCarran-Ferguson Act is inapplicable despite the existence of state regulation or the absence of a boycott.¹⁸ For this reason, the characterization of what constitutes the "business of insurance" is critical.

The McCarran-Ferguson Act does not define the term "business of insurance." Additionally, congressional debate on the issue was brief and ambiguous.¹⁹ Among insurance scholars there is no consensus as to the meaning of the term²⁰ and the courts have had scant opportunity to consider the issue in the thirty-four years since the Act's passage.²¹ Nevertheless, two cases, *SEC v. Variable Annuity Life Insurance Co. of America*²² and *SEC v. National Securities, Inc.*,²³ have indicated how the Supreme

ing state insurance commissioners' and insurance industry pressures on Congress prior to passage of the McCarran-Ferguson Act).

16. 15 U.S.C. §§ 1012 & 1013(b) (1976). See generally Note, *Insurance Under The McCarran-Ferguson Act*, 33 GEO. L.J. 321 (1945).

17. See, e.g., *Battle v. Liberty Nat'l Life Ins. Co.*, 493 F.2d 39, 49 (5th Cir. 1974), cert. denied, 419 U.S. 1110 (1975); *Travelers Ins. Co. v. Blue Cross*, 481 F.2d 80, 82 (3d Cir.), cert. denied, 414 U.S. 1093 (1973). See generally Rosdeitcher, *Recent Judicial Interpretations of the McCarran Act Antitrust Exemption*, 13 FORUM 873 (1978).

18. See, e.g., *SEC v. National Sec., Inc.*, 393 U.S. 453 (1969); *SEC v. Variable Annuity Life Ins. Co. of America*, 359 U.S. 65 (1959); *American Family Life Assurance Co. v. Planned Marketing Assocs.*, 389 F. Supp. 1141 (E.D. Va. 1974); *American Gen. Ins. Co. v. FTC*, 359 F. Supp. 887 (S.D. Tex. 1973), aff'd, 496 F.2d 197 (5th Cir. 1974).

19. See generally *SEC v. National Sec., Inc.*, 393 U.S. 453, 458-59 (1969); Rosdeitcher, *supra* note 17. The legislative history of the McCarran-Ferguson Act provides support for conflicting conclusions as to what Congress meant by the term business of insurance. For example, one commentator has written that there is no indication that Congress understood the term business of insurance to include anything more than its plain meaning suggests. Weller, *The McCarran-Ferguson Act's Antitrust Exemption for Insurance: Language, History and Policy*, 1978 DUKE L.J. 587, 628. This plain meaning concept would include such activities as cooperative service agreements, reinsurance agreements, the use of advisory rates, rules or plans, and the use of mandatory state approved rates or forms. See 90 CONG. REC. A4406 (1944). Further, Congress seemed to assume that the theory of insurance was the distribution of risks according to hazard, experience, and the law of averages. See S. REP. NO. 1112, 78th Cong., 2d Sess. 6 (1944); 90 CONG. REC. 6526 (1944) (remarks of Rep. Hancock). As a result, because cost containment efforts reflected none of these factors and were within the control of the insurance companies, they were not considered to be the business of insurance. See H.R. REP. NO. 873, 78th Cong., 1st Sess. 8-9 (1943). Nevertheless, remarks by Senator Murdock have been cited to support the broader conclusion that the business of insurance was intended by many Congressmen to be synonymous with insurance companies. See 91 CONG. REC. 480 (1945).

20. One expert remarked: "Because the purposes for which definitions of insurance are invoked differ, no single definition will serve always, even in a single jurisdiction." R. KEETON, *BASIC TEXT ON INSURANCE LAW* 2 (1971). For a more complete discussion on the variety of meanings attributed to insurance, see *id.* at 2-11.

21. See Rosdeitcher, *supra* note 17, at 873.

22. 359 U.S. 65 (1959). See generally Note, *Insurance—Securities—Variable Annuity Contracts*, 12 SW. L.J. 514 (1958); Note, *Annuities—Government Regulation—Insurance—Investment—Sale of Variable Annuity Contracts Held Subject to Federal Securities Regulation*, 38 TEXAS L. REV. 248 (1959).

23. 393 U.S. 453 (1969). See generally *The Supreme Court, 1968 Term*, 83 HARV. L.

Court might define the term business of insurance when directly confronted with the question.²⁴

In *Variable Annuity Life* the respondent corporations, which called themselves life insurance companies and were regulated by the insurance commissioners of several states, offered variable annuity contracts²⁵ for sale in interstate commerce. The Securities Act of 1933 specifically excludes any insurance policy and any insurance company from its coverage.²⁶ The respondents argued that the variable annuity contracts they offered were insurance within the ambit of this exclusion.²⁷ The Court found that the annuity contracts were neither insurance nor annuity policies.²⁸ Central to this conclusion was the Court's statement that insurance involved some investment risk-taking on the part of the insurance company, an element absent from the variable annuity contract.²⁹ The Court emphasized the underwriting of risks as "the one earmark of insurance as it has commonly been conceived of in popular understanding and usage."³⁰

In *National Securities* the Securities and Exchange Commission alleged that National Securities made misrepresentations and omissions of material facts in an attempt to secure stockholder approval of a merger between an independent insurance company and an insurance company controlled by National Securities. Despite SEC intervention, the merger was approved by the Arizona Director of Insurance and later consummated. The SEC sought to unwind the merger, but National Securities argued that the federal securities laws were inapplicable because the McCarran-Ferguson

REV. 7, 252 (1969); Note, *Securities—Rule 10b-5—Shareholder Action Approving a Merger Is a Purchase or Sale of Securities Within the Antifraud Provisions of the Securities Exchange Act*, 47 TEXAS L. REV. 1238 (1969).

24. Although the Supreme Court has not directly dealt with the term business of insurance and the McCarran-Ferguson Act in an antitrust context, it has dealt with other issues under the Act. Three cases dealt with the validity of state regulation and taxation of insurance. Compare *Robertson v. California*, 328 U.S. 440 (1946), and *Prudential Ins. Co. v. Benjamin*, 328 U.S. 408 (1946), with *State Bd. of Ins. v. Todd Shipyards Corp.*, 370 U.S. 451 (1962). Two cases dealt with the preemptive effects of state law on federal law. Compare *FTC v. Travelers Health Ass'n*, 362 U.S. 293 (1960), with *FTC v. National Cas. Co.*, 357 U.S. 560 (1958). Two cases dealt with the preemptive effects of state insurance law in the context of admiralty. Compare *Wilburn Boat Co. v. Fireman's Fund Ins. Co.*, 348 U.S. 310 (1955), with *Maryland Cas. Co. v. Cushing*, 347 U.S. 409 (1954).

The Court did not specifically address the antitrust exemption until 1978. In *St. Paul Fire & Marine Ins. Co. v. Barry*, 438 U.S. 531 (1978), the issue was the meaning of the boycott exemption in § 3(b) of the McCarran-Ferguson Act. The adequacy of regulation by state law for the purposes of § 2(b) has yet to be considered by the Court.

25. The contracts had some of the features of conventional life insurance and annuity contracts with the exception that purchasers were entitled not to a fixed return but only to fluctuating amounts based on a pro rata participation in the companies' investment portfolios. 359 U.S. at 70-71.

26. 15 U.S.C. § 77c(a)(8) (1976).

27. See 359 U.S. at 70. The question common to the exemption provisions of the Securities Act of 1933 and § 2(b) of the McCarran-Ferguson Act is whether the insurance company and the contract it issues are subject to state insurance regulation.

28. *Id.* at 71-73.

29. *Id.* at 71. To the contrary, the annuitant assumed all of the risk under the contracts in question.

30. 359 U.S. at 73.

Act protects state insurance laws from preemption by federal law.³¹ The Court rejected this argument and held that a state statute for the protection of the interests of insurance company stockholders was not a state attempt to regulate the business of insurance.³² The Court noted that the McCarran-Ferguson Act was not designed to make the states supreme in regulating all the activities of insurance companies.³³ The language of the McCarran-Ferguson Act refers not to the persons or companies subject to state regulation, but to laws regulating the business of insurance.³⁴ The Court concluded that the core of the business of insurance was the contract of insurance, specifically "[t]he relationship between insurer and insured, the type of policy which could be issued, its reliability, interpretation and enforcement."³⁵ Therefore, although the Arizona statute applied only to insurance companies, such regulation was not within the scope of the McCarran-Ferguson Act because it operated to protect stockholders of the insurer as opposed to purchasers of insurance policies.³⁶

Prior to the Supreme Court's decision in *National Securities*, lower federal courts had little opportunity to define the limits of the antitrust exemption for the business of insurance.³⁷ The language in *National Securities* appeared to provide clear guidelines as to what constituted the business of insurance. Subsequently, relying on *National Securities*, the courts considered such concepts as the obligation of the insurance company to its insured as provided for in the contract of insurance,³⁸ the requisite closeness between the challenged conduct and the relationship between the insurer and policyholder,³⁹ and the reliability of the insurer.⁴⁰ Several courts further considered additional criteria such as whether state

31. 393 U.S. at 456; see note 5 *supra* for text of the McCarran-Ferguson Act.

32. 393 U.S. at 457.

33. *Id.* at 459 (quoting H.R. REP. NO. 143, 79th Cong., 1st Sess. 3 (1945)).

34. 393 U.S. at 459. According to the Court, the business of insurance would include the fixing of rates, the selling and advertising of policies, and the licensing of companies and their agents. *Id.* at 460.

35. *Id.* at 460. The Court added:

Undoubtedly, other activities of insurance companies relate so closely to their status as reliable insurers that they too must be placed in the same class. But whatever the exact scope of the statutory term, it is clear where the focus was—it was on the relationship between the insurance company and the policyholder.

Id.

36. *Id.*

37. *E.g.*, Hill v. National Auto Glass Co., 293 F. Supp. 295, 296 (N.D. Cal. 1968).

38. See Proctor v. State Farm Mut. Auto. Ins. Co., 561 F.2d 262 (D.C. Cir. 1977), *vacated and remanded*, 99 S. Ct. 1417, 58 L. Ed. 2d 631 (1979); Royal Drug Co. v. Group Life & Health Ins. Co., 556 F.2d 1375 (5th Cir. 1977).

39. See Proctor v. State Farm Mut. Auto. Ins. Co., 561 F.2d 262 (D.C. Cir. 1977), *vacated and remanded*, 99 S. Ct. 1417, 58 L. Ed. 2d 631 (1979); Battle v. Liberty Nat'l Life Ins. Co., 493 F.2d 39 (5th Cir. 1974), *cert. denied*, 419 U.S. 1110 (1975); Schwartz v. Commonwealth Land Title Ins. Co., 374 F. Supp. 564 (E.D. Pa. 1974); Hill v. National Auto Glass Co., 293 F. Supp. 295 (N.D. Cal. 1968).

40. See Royal Drug Co. v. Group Life & Health Ins. Co., 556 F.2d 1375 (5th Cir. 1977); Travelers Ins. Co. v. Blue Cross, 481 F.2d 80 (3d Cir.), *cert. denied*, 414 U.S. 1093 (1973); Manasen v. California Dental Servs., 424 F. Supp. 657 (N.D. Cal. 1976).

law treated the activities as the business of insurance,⁴¹ whether the activities had a substantial effect on insurance rates,⁴² whether the purpose of the activity was solely to control costs or included the intent to restrain trade,⁴³ and whether the business activity of the insurance company was peculiar to the insurance industry.⁴⁴ As a result, despite the apparent clarity of the Court's language in *National Securities*, in at least one situation⁴⁵ courts were sharply divided as to the meaning of the business of insurance.⁴⁶

41. See *Lawyers Title Co. v. St. Paul Title Ins. Corp.*, 526 F.2d 795 (8th Cir. 1975); *Royal Drug Co. v. Group Life & Health Ins. Co.*, 415 F. Supp. 343 (W.D. Tex. 1976).

42. See *Proctor v. State Farm Mut. Auto. Ins. Co.*, 561 F.2d 262 (D.C. Cir. 1977), *vacated and remanded*, 99 S. Ct. 1417, 58 L. Ed. 2d 631 (1979); *Travelers Ins. Co. v. Blue Cross*, 481 F.2d 80 (3d Cir.), *cert. denied*, 414 U.S. 1093 (1973).

43. See *Proctor v. State Farm Mut. Auto. Ins. Co.*, 561 F.2d 262 (D.C. Cir. 1977), *vacated and remanded*, 99 S. Ct. 1417, 58 L. Ed. 2d 631 (1979).

44. See *Royal Drug Co. v. Group Life & Health Ins. Co.*, 556 F.2d 1375 (5th Cir. 1977); *American Family Life Assurance Co. v. Planned Marketing Assocs.*, 389 F. Supp. 1141 (E.D. Va. 1974); *American Gen. Ins. Co. v. FTC*, 359 F. Supp. 887 (S.D. Tex. 1973), *aff'd*, 496 F.2d 197 (5th Cir. 1974).

45. The primary concern of Congress in the passage of the McCarran-Ferguson Act was preservation within the insurance industry of restraints on trade that applied to the business of insurance. Only activities between insurance companies, brokers, and agents were contemplated by Congress. See generally *Weller*, *supra* note 19, at 625-33. While the courts were in agreement as to the application of the McCarran-Ferguson Act exemption to intra-industry restraints of trade, a major disagreement existed when the restraint of trade was inter-industry. An inter-industry restraint of trade arises when the activities of an insurance company adversely affect the relationships between competing noninsurance industries. As one writer sees the issue:

The critical issue which has now arisen is whether the business of insurance encompasses conduct which very plainly affects the relationship between the insurance company and its policyholders, the reliability and solvency of the company and the obligations of the insurance company to its insured, but at the same time also affects integrally-related economic interests of health care providers and other industries which provide insured services. The issue is raised in the context of insurance company efforts to control costs of insured services, which in turn directly affect claims costs and premiums.

Rosdeitcher, *supra* note 17, at 876.

46. Compare *Proctor v. State Farm Mut. Auto. Ins. Co.*, 561 F.2d 262 (D.C. Cir. 1977), *vacated and remanded*, 99 S. Ct. 1417, 58 L. Ed. 2d 631 (1979) (insurance companies' agreement with repair shops to provide insureds with automobile repairs only at a prevailing rate was the business of insurance because of the close relation between the challenged conduct and the insurer-insured relationship), and *Schwartz v. Commonwealth Land Title Ins. Co.*, 374 F. Supp. 564 (E.D. Pa. 1974) (fees charged to sellers of real estate by title insurance companies and their agents were the business of insurance because of the close relation of the provision of services by realty sellers to the realty conveyance with which title insurance was associated), with *Battle v. Liberty Nat'l Life Ins. Co.*, 493 F.2d 39 (5th Cir. 1974) (insurance policies for burial benefits obtainable only through insurers' wholly owned subsidiary might not constitute the business of insurance), *cert. denied*, 419 U.S. 1110 (1975), and *Hill v. National Auto Glass Co.*, 293 F. Supp. 295 (N.D. Cal. 1968) (insurer's practice of placing repair business of its claimants with certain preselected glass installers did not constitute the business of insurance). Compare *Travelers Ins. Co. v. Blue Cross*, 481 F.2d 80 (3d Cir.) (agreements between insurance company and hospitals to assure performance of the insurer's obligation to insureds under the policy are closely related to the reliability of the insurer and therefore are the business of insurance), *cert. denied*, 414 U.S. 1093 (1973), and *Manasen v. California Dental Servs.*, 424 F. Supp. 657 (N.D. Cal. 1976) (contracts between nonprofit corporation engaged in administration and operation of prepaid dental care programs and participating dentists entitled to antitrust exemption as the business of insurance because the contracts directly related to insurer reliability), with *Royal Drug Co. v. Group*

II. GROUP LIFE & HEALTH INSURANCE CO. v. ROYAL DRUG CO.

The Supreme Court granted certiorari to resolve conflicts as to the meaning of the phrase business of insurance.⁴⁷ The sole issue before the Court was whether the Pharmacy Agreements were the business of insurance within the meaning of section 2(b) of the McCarran-Ferguson Act.⁴⁸ Justice Stewart, writing for the majority,⁴⁹ emphasized that the McCarran-Ferguson Act's language exempts the business of insurance and not the business of insurance companies.⁵⁰ He identified the spreading and the underwriting of risks as the primary elements of the business of insurance.⁵¹ The Court rejected Blue Shield's argument that the Pharmacy Agreements involved the underwriting of risks.⁵² The Court distinguished the insurance policies, which insured against the risk that policyholders would be unable to pay for prescription drugs during the period of coverage, from the Pharmacy Agreements, which the Court observed served only to minimize the costs Blue Shield incurred in fulfilling its underwriting obligations.⁵³ The Pharmacy Agreements, then, were merely arrangements by Blue Shield for the purchase of goods and services.⁵⁴

The Court noted that the core of the business of insurance, the relationship between the insurance company and the policyholder, did not exist between the parties to the Pharmacy Agreements.⁵⁵ The Pharmacy Agreements were separate contractual arrangements between Blue Shield and particular pharmacies.⁵⁶ Nevertheless, Blue Shield argued that the Pharmacy Agreements would result in cost savings to their policyholders and

Life & Health Ins. Co., 556 F.2d 1375 (5th Cir. 1977) (contracts between insurer and provider of benefits not related to reliability of insurer and therefore not the business of insurance).

47. 435 U.S. 903 (1978). If the Court had not granted certiorari, and indeed if the Court had reached a different decision in *Group Life & Health*, Congress probably would have chosen to deal with the issue during this term. Representative LaFalce has introduced six bills that would, if enacted, either amend or repeal the McCarran-Ferguson Act and create a Federal Insurance Commission. See H.R. REP. NOS. 1860-1866, 96th Cong., 1st Sess., 125 CONG. REC. H460 (daily ed. Feb. 5, 1979). See generally 125 CONG. REC. H449-50 (daily ed. Feb. 5, 1979) (remarks of Rep. LaFalce). See also Burgoyne, *Special Characteristics of the Business of Insurance*, 13 FORUM 911 (1978).

48. Blue Shield's insurance policies themselves were not at issue. Nor was the question of whether the Pharmacy Agreements were illegal under the antitrust laws before the Court.

49. Justice Stewart was joined by Justices White, Blackmun, Rehnquist, and Stevens.

50. 440 U.S. at 210.

51. *Id.* at 211. The majority relied almost exclusively on the Court's language in *Variable Annuity Life* and *National Securities*. See notes 22-36 *supra* and accompanying text.

52. 440 U.S. at 214. Blue Shield argued that the risk insured against was the possibility that the insured might either suffer a financial loss in the purchase of prescription drugs or be unable to purchase such drugs. In exchange for a premium Blue Shield assumed this risk by contracting with participating pharmacies to provide the insured with needed drugs. *Id.* at 213.

53. *Id.* The Court also pointed out the position taken by the United States in its amicus brief. There is an important distinction between risk underwriting and risk reduction. "By reducing the total amount it must pay to policyholders, an insurer reduces its liability and therefore its risk. But unless there is some element of spreading risk more widely, there is no underwriting of risk." *Id.* at 214 n.12.

54. *Id.* at 214.

55. *Id.* at 216; see *SEC v. National Sec., Inc.*, 393 U.S. 453, 460 (1969).

56. 440 U.S. at 216.

therefore would affect its status as a reliable insurer.⁵⁷ The Court responded that every business decision made by an insurance company has some impact on its reliability, yet these decisions do not automatically qualify as the business of insurance.⁵⁸

The Court's analysis of the legislative history of the McCarran-Ferguson Act reinforced its conclusion that the Pharmacy Agreements were not the business of insurance. The majority stated that the primary purpose of the Act was to insure that the states would continue to have the power to tax and regulate insurance companies⁵⁹ and that the secondary purpose was to create a partial exemption from the antitrust laws.⁶⁰ The scant references to the meaning of the business of insurance in the legislative history suggested to the majority that Congress understood the business of insurance to be the underwriting and spreading of risks.⁶¹ Further, Congress was convinced that cooperative rate-making was essential to informed risk underwriting.⁶² Therefore, allowing such cooperative activity between competitors was a prime concern of Congress in enacting the antitrust exemption.⁶³ The Court further examined what was commonly understood to be the business of insurance at the time that Congress enacted the McCarran-Ferguson Act. Arrangements similar to Blue Shield's Pharmacy Agreements were not construed at that time as insurance. Thus, the Court concluded that Congress could not have intended to broaden the definition of insurance to include such arrangements.⁶⁴

57. *Id.*

58. *Id.*

59. *Id.* at 217. After *South-Eastern Underwriters* the power of the states to regulate and tax insurance companies was threatened because, if insurance was interstate commerce, then the constitutionality of state regulation and taxation would be questionable. The McCarran-Ferguson Act operated to ensure that the states were free to regulate insurance companies without fear of commerce clause attack. *Id.* at 218 n.18; see notes 9-15 *supra* and accompanying text. Indeed, the Supreme Court on several occasions had stated specifically that the primary purpose of the McCarran-Ferguson Act was to protect state regulation and taxation of the insurance industry from commerce clause challenges. See, e.g., *FTC v. Travelers Health Ass'n*, 362 U.S. 293 (1960); *Wilburn Boat Co. v. Fireman's Fund Ins. Co.*, 348 U.S. 310 (1955); *Maryland Cas. Co. v. Cushing*, 347 U.S. 409 (1954); *Prudential Ins. Co. v. Benjamin*, 328 U.S. 408 (1946). See generally Whiting, *The Case for Retaining the Exemption*, 13 *FORUM* 927 (1978); Weller, *supra* note 19, at 599. But see Rosdeitcher, *supra* note 17; Note, *supra* note 13.

60. 440 U.S. at 218. Even assuming that Congress's primary concern was other than the preservation of state regulation and taxation of insurance companies, a total antitrust exemption for the business of insurance was not Congress's chief concern. Congress twice rejected bills that would have provided the insurance industry with a total exemption from the antitrust laws. See, e.g., 90 CONG. REC. 6565 (1944); S. 1362, 78th Cong., 1st Sess. (1943); H.R. REP. NO. 3270, 78th Cong., 1st Sess. (1943). See generally 91 CONG. REC. 1087 (1945); 90 CONG. REC. 8482 (1944).

61. 440 U.S. at 220. Factors involved in the underwriting and spreading of risks did not include insurance company efforts to control costs. See note 19 *supra*.

62. 440 U.S. at 221; see 90 CONG. REC. A4406 (1944).

63. 440 U.S. at 221; see 91 CONG. REC. 1485 (1945) (remarks of Sen. O'Mahoney); 91 CONG. REC. 1444 (1945) (remarks of Sen. O'Mahoney); 91 CONG. REC. 485 (1945) (remarks of Sen. Taft).

64. 440 U.S. at 229. Insurance was commonly understood as the payment of a premium against the risk of an uncertain contingency. When the contingency occurred policyholders were paid in cash rather than in goods and services. Service-benefit providers were corpora-

The majority stressed that exemptions from the antitrust laws are to be construed narrowly.⁶⁵ To extend the definition of the business of insurance to include such cost control measures as the Pharmacy Agreements would require exemption for all agreements insurers might make to keep their costs under control.⁶⁶ The Court maintained that this extension would not only have serious anticompetitive consequences⁶⁷ but would also ignore the language and purpose of the McCarran-Ferguson Act.⁶⁸ Clearly, the Court's decision is consistent with a tradition of narrow judicial interpretation of antitrust exemptions.⁶⁹

Writing for the dissent, Justice Brennan⁷⁰ defined the issue with greater specificity: Does the business of insurance include direct contractual arrangements or provider agreements⁷¹ between an insurance company and third parties to furnish benefits owed to the insurer's policyholders?⁷² The dissent reasoned that since the status of the underlying drug-benefit policy as the business of insurance was not challenged, then some provider agreements, including the challenged Pharmacy Agreements, should be considered part of the business of insurance.⁷³ According to Justice Brennan, congressional silence as to the meaning of "the business of insurance" indicates that Congress chose to phrase the exemption broadly.⁷⁴ The dissent

tions organized for the purpose of providing their members with medical services and hospitalization benefits in the event of illness rather than a cash indemnification. Generally, courts had held that service-benefit providers were not engaged in the business of insurance. *See* *Jordan v. Group Health Ass'n*, 107 F.2d 239 (D.C. Cir. 1939); *California Physicians' Serv. v. Garrison*, 155 P.2d 885 (Cal. App. 1945), *aff'd*, 28 Cal. 2d 790, 172 P.2d 4 (1946); *Commissioner of Banking & Ins. v. Community Health Serv.*, 129 N.J.L. 427, 30 A.2d 44 (1943); *State ex rel. Fishback v. Universal Serv. Agency*, 87 Wash. 413, 151 P. 768 (1915). *But see* *Cleveland Hosp. Serv. Ass'n v. Ebright*, 142 Ohio St. 51, 49 N.E.2d 929 (1943). The Court further observed that historically Blue Shield, as well as the courts, has maintained that Blue Cross and Blue Shield are not insurance companies. *See generally* S. LAW, BLUE CROSS WHAT WENT WRONG? (1976).

65. *See, e.g.*, *Abbott Labs. v. Portland Retail Druggists Ass'n*, 425 U.S. 1 (1976); *Connell Constr. Co. v. Plumbers Local 100*, 421 U.S. 616 (1975); *Federal Maritime Comm'n v. Seatrain Lines, Inc.*, 411 U.S. 726 (1973); *United States v. McKesson & Robbins, Inc.*, 351 U.S. 305 (1956).

66. 440 U.S. at 232. The Court illustrated this point with examples that included auto body repair shops, landlords, hospitals, physicians, and attorneys. *Id.* at 232 n.40.

67. *Id.* at 232. The Court based its statement on the well-known fact that physicians and health care providers dominate Blue Shield organizations. Because it is in the interest of these groups to set fee schedules as high as possible there is little incentive within Blue Shield to minimize costs. Assuming that its conclusion regarding the health care field is correct, the Court nevertheless fails to discuss the possible anticompetitive consequences of such agreements in other industries.

68. *Id.*

69. *See* note 65 *supra*.

70. Justice Brennan was joined by the Chief Justice and Justices Marshall and Powell.

71. Provider agreements (like the Pharmacy Agreements) are contractual arrangements between a service-benefit provider (such as Blue Shield) and third parties for the provision of benefits to policyholders in the form of goods and services.

72. 440 U.S. at 233.

73. *Id.* at 234. The dissent reached this conclusion because, unlike the majority, it concluded that the Pharmacy Agreements were an integral part of the insurance contract and therefore the two were indistinguishable.

74. *Id.* Congress, in fact, rejected bills that limited the business of insurance to a narrow specified list of practices. *See* S. REP. NO. 12, 79th Cong., 1st Sess. (1945); 90 CONG. REC. A4406 (1944).

argued that insurance is an evolving institution,⁷⁵ and, therefore, "if elements common to the ordinary understanding of 'insurance' are present, new forms of the business should constitute the 'business of insurance' for purposes of the McCarran-Ferguson Act."⁷⁶

Justice Brennan insisted that Blue Shield's drug-benefit policy is the business of insurance because it clearly transfers and distributes risks.⁷⁷ The only difference between Blue Shield's insurance policy and other forms of health insurance is that Blue Shield pays the policyholder in goods and services rather than cash.⁷⁸ Historically, service-benefit plans were a widespread and well-recognized form of health insurance,⁷⁹ and these plans were subject to state regulation as insurance.⁸⁰ According to the dissent, some kind of provider agreement is logically necessary for a service-benefit insurer to meet policy obligations to the insureds.⁸¹ The dissent pointed to a history of pervasive state insurance regulation of hospitalization benefit plans whose distinctive feature was a provider agreement with participating hospitals to provide services to insureds.⁸² Justice Brennan referred to the Court's earlier decision in *FTC v. National Casualty Co.*,⁸³ in which the advertising of insurance, which involves neither the underwriting of risks nor the relationship between the insurer and the insured, was held to be within the scope of the McCarran-Ferguson Act.⁸⁴ The dissent observed that the legislative history was replete with examples of activities that did not involve underwriting yet were regarded by Congress as within the scope of the Act's exemption.⁸⁵ The dissent distinguished between arrangements that directly relate to the carrying out of policy obligations and arrangements that relate only to the general opera-

75. 440 U.S. at 238 (citing *SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65, 71 (1959)).

76. 440 U.S. at 238.

77. *Id.* at 239.

78. *Id.*

79. *Id.* at 240. In 1945, the year the McCarran-Ferguson Act was passed, 61% of the total hospital insurance market was composed of service-benefit plans. See *Hearings Before the Senate Comm. on Education and Labor, A National Health Program*, 79th Cong., 2d Sess. 173 (1946).

80. The dissent stated that "regulation of the service-benefit plans was a part of the system of state regulation of insurance that the McCarran-Ferguson Act was designed to preserve." 440 U.S. at 240.

81. The dissent relied on the language in *National Securities*, see note 35 *supra* and accompanying text, and concluded that the Pharmacy Agreements met the criteria stated by the Court. A provider contract in a service-benefit plan is critical to "the type of policy which could be issued" as well as to its "reliability" and "enforcement." 393 U.S. at 460.

82. 440 U.S. at 245.

83. 357 U.S. 560 (1958) (*per curiam*).

84. *Id.* at 563-65.

85. For example, Congress regarded numerous horizontal rate agreements between insurance companies that did not technically involve the underwriting of risk as within the scope of the McCarran-Ferguson Act's antitrust exemption. 440 U.S. at 244. In addition, vertical relationships between insurance companies and independent sales agencies, the subject of the conflict in *South-Eastern Underwriters*, were expressly included as part of the business of insurance in an early draft of the Act. 90 CONG. REC. A4406 (1944). Two such examples are rate agreements and transactions between agents and insurers.

tion of the insurance company.⁸⁶ Justice Brennan concluded that the challenged Pharmacy Agreements are necessary to allow Blue Shield to fulfill the obligations of its service-benefit policy.⁸⁷ Further, these Pharmacy Agreements directly affect insurance rates, costs, and insurer reliability and constitute an important factor in risk prediction.⁸⁸ On this basis, the dissent argued that the provider agreements are included within the business of insurance and therefore should be exempt from antitrust scrutiny.⁸⁹ The dissent proposed a case-by-case analysis of provider agreements.⁹⁰ The majority nevertheless declared that all provider agreements are not the business of insurance.⁹¹

In view of the current legislative sentiment⁹² to limit antitrust exemptions, the Court's failure to clarify the antitrust exemption for the business of insurance may provide the necessary incentive for congressional action.⁹³ Otherwise, the debate as to the meaning of the phrase in other contexts will continue in the courts. In the meantime, the effect of the Court's decision will compel many insurance companies to reexamine their contracts with third-party providers of goods and services.⁹⁴ The decision should have an important effect on insurance industry cost containment efforts.⁹⁵ Assuming that provider agreements have played a significant role in health insurance industry efforts at cost containment, the agreements' new nonexempt status will discourage their use. Yet, while the cost

86. In contrast, the majority found that all such arrangements are not the business of insurance. 440 U.S. at 224. According to the dissent, the former arrangement would constitute the business of insurance; the latter arrangement would not. *Id.* at 253. *See also* note 89 *infra*.

87. 440 U.S. at 252.

88. *Id.* at 253.

89. *Id.* Although this provider agreement is the business of insurance, the dissent would not conclude that all provider agreements are the business of insurance. The other two requirements of the McCarran-Ferguson Act would have to be met in order to qualify for the exemption. *Id.* These requirements are that the challenged conduct must be regulated by the state and that the conduct must not constitute a boycott. 15 U.S.C. §§ 1012(a) & 1013(b) (1976); *see* notes 16-17 *supra* and accompanying text. In addition, an insurance company could not immunize an otherwise prohibited conspiracy by joining it. Similarly, an exclusive arrangement between an insurance company and a single provider, only tenuously related to the provision of policyholder benefits, also would not be exempt. *See generally* Whiting, *supra* note 59, at 633-36.

90. 440 U.S. at 252.

91. *Id.* at 223-24.

92. *See* 125 CONG. REC. H449-50 (daily ed. Feb. 5, 1979) (remarks of Rep. LaFalce). *See generally* Whiting, *supra* note 59, at 927-28.

93. *See* note 47 *supra*. As of this date Congress has taken no action on the pending legislation.

94. *See Pharmacy antitrust ruling affects prepaid legal plans*, 65 A.B.A.J. 544 (1979).

95. It is evident that the majority and the dissent were clearly concerned about the rising cost of health care yet differed in their perceptions of how cost control could best be achieved. The majority seems to assume that the lowest prices for goods and services can be found in the free marketplace. It notes, for example, that the chief concern of insurance companies is maximization of profits and not cost containment, pointing to the disinclination of physician-dominated Blue Shield plans to minimize costs. 440 U.S. at 232 n.40. In response, the dissent stated that the policy aspects of cost control were not as one-sided as the Court described and that settlement of the cost containment controversy was best left to Congress. *Id.* at 256 n.26.