INSIGHTS

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Another Anniversary: Remembering the Supreme Court Case That Prompted a New Era of Insurance Regulation

by Paul Tetrault

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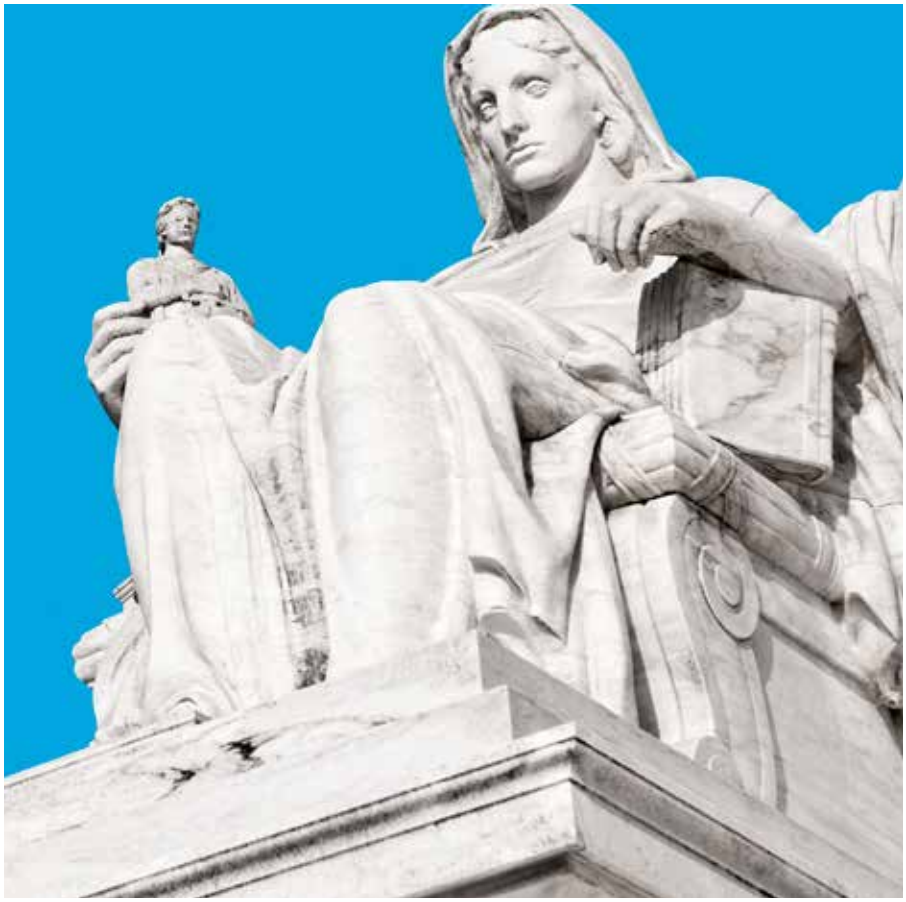

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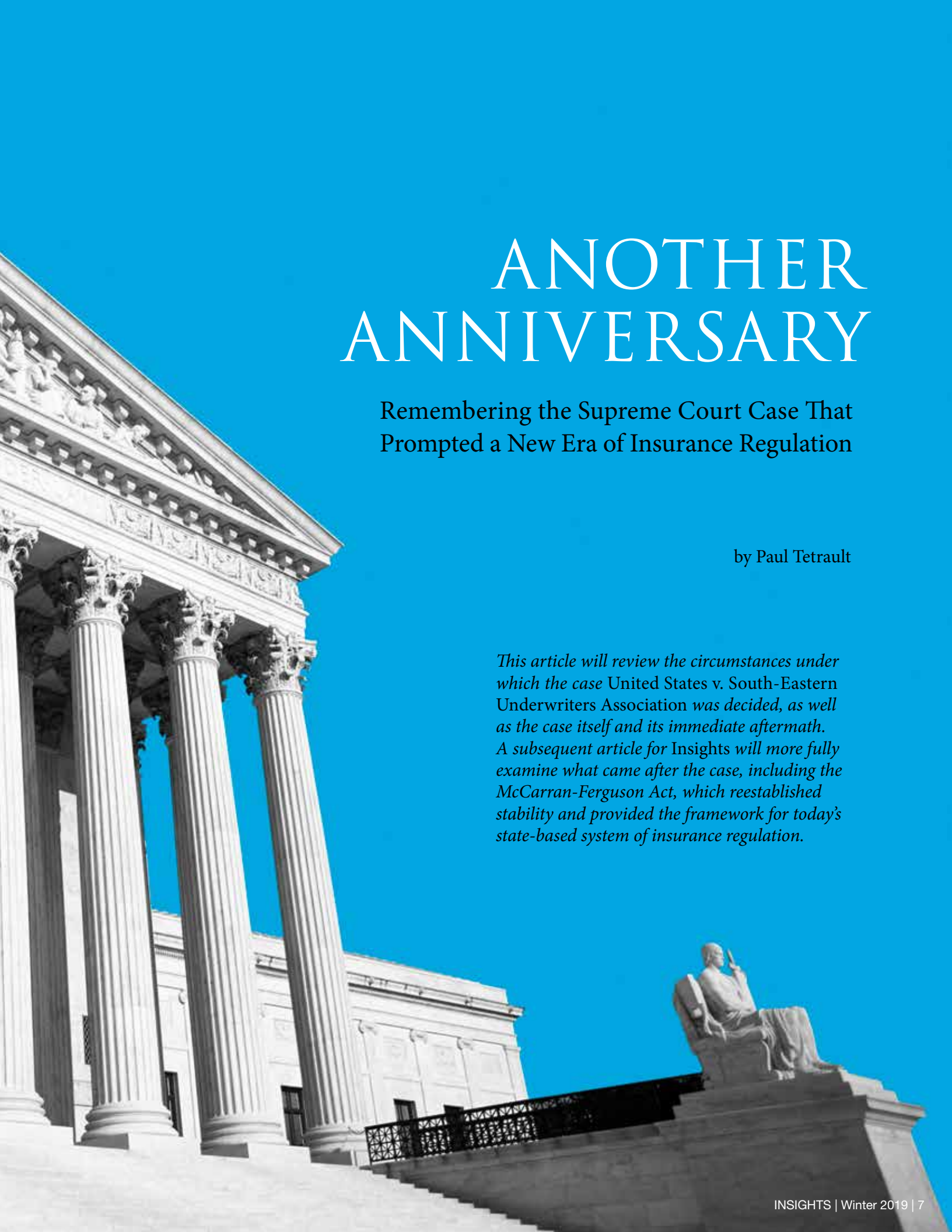
ANOTHER ANNIVERSARY

Remembering the Supreme Court Case That Prompted a New Era of Insurance Regulation

by Paul Tetrault

This article will review the circumstances under which the case United States v. South-Eastern Underwriters Association *was decided, as well as the case itself and its immediate aftermath. A subsequent article for* Insights *will more fully examine what came after the case, including the McCarran-Ferguson Act, which reestablished stability and provided the framework for today's state-based system of insurance regulation.*



2019 marks the 75th anniversary of not only the CPCU Society but also a momentous event that shook the insurance industry to its core.

In 1944, the U.S. Supreme Court threw the entire system by which insurers were regulated into upheaval and forced industry representatives and public policymakers to urgently formulate a plan for establishing the framework by which insurance regulation has since functioned. The case that kicked off this series of events was *United States v. South-Eastern Underwriters Association*, which ostensibly resolved a narrow and seemingly simple issue: whether insurance should be considered commerce. But the ramifications of that determination were so portentous that the entire insurance industry was riveted for months as it awaited the outcome of the case.

The decision holding that insurance is commerce meant that the insurance industry was subject to federal laws that had previously been inapplicable, including the Sherman Antitrust Act. It also instantly made the way that insurance had been priced and sold for decades appear fraught with illegal conspiracies.

The manner in which generations of insurance professionals had done business essentially became criminal behavior.

Questioning the Question

A modern reader might wonder why insurance was ever considered as something other than commerce and outside the scope of congressional authority.

When the U.S. Constitution was adopted in 1787, the founders had concerns about the national government being too powerful, and they viewed states as primary government entities in the federal system. Because of this, rather than giving Congress general power to make laws as it saw fit, the Constitution gives Congress a surprisingly short list of powers—among them, the power to regulate interstate commerce.

At the time of the Constitution's adoption, this was viewed as a limited power to facilitate business dealings among the states. Over time, however, Supreme Court decisions greatly expanded that power by reconsidering what commerce could properly be considered interstate in nature. Just a couple years before the *South-Eastern* case, in fact, the court ruled that activity occurring exclusively in one state was within Congress's control as long as it might possibly affect interstate commerce.[1]

In addition to an expanding concept of what is considered "interstate," Supreme Court cases reflect an evolving concept of what should be considered "commerce." The court specifically addressed the question of whether insurance constituted commerce in the 1869 case, *Paul v. Virginia*, which involved an attempt to invalidate state regulation of insurance by challenging a state law requiring an out-of-state company to obtain a license and post a bond before doing business in Virginia.[2] (For purposes of this retrospective, it is worth nothing that this case came 75 years before the *South-Eastern* case.)

One question in the case was whether the state law being challenged conflicted with the congressional power to regulate interstate commerce. A unanimous court ruled it did not because, "Issuing a policy of insurance is not a transaction of commerce."

THE MANNER IN WHICH GENERATIONS OF INSURANCE PROFESSIONALS HAD DONE BUSINESS ESSENTIALLY BECAME CRIMINAL BEHAVIOR

To justify this conclusion, the court offered the following observations:

> 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 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 interstate 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 Virginia. 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 conclusion, again in a case issued by a unanimous court, was definitive, with the holding that insurance is not commerce remaining for more than 75 years after. But by 1944, the notion of commerce had evolved significantly, as had the concept of interstate commerce. The issue, it seems, was ripe for review.

The Lead Up

That the *South-Eastern* case was closely watched by the industry is plainly evident. Trade journals of the time filled their pages with reporting covering the filing of briefs, oral arguments, and ultimately the decision and its aftermath.

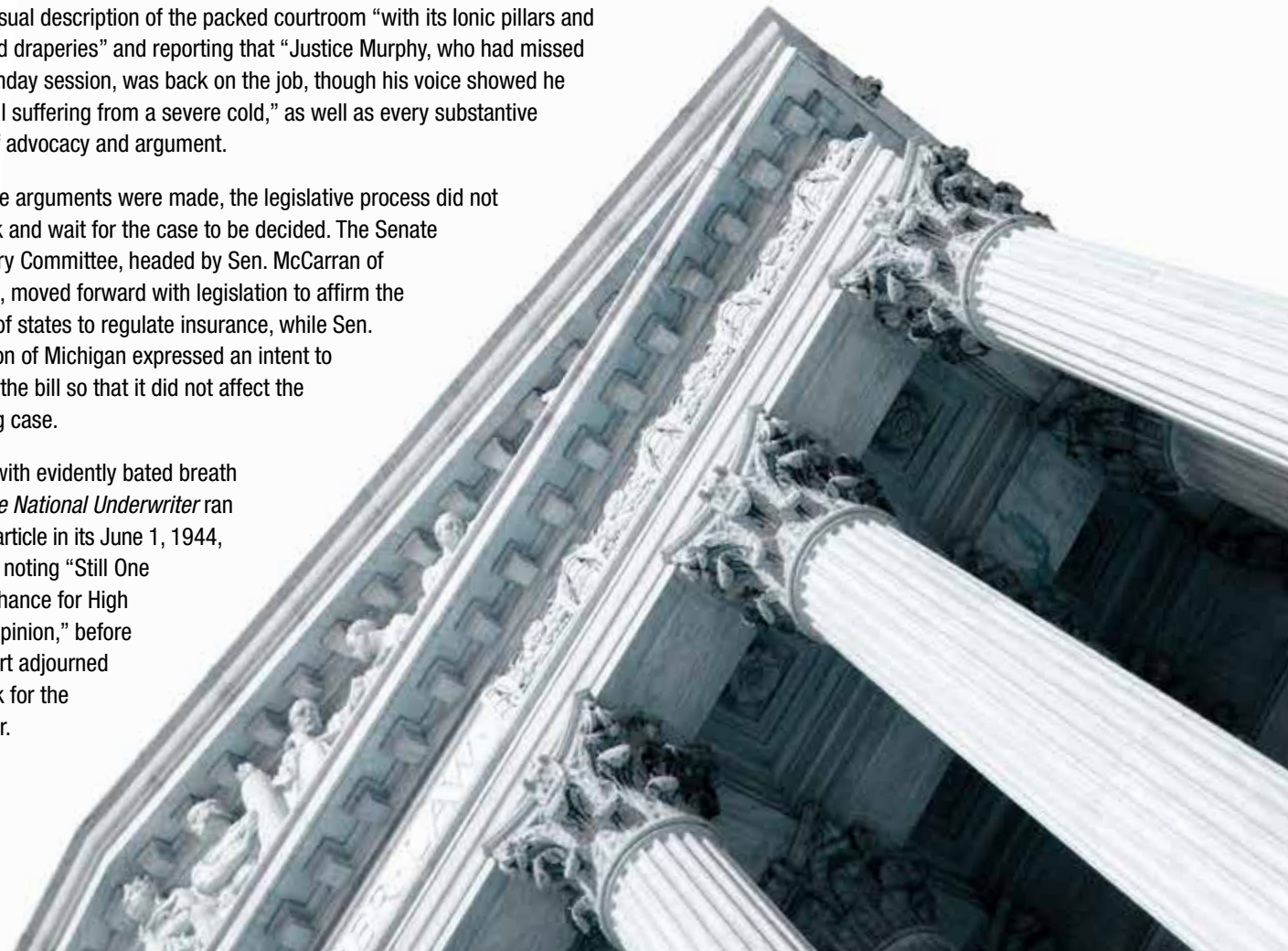
The January 6, 1944, edition of *The National Underwriter*, for instance, featured a lead story on the "Hard Hitting" brief filed by South-Eastern Underwriters, as well as a secondary story noting that the Supreme Court had scheduled oral arguments on the "Momentous Case" for January 10. The former article reported that the South-Eastern Underwriters brief "gives a graphic but not overdrawn picture of what the companies and their executives would face during the many years that would be required to resolve the numerous conflicts that would arise between state and federal law should the Sherman Act be held valid with respect to insurance."

The brief stressed an inherent conflict with the system of regulation developed by the states, based upon the principle that "solvency is the first requisite of any intelligent regulation of insurance" and the "unrestricted rate competition" that would be required under the Sherman Act, which it said would be "incompatible with solvency."

"Momentous Litigation Is Argued," declared the banner headline of *The National Underwriter*'s January 13 edition, with "Most Important Case in Insurance History Nears Decision" running as a subhead over the first column. The report on oral arguments was painstakingly detailed, recounting a full visual description of the packed courtroom "with its Ionic pillars and dark red draperies" and reporting that "Justice Murphy, who had missed the Monday session, was back on the job, though his voice showed he was still suffering from a severe cold," as well as every substantive point of advocacy and argument.

After the arguments were made, the legislative process did not sit back and wait for the case to be decided. The Senate Judiciary Committee, headed by Sen. McCarran of Nevada, moved forward with legislation to affirm the power of states to regulate insurance, while Sen. Ferguson of Michigan expressed an intent to amend the bill so that it did not affect the pending case.

It was with evidently bated breath that *The National Underwriter* ran a brief article in its June 1, 1944, edition, noting "Still One More Chance for High Court Opinion," before the court adjourned its work for the summer.



The Decision

Issued on June 5, 1944, the *South-Eastern* case lived up to the hype. Written in clear if not eloquent prose by Justice Hugo Black, the majority opinion was joined by just three of his colleagues. But with two of the nine justices not taking a part in the decision, four votes were enough for a majority ruling that would drastically change the balance of power for government regulation of insurance.

"Insurance is Supreme Court Loser," *The National Underwriter* declared in another banner headline. It also hinted at what the future would bring in the subhead, "Insurance Is Commerce. Period. Up to Congress Now."

The court notes that not including insurance as commerce would require applying an unusually narrow meaning to the word "commerce." Its decision in fact noted the following: "Whatever other meanings 'commerce' may have included in 1787, the dictionaries, encyclopedias, and other books of the period show that it included trade: business in which persons bought and sold, bargained and contracted." The court further offered as support a quote from Alexander Hamilton, who wrote that it would "'admit of little if any question' that the federal power to regulate foreign commerce included 'the regulation of policies of insurance.'"

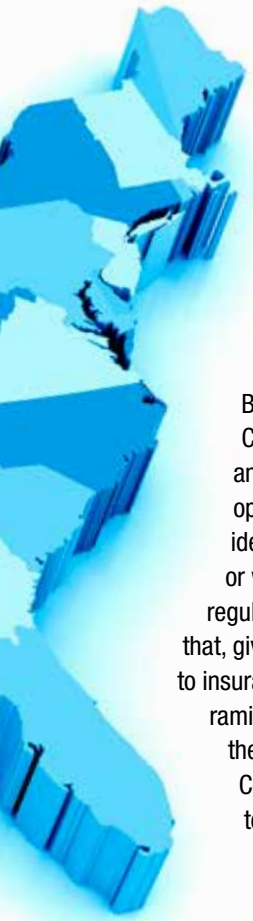
To support its position, the court offered the following statistics to show how the "modern insurance business holds a commanding position in the trade and commerce of our Nation [as] one of the largest and most important branches of commerce":

- Total assets exceeding $37,000,000,000 (the approximate value of all farms and buildings in the United States at that time)
- Annual premium receipts exceeding $6,000,000,000 (more than the average annual revenue receipts of the United States government over the prior decade)
- Employment of 524,000 workers (almost as many as worked in coal mining or automobile manufacturing)

The court concluded this section with a stirring assertion that is as true today as it was then: "Perhaps no modern commercial enterprise directly affects so many persons in all walks of life as does the insurance business. Insurance touches the home, the family, and the occupation or the business of almost every person in the United States."

THE IMPACT OF THE DECISION REVERBERATED WELL BEYOND THE REALM OF INSURANCE PUBLIC POLICY DEBATE

The court then addressed the line of cases since *Paul v. Virginia*, which conversely held that insurance was not commerce. It hinged its departure from past court precedents largely on these cases' emphasis on state regulation. It also cited noninsurance Commerce Clause cases to undermine distinctions between insurance and previous court-approved examples of commerce.



The court finished its commerce analysis with a conclusion that, if not accurate 75 years before, was by 1944: "No 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."

In addition to the majority opinion by Justice Black, the case included dissenting opinions by Chief Justice Harlan Stone, Justice Felix Frankfurter, and Justice Robert Jackson. To a large extent, their opinions did not disagree with the fundamental idea that insurance could be considered commerce or with the notion that Congress had the power to regulate insurance if it wished. But they suggested that, given the previously established distinction applied to insurance, and in light of the significant negative ramifications of suddenly challenging its status, the more reasonable resolution was to hold that Congress did not intend the Sherman Act to apply to insurance when the antitrust law was enacted.

The Reaction

Because the prelude to the decision was so closely followed, the reaction to it was swift and largely predictable. The National Association of Insurance Commissioners (NAIC) was scheduled to meet in Chicago within weeks, and the organization of regulators was poised to act, having already created a subcommittee on federal legislation in October of 1943. That panel, which had previously been exploring legislative proposals to stave off federal incursion, now turned its attention to developing legislation in response to the decision. The committee met several times in the weeks and months that followed, and the NAIC had a legislative proposal prepared by November of 1944.

The impact of the decision reverberated well beyond the realm of insurance public policy debate. For instance, it entered presidential politics, with New York Gov. Thomas Dewey discussing it when he accepted the Republican Party nomination, and the Democratic Party considering adding an "insurance plank" to the Democratic Party platform. Meanwhile, the National Association of Attorneys General discussed whether to seek a rehearing of the case before the Supreme Court.

Clearly, a level of anxiety prevailed in the weeks and months following the decision, as uncertainty reigned regarding how and when the complexities it raised would be resolved. With the benefit of time, we know now that the subsequent legislation, the McCarran-Ferguson Act, served well as the foundation for an evolving and dynamic state-based regulatory system for (at least) three quarters of a century. ■

Many thanks to the Regulatory & Legislative Interest Group for its contributions to this article.

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1. Wickard v. Filburn, 317 U.S. 111 (1942).
2. 75 U.S. 168.

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