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## ***Group Life & Health Ins. v. Royal Drug Co.:* The Narrowing Exemption of the Business of Insurance from Federal Antitrust Scrutiny**

*Using as his guide a careful analysis of the legislative history of Federal Antitrust law, the author examines two recent Supreme Court decisions dealing with the exemption of insurance companies from Federal Antitrust law. The author shows how there has been a consistent narrowing of exemptions in the insurance area caused by the Supreme Court's interpretation of the term "business of insurance" within the meaning of the McCarran-Ferguson Act. The term does not include the business of insurance companies, thus certain provider contracts are subject to federal law.*

The Supreme Court, in *Group Life & Health Ins. v. Royal Drug Co.*,<sup>1</sup> held that provider contracts between insurance companies and third parties for the purchase of goods and services did not constitute the "business of insurance"<sup>2</sup> as contemplated by Congress in the McCarran-Ferguson Act,<sup>3</sup> such agreements thus being excluded from the Act's federal antitrust exemption.

This decision changes prior law regarding federal jurisdiction over the insurance industry, by narrowing the scope of the industry's exemption from federal antitrust scrutiny. Previously, provider contracts were exempt from federal antitrust laws; *Royal Drug* has now closed that loophole.

This article will discuss the legislative and case history of the McCarran-Ferguson Act insofar as it influenced the Court's conclusion in *Royal Drug*. Thereafter, the *Royal Drug* decision will be analyzed. Finally, an examination will be made of the impact of *Royal Drug* on the holding in *Proctor v. State Farm Mut. Auto. Ins. Co.*,<sup>4</sup> a subsequent case involving similar insurance agreements.<sup>5</sup>

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1. 440 U.S. 205 (1979).

2. McCarran-Ferguson Act, § 2 (b), 15 U.S.C. § 1012 (b) (1945).

3. 15 U.S.C. §§ 1011-1015.

4. 99 S. Ct. 1417 (1979) (agreements to set auto repair prices).

5. This article will not discuss the boycott exception to the antitrust exemption of the Act. 15 U.S.C. § 1013 (b). See generally Note, *Barry v. St. Paul Fire & Marine Insurance Co.: A Re-Interpretation of the Boycott Exception to the McCarran Act*, 1977 DUKE L.J. 1069; Note, *Insurance Regulation and Antitrust Exemptions: McCarran-Ferguson, the Boycott Exception, and the Public Interest*, 27 RUTGERS L. REV. 140 (1973); Recent Developments, *Antitrust Law-Insurance-Policyholders May Maintain Sherman Act Antitrust Suit Against Insurer Under Boycott Exception of McCarran-Ferguson Act*, 63 CORNELL L. REV. 490 (1978).

## I. HISTORICAL PERSPECTIVE

### A. *History of Cases Prior to the McCarran-Ferguson Act*

The framework of any discussion involving the insurance industry vis-à-vis federal regulation, must be grounded in the case of *Paul v. Virginia*<sup>6</sup> where the Court, in effect, granted the insurance industry immunity from federal jurisdiction by stating, in dicta, that “[i]ssuing a policy of insurance is not a transaction of commerce . . . and “[s]uch contracts are not inter-state transactions, though the parties may be domiciled in different States.”<sup>7</sup> Thereafter, it was assumed that Congress had no authority under the Commerce Clause<sup>8</sup> to regulate insurance transactions.<sup>9</sup> Hence, the states enjoyed sole regulation of the insurance industry for seventy-five years until the landmark decision in *United States v. South-Eastern Underwriters Association*.<sup>10</sup>

The Court in *Underwriters*, ruled the insurance industry was, indeed, part of interstate commerce, and consequently fell within the purview of federal regulation,<sup>11</sup> (i.e., the Sherman Anti-Trust Act<sup>12</sup>). Congressional reaction to this broad decision was surprisingly swift. Within a year, the McCarran Act had clarified federal policy made possible by *Underwriters*.<sup>13</sup>

### B. *The McCarran-Ferguson Act: Substance, Intent and Purpose*<sup>14</sup>

The Act states in pertinent part:

§1011. Congress declares that the continued regulation and taxation by the several States of the business of insurance, is in the public interest,

§1012. (a) The business of insurance . . . shall be subject to the laws of the several States which relate to the regulation or taxation of such business.

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6. 75 U.S. (8 Wall) 168 (1869).

7. *Id.* at 183. The Court equated insurance policies to personal contracts. “They are, then, local transactions, and are governed by local law.” *Id.*

8. U.S. CONST. art. I, § 8, cl. 3. For a discussion of the scope of the Commerce Clause, see generally B. SCHWARTZ, CONSTITUTIONAL LAW 105 (2d ed. 1979).

9. Recent Developments, *Antitrust Law-Insurance-Policyholders May Maintain Sherman Act Antitrust Suit Against Insurer Under Boycott Exception of McCarran-Ferguson Act*, 63 CORNELL L. REV. 490, 492 n.9.

10. 322 U.S. 533 (1944) (The 200 insurers in *Underwriters* conspired to restrain interstate trade by fixing non-competitive prices).

11. *Id.* at 560.

12. 15 U.S.C. § 1.

13. The Act was passed in 1945, but the federal regulation effective date was postponed until June 30, 1948. 15 U.S.C. § 1012 (b). The purpose of the moratorium was to enable the States to amend their insurance laws to conform with *Underwriters*. S. REP. NO. 20, 79th Cong., 1st Sess. 1 (1945).

14. See also Weller, *The McCarran-Ferguson Act's Antitrust Exemption For Insurance: Language, History and Policy*, 1978 DUKE L.J. 587; Note, *The McCarran-Ferguson Act: A Time For Procompetitive Reform*, 29 VAND. L. REV. 1271 (1976).

§1012. (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 . . . unless such Act specifically relates to the business of insurance: *Provided*, That after June 30, 1948, . . . the Sherman Act, and . . . the Clayton Act . . . shall be applicable to the business of insurance to the extent that such business is not regulated by State law.

§1013. (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.<sup>15</sup>

The primary purpose of the Act was to ensure continued state regulation of the business of insurance,<sup>16</sup> thus placating the distraught insurance industry whose visions of federal dominion had raised intense concern. A secondary purpose was the industry need for an exemption from federal antitrust scrutiny to, "engage in activities such as price fixing, loss pooling, reinsurance and information exchanges" resulting in financial solvency and status as reliable insurers. This purportedly justified limiting the exemption to "activities closely related to ratemaking and other insurer-insured relationships."<sup>17</sup> The industry had grown quite comfortable under state regulation during the seventy-five years following *Paul v. Virginia*<sup>18</sup> and it vigorously argued to remain exempt from federal law.<sup>19</sup>

The insurance industry's efforts were rewarded by the general exemption.<sup>20</sup> Congress did not, however, intend to return to the pre-*Underwriters* blanket exclusion.<sup>21</sup> This was evidenced by the insertion of §1012(b) which invoked federal law to the extent not covered by state law, and §1013(b) which carved out an exception to the general exemption.<sup>22</sup> The stage was now set for judicial interpretation of what was meant by "the business of insurance",<sup>23</sup>

15. 15 U.S.C. §§ 1011, 1012 (a) & (b), 1013 (b).

16. *Prudential Ins. Co. v. Benjamin*, 328 U.S. 408, 429 (1946) (the first case involving the Act after its passage which upheld its constitutionality).

17. Kissam, *Health Maintenance Organizations and the Role of Antitrust Law*, 1978 DUKE L.J. 487, 531.

18. *See State v. Prudential Ins. Co. of America*, 223 Ind. 198, 64 N.E.2d 150 (1945), *aff'd mem.*, *Prudential Ins. Co. v. Indiana*, 328 U.S. 823 (1946).

19. Industry commentators charged that antitrust laws were anathema to the insurance industry, would cause state laws governing the industry to become unconstitutional, and that this was an attempt to federalize the insurance industry. As a result, bills were introduced in Congress exempting the entire industry from antitrust laws. Weller, *supra* note 14, at 590-602.

20. 15 U.S.C. § 1012 (a).

21. *See* text accompanying notes 6-10, *supra*.

22. 15 U.S.C. § 1013 (b) applies the Sherman Act upon any act or agreement of boycott, coercion or intimidation, regardless of state law.

23. 15 U.S.C. § 1012.

a phrase which had been left unexplained by Congress.<sup>24</sup>

C. *Piecemeal Definitions of the "Business of Insurance"*<sup>25</sup>

In *SEC v. Variable Annuity Co.*,<sup>26</sup> the Court was asked to determine whether variable annuity contracts<sup>27</sup> were policies of insurance, thus exempting them from federal antitrust law via the McCarran Act.<sup>28</sup> In defining insurance policies, Mr. Justice Douglas, speaking for the Court, held the underwriting of risk essential to the concept of insurance.<sup>29</sup> Thus, variable annuities were held not to be the business of insurance and were therefore outside the scope of the McCarran exemption.<sup>30</sup>

The leading case, *SEC v. National Securities, Inc.*,<sup>31</sup> was decided in 1969. There the Court further considered the scope of the phrase "the business of insurance." The case involved the merger of two insurance companies under state law. Holding that the state statute did not regulate the business of insurance, the Court defined the core of the business of insurance as, "[t]he relationship between insurer and insured, the type of policy which could be issued, its reliability, interpretation, and enforcement."<sup>32</sup> The Court especially emphasized that the focus of the statutory phrase was, "the relationship between the insurance company and the policyholder."<sup>33</sup> Newly armed with this general definition, the lower federal courts fell in line after the *National Securi-*

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24. This is the only phrase relevant to the scope of this article, as the main issue in *Royal Drug*, was whether provider contracts were the "business of insurance," thereby deciding if federal scrutiny of the agreements would be appropriate.

25. "With the exception of a few cases, for more than twenty years after the passage of the McCarran Act courts generally assumed that the term encompassed virtually all activities in which insurance companies and agents engaged." Note, *The McCarran-Ferguson Act: A Time For Procompetitive Reform*, 29 VAND. L. REV. 1271, 1281 (1976). The following cases, in the text, are the exceptions to the general trend in the lower courts.

26. 359 U.S. 65 (1958). This action by the SEC came about to enjoin *Variable* from selling annuity contracts to the public without registering them under the Securities Act of 1933. 15 U.S.C. § 80a. In these annuity contracts, the amount of the benefit payment fluctuated with the success of the investment policy.

27. 359 U.S. at 69-71.

28. 15 U.S.C. § 1012(b).

29. 359 U.S. at 71, 73. The "variable annuity places all the investment risks on the annuitant, none on the company." *Id.* at 71.

30. *Id.* at 68. There had been a split among the states as to this issue, but the Court held it to be a federal question since it concerned Federal Acts. *Id.* at 69.

31. 393 U.S. 453 (1969) (Alleged security violation in the merger of two insurance companies. The corporations successfully argued that a communication to a shareholder was within the meaning of "business of insurance," Supreme Court reversed.).

32. *Id.* at 460 (emphasis added).

33. *Id.*

ties decision.<sup>34</sup>

The dearth of high court cases defining the business of insurance, could be attributed to judicial reluctance to intervene in what is generally regarded as a state concern.<sup>35</sup> The result was that the lower courts had only broad standards for determining what the business of insurance involved. The standards were the underwriting of risk<sup>36</sup> and the relationship between the insurer and the insured.<sup>37</sup>

With this general framework as a backdrop, the *Royal Drug* decision can now be analyzed. This analysis will show that the Court's conclusions in this case conform to the legislative intent and purpose of the Act.

## II. GROUP LIFE V. ROYAL DRUG

### A. Facts

Eighteen owners of independent pharmacies in Texas brought suit against the Petitioners, Group Life (known in Texas as Blue Shield) and three other Texas pharmacies, charging violations of the Sherman Act.<sup>38</sup> Specifically, respondents alleged that by contracting with other pharmacies in San Antonio to fix the prices of

34. See, e.g., *Proctor v. State Farm Mut. Auto. Ins. Co.*, 406 F. Supp. 27 (citing *National Securities*, the court held certain claims settlement practices which used a price-fixing formula as the "business of insurance" since they were closely connected with the insurer-insured relationship); *Mathis v. Automobile Club Inter-Ins. Exch.*, 410 F. Supp. 1037 (D. Mo. 1976) (where membership in auto club required to obtain insurance—court held McCarran exemption applicable citing comprehensive state laws which regulated the "business of insurance" as defined in *National Securities*); *Ray v. Unified Family Life Ins. Co., Inc.*, 430 F. Supp. 1353 (D.N.C. 1977) (held relationship between insurance company and its agents not the "business of insurance"); *American Gen. Ins. Co. v. F.T.C.*, 359 F. Supp. 887 (D. Tex. 1973) (involved the merger of two interstate insurance companies in which the court ruled the McCarran exemption inapplicable since the definition of "the business of insurance" was the relationship between insurer and insured, and not insurance company mergers).

35. See J. APPLEMAN, *INSURANCE LAW & PRACTICE* § 10321 (1946); 2 *COUCH CYCLOPEDIA OF INSURANCE LAW* § 21:45 (2d ed. R. Anderson 1959). In fact, the first case decided by the Court on the application of the Act to federal antitrust law did not occur until 1978 in *St. Paul Fire & Marine Ins. Co. v. Barry*, 438 U.S. 531 (1978) (meaning of the boycott exception of 15 U.S.C. § 1013(b)). Weller, *supra* note 14, at 587.

36. *SEC v. Variable Annuity*, 359 U.S. 65 at 71, 73 (1958).

37. *SEC v. National Securities*, 393 U.S. 453, 460 (1969). Although this was, in fact, a narrowing of the blanket exemption enjoyed by the industry prior to *Variable*.

38. 15 U.S.C. § 1.

drugs and other pharmaceuticals, Blue Shield had caused policyholders to unlawfully boycott their business establishments.

The agreements, which were offered to all licensed pharmacies in Texas, called for participating pharmacies to dispense drugs to policyholders at the rate of two dollars per prescription. Blue Shield would then pay the pharmacies the acquisition cost of the drugs. Assureds who frequented the non-participating pharmacies were charged the full retail price and were then reimbursed at the rate of seventy-five percent of the retail price over two dollars. This formula contained an inherent penalty for those policyholders who did business with respondents,<sup>39</sup> those pharmacies that could not afford to profitably participate at the two dollar markup ceiling imposed by the agreements.<sup>40</sup>

The United States District Court for the Western District of Texas<sup>41</sup> granted summary judgment for Blue Cross, citing the McCarran-Ferguson insurance exemption to antitrust laws.<sup>42</sup> Additionally, it was held that the agreements were the "business of insurance" under §1012(b), and were regulated by state law and were not boycotts within the meaning of §1013(b).

On appeal, the Fifth Circuit reversed,<sup>43</sup> holding the agreements were not the business of insurance and therefore not shielded from federal antitrust laws.<sup>44</sup>

Certiorari was granted to resolve intercircuit conflicts regarding the definition of "the business of insurance."<sup>45</sup>

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39. Insured who traded at participating pharmacies would pay two dollars regardless of the retail cost of the drug, while insureds who traded at non-participating pharmacies would pay proportionately more as the retail cost rose, in addition to the requirement of filing a claim for reimbursement. See 440 U.S. 205, 209 n.3 (1979).

40. This resulted in a saving to Blue Shield since they would only be liable for the wholesale cost of the drugs to participating pharmacies and for seventy-five percent of the retail cost over the two dollar deductible to insureds who dealt with non-participating pharmacies.

41. *Royal Drug Co. v. Group Life & Health Ins. Co.*, 415 F. Supp 343 (W.D. Tex. 1976).

42. 15 U.S.C. §§ 1011-1015.

43. *Royal Drug Co. v. Group Life & Health Ins. Co.*, 556 F.2d 1375 (5th Cir. 1977).

44. *Id.* at 1387. The Court recognized that this decision was contrary to other circuit decisions involving similar agreements which were designed to lower the cost of providing goods and services to policyholders. Compare *Anderson v. Medical Service of the District of Columbia*, 551 F.2d 304 (4th Cir. 1977) (agreements between physicians and medical insurance company) and *Frankford Hospital v. Blue Cross*, 554 F.2d 1253 (3d Cir. 1977) (agreements between hospitals and medical insurance company). The court in *Royal Drug* recognized the relationship between the agreements and premium rates, but declined to validate the contracts as the business of insurance, claiming the relationship between Blue Shield and the participating pharmacies too attenuated to allow the exemption. 556 F.2d at 1384.

45. *Royal Drug* is the only circuit case holding such agreements to be outside

### B. *The Court's Analysis*

The Supreme Court, at the onset, premised its decision on the basis that the exemption covered only the business of insurance and not the business of insurance companies as stated in *SEC v. National Securities*.<sup>46</sup>

The object of inquiry was whether the provider contracts involved were the business of insurance as contemplated by Congress in its ordinary meaning and usage.

In citing *SEC v. Variable*<sup>47</sup> the Court reemphasized the importance of spreading and underwriting risk as essential elements of insurance. In the instant case, the Court saw no element of risk underwriting in the agreements since they were made between the insurance company and third parties. The Court differentiated between the actual insurance policy, which underwrites the risk of sudden loss to the insured, and the provider contracts, which merely served to minimize Blue Shield's cost of providing such coverage. This cost savings arrangement, said the Court, while necessary to provide coverage, does not, by itself, result in the business of insurance. The Court reasoned that the insured had no interest whatsoever in the provider contract, so long as they received the bargained for benefits of the policy.<sup>48</sup>

It can be seen that this relationship is a vital primary element to a finding that the business of insurance is the "relationship between insurer and insured."<sup>49</sup> Justice Stewart saw no relationship between Blue Shield and its policyholders, within the meaning of the above phrase, in a contract for the provision of goods and services with third parties, where the sole purpose was to lower Blue Shield's cost of coverage. Legislative intent was not so broad as to include every business decision made by insurance companies within the exemption.<sup>50</sup> On the contrary, their intent was to give the industry only a narrow exemption from federal

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the Act's exemption. See *Proctor v. State Farm Mut. Auto. Ins. Co.*, 561 F.2d 262 (D.C. Cir. 1977) (auto repair shops); *Frankford Hospital v. Blue Cross*, 554 F.2d 1253 (3d Cir. 1977) (hospitals); *Anderson v. Medical Services of the District of Columbia*, 551 F.2d 304 (4th Cir. 1977) (doctors).

46. 393 U.S. 453, 459-60 (1969).

47. 359 U.S. 65 (1959).

48. 440 U.S. at 214. The contracts were viewed as legally indistinguishable from any business agreement made by the insurance company in the day-to-day affairs of running an efficient business. *Id.* at 215.

49. 393 U.S. at 460.

50. 440 U.S. at 217.



antitrust laws.<sup>51</sup>

Reflecting upon Congressional debate prior to passage of the Act, the Court also noted a major concern of the legislators was that intra-industry ratemaking be included in the exemption.<sup>52</sup> This view has long been recognized in the lower federal courts and was previously validated by the Supreme Court in the *National Securities* case.<sup>53</sup> The Court placed great weight on Congress' previous rejection of a version of the Act, which contained several specific exemptions to federal laws as being too broad.<sup>54</sup> Significantly, none of these proposed exemptions involved provider contracts.<sup>55</sup> Thus, the passage of the final bill was construed as part of the overall narrowing of the exemption intended by Congress. Justice Stewart reasoned that the only conclusion possible in this matter was that Congress did not intend for provider contracts to be considered as "the business of insurance" within the meaning of the Act.<sup>56</sup>

The Court's conclusion is significantly reinforced with the realization that health care plans, similar to the one at bar, were not considered to be the business of insurance at the time of the Act's passage.<sup>57</sup> The primary case in point is *Jordan v. Group Health Ass'n*.<sup>58</sup> After noting the similarities between the agreements involved in *Jordan* and those in *Royal Drug*,<sup>59</sup> the Court surmised that the adverse decision in *Jordan* prior to the passage of the Act would have made it clear to Congress such contracts were not the

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51. See text accompanying notes 20-22, *supra*.

52. 440 U.S. at 221-24. Chaos was foreseen if competitive ratemaking practices were allowed, since the industry had no way to control cost without cooperative efforts. This was seen as the essential "spreading of risk" factor, so implicit in the definition of insurance.

53. *SEC v. National Securities, Inc.*, 393 U.S. 453, 460 (1969) (merger of two insurance companies). See *Proctor v. State Farm Mut. Auto. Ins. Co.*, 561 F.2d 262, 264 (D.C. Cir. 1977) (auto repair shop price setting formula); *Travelers Insurance Co. v. Blue Cross of W. Pa.*, 481 F.2d 80, 83 (3d Cir. 1973) (hospital insurance rates tied to benefit ceiling); *Doctors, Inc. v. Blue Cross of Greater Phil.*, 431 F. Supp. 5, 10 (D.C. Pa. 1975) (hospital insurance agreements related to ratemaking); *but see Hill v. National Auto. Glass Co.*, 293 F. Supp. 295, 296 (N.D. Cal. 1968) (McCarran not applicable to similar provider contracts; apparently cost effect on rates was not enough to invoke exemption).

54. 440 U.S. at 222 n.29.

55. *Id.* at 222. Under the proposed exemptions, the states were to have exclusive control over questions of "risks, rates, premiums, commissions, policies, investments, reinsurance, capital requirements, and items of that nature." 440 U.S. at 222 n.29.

56. *Id.* at 224.

57. *Id.* at 225-27.

58. 107 F.2d 239 (D.C. Cir. 1939) (Contract between insurance company and physicians for compensation for services rendered to insureds held *not* to be "business of insurance").

59. Provider contracts for medical services and supplies which would be administered to the insured by third parties.

business of insurance.<sup>60</sup>

Finally, the Court stated that all exemptions to antitrust laws are narrowly construed, and that an entity forfeits its exemption by acting with a nonexempt party.<sup>61</sup> Thus construed, provider contracts with pharmacies, doctors, lawyers, hospitals, etc., for the provision of goods and services to policyholders are now clearly subject to the various provisions of federal antitrust laws.<sup>62</sup> While this result may be criticized as creating an overly broad exclusion to the McCarran exemption, it is undeniable that the Court's conclusion was grounded in a thorough analysis of legislative intent.

### C. Dissent

Justice Brennan, in a vigorous dissenting opinion, argued that the contracts in question should be construed as falling within "the business of insurance." Citing *National Securities*,<sup>63</sup> he asserts that the policy transfers the risk of loss from the policyholder to Group Life and thus qualifies as an insurance transaction.<sup>64</sup> The dissenting opinion also states that the concept of insurance is not frozen, but rather is in a constant state of flux, changing with needs of policyholders.<sup>65</sup> This premise, it is contended, would place provider contracts within the modern definition of insurance.

The dissenting opinion fails to come to grips with the fact that insurance policies themselves are not at issue. They indeed transfer risk, but the provider contracts do not. The agreements merely lower Group Life's cost of providing benefits and do not concern the policyholder. In addition, Justice Brennan's argument does not explain how such agreements, which were held not to be insurance at the time of the Acts' passage,<sup>66</sup> have evolved into the business of insurance today.

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60. 440 U.S. at 229-30. *Jordan* specifically distinguished insurance companies from Blue Shield type cooperatives, "[Insurance companies] are concerned primarily, if not exclusively, with risk . . . [cooperatives are] concerned principally with getting service rendered . . . [t]heir primary purpose is to reduce cost . . . ." 107 F.2d 239, 247 (D.C. Cir. 1939) (emphasis in original) (footnote omitted).

61. 440 U.S. at 231.

62. *Id.* at 232 n.40.

63. 393 U.S. 453 (1969).

64. 440 U.S. at 239 (Brennan, J., dissenting).

65. *Id.* at 238.

66. *Jordan v. Group Health Ass'n.*, 107 F.2d 239 (D.C. Cir. 1939).

The dissent asserts that in *FTC v. National Casualty Co.*,<sup>67</sup> a case decided in 1958, the Court held insurance advertising (which does not involve risk underwriting) was the business of insurance. This point was invalidated by the subsequent decision in *SEC v. National Securities, Inc.*<sup>68</sup> which required a relationship between insurer and insured; one wholly lacking in the instant case.

Justice Brennan further contends that similar Blue Shield plans were considered to be insurance in the 1930's and 1940's, and were regulated by state law as insurance.<sup>69</sup> Once again, it must be noted that the insurance policy is not at issue here, but the provider agreement themselves.<sup>70</sup>

The dissenting opinion's final argument is that correlation between the agreements and insurance rates is extremely high.<sup>71</sup> Justice Brennan equates the agreements with benefit ceilings since they limit the insurance company's liability and thereby decrease rates.<sup>72</sup> This conclusion disregards Congressional intent to exclusively exclude intra-industry ratemaking efforts from federal antitrust coverage.<sup>73</sup> In addition, the provider agreements do not effect any close relationship between Group Life and its insured, a quality required by *National Securities*<sup>74</sup> for the McCarran Act exemption.

In conclusion, the dissent does not make a tenable case for the argument that agreements with third parties for the provision of goods and services constitute the business of insurance within the McCarran Act exemption as contemplated by Congress. This is so because the agreements lack certain essential qualities of the business of insurance as contemplated by Congress and as interpreted by the Court in prior cases (*i.e.*, a close relationship between insurer and insured;<sup>75</sup> and the underwriting of risk).<sup>76</sup>

### III. THE IMPACT OF *ROYAL DRUG*

At this point, it is undertaken to ascertain the possible impact

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67. 357 U.S. 560 (1958).

68. 393 U.S. 453 (1969).

69. 440 U.S. at 242-43 (Brennan, J., dissenting).

70. *Id.* at 230, n.38. The mere fact that the policy itself is the business of insurance does not mean that the provider contracts which necessarily follow were so contemplated.

71. *Id.* at 250.

72. *Id.* at 251.

73. 440 U.S. at 221.

74. 393 U.S. 453, 460 (1969).

75. *Id.*

76. 359 U.S. 65 (1959). Although the agreements may affect rates, they do not concern intra-industry ratemaking which was the concern of Congress when creating the exemption. Kissam, *supra* note 17, at 531.

*Royal Drug* will have on the outcome of *Proctor v. State Farm Mut. Auto. Ins. Co.*,<sup>77</sup> currently on remand, and future cases involving provider contracts. In *Proctor*, four owners of automobile repair shops brought suit against five automobile insurance companies in the District Court,<sup>78</sup> charging that certain claims adjustment and settlement practices constituted price-fixing and illegal group boycotts. Summary judgment was granted by the trial court and was upheld on appeal.<sup>79</sup> The Supreme Court granted certiorari and reversed and remanded *Proctor*<sup>80</sup> in light of the holding *Royal Drug*.<sup>81</sup>

The price-fixing scheme alleged by *Proctor* involved certain agreements made between insurance companies and participating garages, under which the price of repairs and the amount of policyholder reimbursement were determined by a common formula.<sup>82</sup> The effect of these agreements, according to *Proctor*, was to slow down legitimate price increases. The point of examination in light of *Royal Drug* concerns the agreements between the insurance companies and third party automobile repair shops, solely for the purpose of providing goods and services to insureds at a lower cost to the insurance companies (provider contracts). According to the D.C. Circuit Court,<sup>83</sup> this practice constituted "the business of insurance," thereby placing it within the McCarran Act's exemption from federal antitrust laws. It is the author's opinion that this conclusion was erroneous. This can be demonstrated through an application of the principles of *Royal Drug*.

In *Proctor*, the lower court concluded the agreements were within the "core" of the "business of insurance" since, "[t]he essence of the automobile insurance contract is the insurance company's agreement, in return for a premium, to make payments . . . for losses."<sup>84</sup> The court felt that since the amount to be paid

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77. 561 F.2d 262 (D.C. Cir. 1977). Only the "business of insurance" aspect of the case is within the scope of this note. The claim of group boycott will not be discussed.

78. 406 F. Supp. 27 (D.C.D.C. 1975).

79. 561 F.2d 262 (D.C. Cir. 1977) (McCarran exemption cited as basis of the court's decision).

80. 99 S. Ct. 1417 (1979).

81. 440 U.S. 205 (1979).

82. The formula set the cost of repairs at the "prevailing labor rate," a standardized estimate of the amount of labor required, and a compulsory discount on parts." 561 F.2d at 264.

83. See note 78 *supra* at 270.

84. *Id.* at 267.

for the losses was directly related to the insurance agreement, then the provider contract which set that rate was also vitally related, within the meaning of the Act's exemption.<sup>85</sup>

The erroneous nature of this conclusion stems from a confusion between the provider contract and the insurance contract. The goal of Congress in passing the McCarran-Ferguson Act was not to exempt the business of insurance *companies*, but rather, the *business of insurance* itself.<sup>86</sup> This cannot include agreements with entities wholly outside the insurance relationship.<sup>87</sup>

Secondly, the lower court relies on the impact which the agreements have on insurance rates as a qualifying factor for the business of insurance.<sup>88</sup> This conclusion falls under the weight of the *Royal Drug* edict that mere cost-savings activities are not the business of insurance solely because they have a favorable effect on rates.<sup>89</sup> The rationale for exempting ratemaking practices from federal scrutiny pertained to *intra*-industry ratemaking<sup>90</sup> and not to *inter*-industry agreements which tend to lower rates in a particular instance.

Thus, we find that the agreements in *Proctor* should not be considered the "business of insurance" because they do not involve the insurer and the insured, they do not spread or underwrite risk, and they are merely cost-savings techniques wholly outside the intent of Congress.

#### IV. CONCLUSION

This article has traced the development of the insurance industry's one-time blanket exclusion from federal scrutiny to the present narrowing of the exclusion to only those activities which directly relate to the "business of insurance" within the meaning of the McCarran-Ferguson Act.

These activities as defined by the Court over the years must involve a direct relationship between the insurer and insured, they must involve the spreading and underwriting of risk, and they must conform to Congress' intent and purpose for passing the Act. Such purposes include the continued authority of the states to tax and regulate the insurance industry, the exclusion of intra-industry ratemaking from federal scrutiny, and the desire to ex-

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85. *Id.*

86. *Royal Drug*, 440 U.S. at 211.

87. Exemptions to antitrust laws are to be narrowly construed. 440 U.S. at 231.

88. 561 F.2d at 269.

89. 440 U.S. at 221 n.25.

90. *Id.* at 221.

clude only the "business of insurance" from federal antitrust laws.

Specifically, this article has indicated the Court's recent decisions in *Royal Drug* and *Proctor*, have held that provider contracts with third parties for the provision of goods and services to insureds, which merely tend to lower the cost of providing benefits, are not the "business of insurance" within the meaning of the Act and intent of Congress. They are, therefore, subject to federal antitrust scrutiny.

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