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Insurance—McCarran-Ferguson Act—Section 2 (b)—Scope of Federal Regulation of Insurance.—Hamilton Life Ins. Co. v. Republic Nat'l Life Ins. Co

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CASE NOTE

Insurance—McCarran-Ferguson Act—Section 2(b)—Scope of Federal Regulation of Insurance.—*Hamilton Life Ins. Co. v. Republic Nat'l Life* Ins. Co.[1]—The Republic National Life Insurance Company, a Texas corporation, and the Hamilton Life Insurance Company of New York, a New York corporation, were parties to a group reinsurance agreement. Under this agreement, Hamilton assigned to Republic for reinsurance 80 percent of its group life insurance policies covering civil service employees in the New York City area. The agreement also contained a broad arbitration clause.[2] Acting pursuant to this clause, Hamilton served a demand for arbitration in New York on Republic. Hamilton claimed it had paid certain claims assigned to and accepted by Republic and that, under their agreement, Republic owed Hamilton $278,023.41. Four months later Hamilton appointed an arbitrator but Republic refused to proceed to arbitration. Instead, it "subjected Hamilton to a barrage of court proceedings in an effort to obtain judicial relief."[3] During this "barrage," which lasted nearly eight months, Hamilton filed a petition in the United States District Court for the Southern District of New York to compel arbitration under Section 4 of the Federal Arbitration Act.[4]

Republic argued that the Federal Arbitration Act was inapplicable in this dispute because Section 2(b) of the McCarran-Ferguson Act[5] (McCarran Act) prevented its application. Section 2(b) provides:

> 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. . . .

Republic argued that this section exempts the insurance business from all federal statutes which do not specifically state that they are applicable to insurance. Thus, the Federal Arbitration Act, with no specific reference to insurance, would be inapplicable to the dispute and the court would lack jurisdiction over the subject matter since the suit was based on the Act.

On the other hand, Hamilton argued that Section 2(b) of the McCarran Act did not prevent the Arbitration Act from applying in this case. Hamilton's position was that under section 2(b) the court should determine whether a general[6] federal statute, such as the Federal Arbitration Act, invalidates,

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[1] 291 F. Supp. 225 (S.D.N.Y. 1968).

[2] The arbitration clause provided, inter alia, that "all disputes and differences between the two contracting parties upon which an amicable understanding cannot be reached are to be decided by arbitration" and that "the arbitrators shall place a liberal construction upon this agreement, free from legal technicalities, for the purpose of carrying out its evident intent." Id. at 227.

[3] Id. at 228.

[4] 9 U.S.C. § 4 (1964).

[5] 15 U.S.C. § 1012(b) (1964).

[6] The word "general" is used throughout this note to identify those federal or state statutes which may affect the insurance business, but which are not specifically enacted to regulate insurance. "General" statutes should be distinguished from "affirma-

impairs or supersedes any state law designed to regulate the insurance business. If the court found no such state law, the general federal statute would not be rendered inapplicable by the McCarran Act even though the federal statute conflicted with a general state law. Thus, since the Federal Arbitration Act does not invalidate, impair or supersede any state law enacted for the purpose of regulating insurance, the Act would be applicable to the dispute.

Thus the principal issue[7] in the case was whether Section 2(b) of the McCarran Act renders general federal statutes, such as the Federal Arbitration Act, inapplicable to the insurance business. The court HELD: The McCarran Act does not preclude the application of federal statutes which do not specifically apply to the business of insurance unless the pertinent state laws to be invalidated, impaired or superseded by the federal statutes were enacted for the purpose of regulating the business of insurance.[8] The court reached its conclusion by examination of the language and legislative history of the McCarran Act.

After determining that the Federal Arbitration Act is not specifically directed at insurance, the court considered whether there was an applicable state statute with the purpose to regulate insurance. The *Hamilton* court inspected the relevant statutes of both Texas and New York, and decided that neither was designed to regulate insurance. As a result, the two statutes were considered to be outside the protection of section 2(b). Thus they did not preclude the application of the Federal Arbitration Act.

The McCarran Act was the result of a troublesome interrelationship among insurance, state regulation of insurance and the Commerce Clause of the Constitution. In *Paul v. Virginia,* the Supreme Court held that issuance of an insurance policy was not commerce.[9] Thus the states were assured that they had the exclusive right to regulate insurance.[10] However, in *United States v. South-Eastern Underwriters Ass'n,*[11] insurance transactions became subject to federal laws enacted pursuant to the Commerce Clause. This decision cast the insurance business into a state of legal turmoil, as the insurance companies feared antitrust prosecution and the state governments feared loss of tax revenue under their existing laws.[12] In addition, the states were confused as to what type of new legislation they could enact without violation of the Commerce Clause.[13] Thus, pressure grew for Congress to clarify the state of the law. The result was the passage of the McCarran Act in 1945.[14]

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tive" statutes which refer to federal or state statutes specifically designed to regulate insurance.

[7] Two other issues emerged in the district court. They were, however, procedural in nature. One concerned the proper service upon Republic and the other a question of joinder of a third indispensable party.

[8] With respect to the other two issues, the court held that proper service was given to Republic because Republic, by agreeing to arbitrate in New York, consented to the court's jurisdiction to compel arbitration; and that there was no unjoined indispensable party.

[9] 75 U.S. 168, 183 (1868).

[10] SEC v. National Sec., Inc., 89 S. Ct. 564 (1969).

[11] 322 U.S. 533 (1944).

[12] 3 Rutgers L.J. 95, 95-96 (1949).

[13] Id. at 96.

[14] 15 U.S.C. §§ 1011–15 (1964).

The court considered the language of the McCarran Act as unambiguous and concluded that Section 2(b) of the Act does not preclude the application of general federal statutes unless the conflicting state laws were enacted for the purpose of regulating insurance.[15] In other words, the general federal statutes apply if the pertinent state statutes are not designed to regulate the business of insurance. This is the correct statutory interpretation because the Act is expressly concerned with the relationship between acts of Congress and state laws "enacted for the purpose of regulating the business of insurance." Without such state statutes there is no relationship which the Act is to govern. This conclusion is also clear from the purpose of the Act. The purpose of the McCarran Act is to reaffirm the states' power to regulate insurance.[16] This policy seems to require that the state regulation be specifically designed for insurance. Otherwise the Act would have the effect of destroying federal rights, such as those created by the Federal Arbitration Act, simply because the subject of the agreement was insurance. There is no evidence that the McCarran Act was intended to have such an effect. Moreover, even cases that do not require elaborate manifestations of the purpose to regulate insurance in state statutes in order to find a protected regulation of insurance give no indication that they would also include, within the Act's protection, statutes not designed to regulate the business of insurance.[17]

The *Hamilton* court also concluded that the purpose of the McCarran Act was to reaffirm the power of the states to regulate insurance despite the *South-Eastern Underwriters* decision making insurance subject to commerce clause enactments.[18] Although the court considered the states' power to regulate insurance as remaining subject to constitutional limitations,[19] it concluded that state statutes intending to regulate the business of insurance could not be overridden except by specific congressional enactments.[20] This interpretation seems reasonable and correct in light of the legislative history of the bill and the relevant case law. For example, the House Report on the bill recognized the problems which arose after the *South-Eastern Underwriters* case and clearly indicated that insurance regulation should be continued by the states subject to the constitutional limitations expressed by the Supreme Court.[21] In *FTC v. Travelers Health Ass'n*[22] the Supreme Court stated that the major purpose of the McCarran Act was to dispel the doubts raised by the *South-Eastern Underwriters* decision with respect to the continuing power of the states to regulate insurance.

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[15] 291 F. Supp. at 230.

[16] H.R. Rep. No. 143, 79th Cong., 1st Sess. (1945), U.S. Code Cong. Serv. 670, 671–72.

[17] E.g., California League of Independent Ins. Producers v. Aetna Cas. & Sur. Co., 175 F. Supp. 857 (N.D. Cal. 1959) (where the court considered a general authorization of conduct as protected state regulation of insurance since the state statute was in the California Insurance Code). See also FTC v. National Cas. Co., 357 U.S. 560 (1958).

[18] 291 F. Supp. 230.

[19] Id. at 229.

[20] Id. at 230.

[21] H.R. Rep. No. 143, 79th Cong., 1st Sess. (1954), U.S. Code Cong. Serv. 670, 671–72.

[22] 362 U.S. 293, 299 (1960).

However, the *Hamilton* court found no legislative history indicating that the intent of the McCarran Act was to make general federal laws inapplicable to the insurance business even where the conflicting state statutes were not aimed at regulating the business of insurance.[23] To buttress this conclusion, the court relied upon two cases where federal law was held to apply despite a conflicting state statute designed to regulate insurance.

In *Maryland Cas. Co. v. Cushing*[24] a ship collided with a pier and caused several drownings. Under Louisiana law, the representatives of the deceased men could sue the insurer of the owner of the vessel separately. But under the Federal Limitation Act[25] all claims against a shipowner could be consolidated in admiralty in order to limit the owner's liability, at least in some circumstances, to the value of his interest in the vessel and its cargo. The representatives of the deceased brought separate suits in the state courts against the insurer of the owner, but the shipowner filed a consolidation petition in admiralty in the federal district court to limit his liability. The Supreme Court found a clash between the Louisiana direct action statute and the federal maritime law because the local law would splinter the claims by permitting each party to sue the insurance company while the federal law allowed consolidation of all claims to limit the shipowner's liability.[26] The Court found that the exclusive purpose of the McCarran Act was to offset the adverse effects on state regulation of insurance caused by the decision in *South-Eastern Underwriters*.[27] Since *South-Eastern Underwriters* dealt with the clash between state regulation of insurance and interstate commerce and since the clash in *Maryland Casualty* was between state regulation of insurance and maritime law, the Court held that the McCarran Act was not relevant and allowed the consolidation under the Federal Limitation Act.[28] Thus, even though the state had specifically regulated insurance, the Court refused to apply the state law in place of the federal law.

Sears, Roebuck & Co. v. All States Life Ins. Co.[29] involved an action for trademark infringement and alleged unfair competition under the Lanham Act.[30] The state law gave the state Board of Insurance Commissioners the power to consent to the names of insurance companies, and the defendant obtained such consent. However, when the plaintiff, Sears, filed suit, the court, despite the state insurance regulation, viewed the matter under the trademark protection afforded by the Lanham Act. The court concluded that the McCarran Act does not limit the right of the owner of a trade or service to sue in the federal courts merely because one of the duties of the state board is to approve the name of the infringing insurance company.[31] Following the approach used in *Maryland Casualty*, the court determined that the purpose of the McCarran Act was to resolve the problems caused by the *South-Eastern*

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[23] 291 F. Supp. at 230.
[24] 347 U.S. 409 (1954).
[25] 46 U.S.C. §§ 183, 186 (1964).
[26] 347 U.S. at 415.
[27] Id. at 413.
[28] Id.
[29] 246 F.2d 161 (5th Cir. 1957).
[30] 15 U.S.C. § 1051 (1964).
[31] 246 F.2d at 172.

Underwriters decision and therefore that no legislative intent existed to limit the application of the Lanham Act.[32]

Both *Maryland Casualty* and *Sears, Roebuck* indicate the reluctance of courts to hold general federal statutes inapplicable even where there is an applicable state statute designed to regulate insurance. The courts appear to start from the premise that the federal law applies and then interpret the limitations of the McCarran Act very narrowly. The only decision appearing to sustain the contention that under the McCarran Act general federal laws should not apply, even where the applicable state statutes were not enacted for the purpose of regulating insurance, is the court of appeals decision in *SEC v. National Sec., Inc.*[33] However, this decision was later reversed by the Supreme Court.[34]

In *National*, the SEC sought to invalidate a merger of two stock life insurance companies on the grounds of misrepresentation in the proxy statement. The merger agreement had been previously submitted to the Arizona Director of Insurance and approved by him. Under Arizona law the Director of Insurance had the power to approve such mergers if he found that the parties complied with specified statutory criteria. The Court of Appeals for the Ninth Circuit found the Securities Exchange Act inapplicable under the McCarran Act because use of the federal act would impair the state law.[35]

However, in its discussion of the McCarran Act the court employed language from the Act's legislative history out of proper context and concluded that the statutory intent was to put the business of insurance beyond all present and future federal legislation not specifically relating to that business.[36] The court cited statements to the effect that any federal legislation which does not specifically relate to the business of insurance will not apply to insurance.[37] These statements are inapplicable to instances involving a general federal statute and a pertinent state statute not enacted for the purpose of regulating insurance. Proponents of the Act made such statements to emphasize the federal power to supersede existing or future state laws specifically designed to regulate the business of insurance by federal legislation specifically related to insurance.[38] There is no indication that affirmative federal legislation is needed where there are no such state laws. Any doubt that the McCarran Act does not render inapplicable general federal statutes where the pertinent state statutes were not enacted for the purpose of regulating the business of insurance is erased by the Supreme Court's reversal of the court of appeals in *National Securities*.[39] There the Court went directly to the question whether the applicable Arizona statute was enacted for the pur-

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[32] Id.

[33] 387 F.2d 25 (9th Cir. 1967).

[34] 89 S. Ct. 564 (1969).

[35] 387 F.2d at 32.

[36] Id. at 30.

[37] E.g., "If there is on the books of the United States a legislative act which relates to interstate commerce, if the act does not specifically relate to insurance, it would not apply at the present time." 91 Cong. Rec. 481 (1945) (remarks of Sen. Ferguson).

[38] Id. at 478-88, 1487 (remarks of Sen. Ferguson).

[39] 89 S. Ct. 564 (1969).

pose of regulating the business of insurance.[40] It strongly implied that if the Arizona statute did not have such a purpose, the general federal statute, the Securities Exchange Act of 1934, would apply notwithstanding the McCarran Act. Certainly there would be no need to examine the purpose of the relevant state law if the McCarran Act precluded all general federal statutes.

The *Hamilton* holding appears to be correct. The McCarran Act does not preclude the application of federal statutes not specifically relating to the insurance business unless the pertinent state laws which they "invalidate, impair, or supersede" were enacted for the purpose of regulating the business of insurance. The *Hamilton* decision narrowly applies the McCarran Act and prevents its use as a barrier to federal regulation of insurance. This interpretation not only enables the states, within certain constitutional limits, to regulate the business of insurance as little or as much as they desire, but it also promotes one of the purposes of the McCarran Act—a more adequate regulation of the insurance business.[41] In the absence of state legislation regulating insurance, the general federal statutes apply to provide a comprehensive and coherent scheme of regulation. Having determined the scope of the McCarran Act, the *Hamilton* court found that neither the Texas nor the New York arbitration statute was enacted for the purpose of regulating the business of insurance. Therefore the McCarran Act did not preclude the application of the Federal Arbitration Act.

The court first examined the applicable Texas arbitration statute.[42] The statute judicially enforced arbitration agreements for existing controversies but it did not enforce agreements to arbitrate future disputes.[43] The court viewed the statute as outside the protection of section 2(b) of the McCarran Act for two reasons. First, the purpose of the Texas statute was not to regulate insurance but rather to preserve the jurisdiction of the courts,[44] since at common law agreements to arbitrate either existing or future disputes were specifically unenforceable in the courts.[45] Thus, the statute was enacted as a general regulation of arbitration. Second, the court found that "regulating" in section 2(b) includes only regulation by the state of intrastate activity.[46] The House Report on the bill specifically declared that states do not have the power to tax or to regulate insurance contracts entered into outside their jurisdiction.[47] Because the contract was executed in New York, provided for arbitration in New York and dealt with New York municipal employees, application of the

[40] Id. at 567.

[41] H.R. Rep. No. 143, 79th Cong., 1st Sess. (1945), U.S. Code Cong. Serv. 670, 673.

[42] Tex. Rev. Civ. Stat. Ann. arts. 224–38 (1959).

[43] The 1965 revision of the Texas arbitration statute, Tex. Rev. Civ. Stat. Ann. arts. 224–38 (Pocket Supp. 1968), which allows agreeements to arbitrate all existing and future disputes except agreements dealing with insurance, was not applicable to the present dispute because the revision was subsequent to the present arbitration agreement. 291 F. Supp. at 231.

[44] 291 F. Supp. at 232.

[45] Simpson, Specific Enforcement of Arbitration Contracts, 83 U. Pa. L. Rev. 160, 164 (1934).

[46] 291 F. Supp. at 232.

[47] H.R. Rep. No. 143, 79th Cong., 1st Sess. (1945), U.S. Code Cong. Serv. 670, 672.

Texas statute would give the statute an extraterritorial effect not contemplated as permissible by Congress. Thus, the general nature of the Texas statute and its extraterritorial effect in this situation indicated that it was not a state law intended to regulate the insurance business and consequently that it was not protected by the McCarran Act. Similarly, the court found the New York arbitration law[48] to be intended for general use, applicable to any disputable subject, and thus not a law protected by section 2(b).[49] Absent applicable state law in either state, section 2(b) did not preclude the application of the Federal Arbitration Act.

The *Hamilton* view of the New York and Texas statutes draws support from the Supreme Court's discussion of "laws regulating the business of insurance" in the *National Securities* case.[50] There the Court regarded "[s]tatutes aimed at protecting or regulating [the relationship between the insurance company and the policyholder], directly or indirectly," as laws regulating the business of insurance.[51] More specifically, the court stated that the business of insurance included "the type of policy which could be issued, its reliability, interpretation and enforcement."[52] Therefore a law aimed at the interpretation and enforcement of an insurance contract would be a law regulating the business of insurance because it would be regulating the relationship between the insurance company and the policyholder.

Although both the New York and the Texas arbitration statutes affect the interpretation and enforcement of the insurance contract, neither should be considered as a law regulating the business of insurance. Neither statute was aimed, directly or indirectly, at the relationship between the insured and the insurer. The Texas statute was intended to preserve the jurisdiction of the courts and the New York statute was merely a general arbitration statute. Thus the court in *Hamilton* was correct in the holding that neither the Texas nor the New York arbitration statute was a statute with the purpose of regulating the business of insurance.

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48 N.Y. Civ. Prac. Law §§ 7501-14 (McKinney 1963).
49 291 F. Supp. at 233.
50 89 S. Ct. 564 (1969).
51 Id. at 569.
52 Id. at 568.