Market Allocation in the Insurance Industry and the McCarran-Ferguson Act

Randy Stutz*

I. Introduction

It is not often that obscure 1940’s legislation occupies headlines in the nation’s major newspapers. However, during the last year, national discourse found its way to the McCarran-Ferguson Act as Congress reinvigorated an old and recurring question: whether to repeal the insurance industry’s exemption from the antitrust laws. The McCarran Ferguson Act (“MFA” or “the Act”) exempts the “business of insurance” from the federal antitrust laws to the extent it is “regulated by State Law” and does not constitute “boycott, coercion or intimidation.” The Act was passed in 1945 in response to the Supreme Court’s opinion in United States v. South Eastern Underwriters Assn., which, in keeping with then-recent, expansive interpretations of the Commerce Clause, held that insurance transactions were “interstate commerce.” Were it not for the Act, the Court’s opinion would have subjected the business of insurance to scrutiny under the federal antitrust laws for the first time.

Since then, judicial interpretation of the statutory language has circumscribed the scope of the exemption, and Congress has occasionally revisited the durability of its mid-20th Century wisdom. In a trilogy of opinions beginning in the late 1970s, the Court explicated the definition of “insurance” for purposes of the Act, clarified that the involvement of certain parties was essential to or instructive of whether conduct was the “business” of insurance, and outlined the parameters of conduct constituting “boycott” that falls outside the exemption.

For its part, Congress has for many years considered the continuing vitality of the exemption through a number of bills proposing to repeal the Act in whole or in part. More recently, Congressional debate has centered on partially repealing the exemption with respect to the health insurance industry. Among several differing proposals over the last year, identical bills were introduced in the House and Senate in September 2009 (the “September Bills”) that would have

---

* Randy Stutz is a Research Fellow at the American Antitrust Institute (AAI), a non-profit research and advocacy organization devoted to advancing the role of competition in the economy, protecting consumers, and sustaining the vitality of the antitrust laws. See http://www.antitrustinstitute.org. The author wishes to thank AAI Research Intern Matthew Grierson for his insight, creativity and invaluable assistance researching the activities of the Blue Cross and Blue Shield Association and its member plans.

1 322 U.S. 533 (1944).


3 See, e.g., S. 80, 100th Cong. (1987); H.R. 2401, 109th Cong. (2006); S. 1525, 109th Cong. (2006); H.R. 1081, 110th Cong. (2007); S. 618, 110th Cong. (2007);
repealed the Act only to the extent it exempts bid rigging, price fixing and market allocation in the health and medical malpractice insurance industries.4

Although the September Bills sought lesser reform than subsequent bills introduced in November 2009 and February 2010 respectively, they were significant apart from their legislative aim insofar as they provoked questions concerning whether bid rigging, price fixing and market allocation were exempt under the MFA to begin with.5 Indeed, to the extent this question remains unanswered, the extent to which the September Bills would have altered the insurance exemption remains unclear.

Bid rigging, price fixing and market allocation by horizontal competitors are considered “hard core” antitrust violations, and are accorded per se treatment in the courts as such. Unlike other alleged violations that are accorded rule of reason treatment, whereby conduct is evaluated upon balancing procompetitive and anticompetitive effects in a properly defined market, courts deem per se violations so predictably and seriously harmful to competition that they are considered presumptively unlawful without analysis of market conditions or actual effects. Furthermore, per se offenses frequently earn criminal prosecution by the Antitrust Division of the Department of Justice.

It may seem unlikely that courts would read the broad statutory language of the MFA to effectuate an arguably discordant Congressional policy position: that through the MFA Congress sought to immunize conduct by health insurers that is otherwise presumptively unlawful and perhaps criminal under the Sherman Act, without expressly stating as much. Indeed, one federal court has held that a bid rigging scheme involving commercial property and casualty insurers was not protected by the exemption.6

With regard to price fixing, Congress did make clear that it sought to immunize cooperative ratemaking practices in the insurance industry. The legislative history of the Act and the fact that it was passed in response to South Eastern Underwriters strongly suggests that cooperative ratemaking was to form the core of the statutory phrase, “business of insurance.”7 Courts have thus held that

---

4 H.R. 3596, 111th Cong. (2009); S. 1681, 111th Cong. (2009). The House bill was reported by committee but never received a vote, while the Senate bill stalled upon being referred to committee. In November 2009, the House passed a sweeping health care reform bill including language that would have repealed the Act in its entirety as to only the health insurance industry. H.R. 3962, 111th Cong. (2009). The operative language was dropped after both Houses passed a different bill in its stead. However, in February of this year, the House overwhelmingly passed yet another bill that would accomplish repeal similar to that contemplated in the original House health care reform bill. H.R. 4626, 111th Cong. (2010). As of this writing, that bill’s fate in the Senate remains unclear.

5 The stated purpose of the September Bills was “to ensure that health insurance issuers ... cannot engage in price fixing, bid rigging and market allocations ....” S. 1681, 111th Cong. § 2 (2009) (emphasis added).

6 In re Ins. Brokerage Antitrust Litig., 2006 U.S. Dist. LEXIS 73055, 66 (D.N.J. 2006) (defendants’ bid rigging and steering practices were not the business of insurance and thus not exempt under MFA because, among other things, “the challenged practices are, at most, only tangentially related to the relationship between an insurer and insured ... [and] are not an integral part of the policy relationship between the insurer and the insured”) (emphasis in original) (internal quotation and citation omitted).

7 See Owens v. Aetna Life & Casualty Co., 654 F.2d 218, 247 (3d Cir. 1981) (Sloviter, J., dissenting) (“Certainly the fixing of rates is part of this business; that is what South-Easter Underwriters was all about.”) (quoting FTC v. National Casualty Co., 357 U.S. 560 (1958)).
cooperative ratemaking practices are exempt under the MFA accordingly.  

Market allocation, however, remains an open question. While a small number of federal courts have reached the inquiry, it appears that no court has categorically classified market allocation as either within or outside the scope of the exemption. This paper examines the scope of the MFA under existing Supreme Court precedent and reviews the sparse case law addressing the MFA’s applicability to market allocation schemes in the insurance industry. The paper concludes that whether market allocation is exempt is a close, fact-specific question that courts will not answer in the abstract. On any set of facts, insurers will have considerable leeway in attempting to prove that a given market allocation scheme should be treated as “the business of insurance” and thus exempt if “regulated by State Law.”

Should Congress pass legislation removing the MFA exemption from health insurance, attention will certainly focus on whether the Blue Cross/Blue Shield (BCBS) companies, which together form the largest health benefits provider in the nation, are engaged in unlawful market allocation agreements. Not only is the history of the Blue Cross and Blue Shield Association (BCBSA), the national organization that licenses the Blue Cross and Blue Shield trade names and symbols, replete with statements that could support claims of market allocation being a fundamental strategy of BCBS companies, but in fact there are few examples of BCBS companies competing against one another.

If market allocation were not exempt, either in the event of MFA repeal or because the Act is found not to protect it, the next question becomes: can competition in the health insurance field be increased by holding BCBS companies to an antitrust standard, i.e. that such companies cannot be permitted to agree not to enter one another’s market? As the analysis below demonstrates, the outcome of a challenge to BCBS companies on market allocation grounds is by no means preordained. And even in the event of a successful challenge, yet another question arises: is there a practical remedy that would require the companies to go up against one another as head-on competitors? This paper also examines whether a clear determination that market allocation by insurers is not protected would affect competitive dynamics among BCBS companies.

II. Background

The MFA provides that the Sherman Act, the Clayton Act and the Federal Trade Commission Act “shall be applicable to the business of insurance only to the extent that such business is not

regulated by State Law.”9 Thus, insurer market allocation is exempt from scrutiny under the federal antitrust laws if it constitutes “the business of insurance” and is “regulated by State Law.”10

The Supreme Court has identified three criteria for determining whether insurer conduct constitutes “the business of insurance.” “First, the practice must have the effect of transferring or spreading a policyholder’s risk. Second, the practice must be between the insurer and the insured. Third, the practice should be limited to entities within the insurance industry.”11

Insurer conduct is sufficiently “regulated by State Law” for purposes of maintaining the exemption if a state has passed any law purporting to regulate the conduct at issue, and the actors are within the jurisdictional reach of that state.12 “It makes no difference that the state regulation is not actively enforced, or that the state agency simply rubber stamps the insurance companies’ requests. If a statute exists, and the relevant agency or commissioner has jurisdiction over the practice under scrutiny, the ‘regulation’ requirement is met.”13

III. The Business of Insurance

A. Transferring or Spreading Policyholder Risk

In light of the MFA’s silence in explicitly defining the phrase “business of insurance,” the Supreme Court has identified the transfer or spreading of risk as an “indispensable characteristic of insurance.”14 This first of three requirements under the Court’s holding in Union Labor Life Insurance Co. v. Pireno – that the practice in question must have the effect of transferring or spreading risk – is ostensibly the Court’s answer as to how to define the second half of the statutory phrase: “business ... of insurance.” According to the Court, the quality of transferring or spreading risk is what separates insurance from similar but distinct endeavors: “[I]t is characteristic of insurance that a number of risks are accepted, some of which involve losses, and that such losses are spread over all the risks so as to enable the insurer to accept each risk at a slight fraction of the possible liability upon it.”15

---


10 The “boycott, coercion or intimidation” exception to the exemption is not relevant to discussing the Act’s impact on market allocation by insurers, which forms the basis of this paper. See Hartford Fire Insurance Co. v. California, 509 U.S. 764 (1993).


12 Id. at 666.

13 Id.


15 Id. at 128 (internal citation omitted); See Royal Drug, 440 U.S. at 212 (citing the Court’s findings in SEC v. Variable Annuity Life Ins. Co., 359 U.S. 65, 69 (1959), where corporations representing themselves as “life insurance” companies, and which were regulated by the insurance commissioners of the several states, sold variable annuity contracts wherein contract purchasers were not entitled to any fixed return; because all of the investment
Although a seemingly clear and meaningful criterion in the abstract, in reality the “transfer or spreading of risk” is usually elusive and intangible, and perhaps only directly accomplished in a fleeting moment during the execution of a policy agreement. Very little activity can squarely fit such a description. Thus, the inquiry often devolves into whether the activity in question is sufficiently connected to the transfer or spreading of risk to warrant a finding that Congress intended that it be exempt, all else being equal.16 Whether an activity, including a market allocation scheme, is sufficiently connected to the transfer or spreading of risk is of necessity a fact-specific inquiry.17

In Maryland v. Blue Cross and Blue Shield Association,18 the U.S. District Court for the District of Maryland faced such an inquiry. Ruling on cross-motions for partial summary judgment on whether the McCarran Ferguson Act barred certain federal antitrust claims, the Blue Cross court had to determine, among other things, whether a market allocation scheme among health insurers and a trade association had the effect of transferring or spreading policyholder risk.

Blue Cross involved a suit by the State of Maryland against (1) the Blue Cross and Blue Shield Association (“BCBSA”), a national trade association that owns and licenses the rights to the Blue Cross and Blue Shield trade names; (2) Blue Cross and Blue Shield of Maryland, Inc. (“BCBSM”), an insurance provider licensed in Maryland; and (3) Group Hospitalization and Medical Services, Inc. (“GHI”), another insurance provider licensed in Maryland. BCBSM and GHI were members of BCBSA. Among other things, the State alleged that “the licensing agreements between BCBSA and [BCBSM and GHI] impermissibly allocated the insurance market in Maryland” in violation of Section 1 of the Sherman Act.19 The defendants admitted to the existence of territorial allocation agreements,20 but submitted that the agreements were exempt from federal antitrust scrutiny under the McCarran-Ferguson Act.21

---

16 See FTC v. Manufacturers Hanover Consumer Services, Inc., 567 F. Supp. 992, 994 (E.D. Pa. 1983) (“The first criterion is whether the practice is to spread risk. The answer to this inquiry depends largely upon how one defines the “practice””).

17 See Owens v. Aetna Life & Casualty Co., 654 F.2d 218, 247 (3d Cir. 1981) (“The tests applied by the Supreme Court in its two recent opinions interpreting the McCarran-Ferguson Act, St. Paul and Royal Drug, are fact-specific rather than categorical in nature; both will usually require full factual development before they can be applied definitively”) (internal citation omitted).


19 Id. at 909. The defendants had agreed that GHI would operate in Prince George’s County and Montgomery County, while BCBSM would handle the rest of the state. Id.

20 Indeed, BCBSA asserted that it imposes the exclusive service areas on the Maryland and D.C. Plans and other Member Plans as a condition for approval of the right to use the Blue Cross name and symbols. Id. at 911.

21 Id. at 909.
The evidence submitted by both sides in support of their respective arguments belies the clarity of “transferring or spreading risk” as a criterion for determining the business of insurance. BCBSM submitted the affidavit of its director of actuarial research and rating, who stated that “BCBSM considers the geographic locations of the employment groups it insures in determining appropriate rate levels,” and that because it is not familiar with the health care costs charged in the metropolitan area allocated to GHI, “BCBSM might have to charge higher rates were it to market in the GHI area.” BCBSA offered the affidavit of its chief actuary, who asserted that “the Blue Cross plans’ geographic limits enable them to excel in ratemaking ... [and] the geographic limits allow the plans to develop intimate familiarity with the utilization patterns of their own communities and the provider charges common to those communities.”

Conversely, the State’s expert, an assistant professor of actuarial science at the Wharton School’s insurance department, noted that “there have been incursions by both plans into areas across the [territorial] boundary and that these incursions demonstrate the plans saw no underwriting or ratemaking barrier to marketing in each other’s areas,” and further that “the boundary is unrelated to insurance and is the result of a marketing decision not to compete for customers.” The State’s expert also noted that the two plans observed the territorial boundary with respect to administrative services only (“ASO”) contracts, wherein claims are administered and paid by the insurance company, but the “claimants” are self insured, and the group of claimants ultimately reimburses the insurance company for all claims paid plus administrative expenses. The State argued that ASO contracts do not constitute the business of insurance because the insurance company assumes no risk.

Clearly, none of the parties could speak directly to whether the market allocation scheme accomplished the transfer or spreading of risk, and so they reverted to “one-off” arguments, designed to create, in the defendant’s case, or sever, in the State’s case, a link between market allocation and the transfer or spreading of risk. For their part, the defendants sought to intertwine the territorial allocations with the practice of cooperative ratemaking, a form of joint activity clearly recognized to be part of transferring risk and squarely within the business of insurance. The State, meanwhile,

---

22 Id. at 910-911.

23 Id. at 911.

24 Id.

25 Id.

26 Id.; see supra note 15 and accompanying text.

27 See Pireno, 458 U.S. at 129 (“[I]n enacting the McCarran-Ferguson Act, the primary concern of both representatives of the insurance industry and the Congress was that cooperative ratemaking efforts be exempt from the antitrust laws ... because of the widespread view that it was very difficult to underwrite risks in an informed and responsible way without intra-industry cooperation”) (internal citation omitted); Owens v. Aetna Life & Casualty Co., 654 F.2d 218, 225-26 (3d Cir. 1981) (“deciding upon rating classification differences between individual policies and group marketing plans, either individually or jointly through a rating bureau” is “[clearly] the business of insurance”).
sought to distinguish the market allocation scheme from the practice of cooperative ratemaking, alluding to cross-territorial incursions that imply market allocation is ancillary to cooperative ratemaking, and to the fact that territorial boundaries were observed for activities outside the business of insurance, suggesting that they were foremost a means of avoiding competition.

The court elaborated on the parties’ arguments:

The State asserts that defendants’ market allocation scheme is unrelated to underwriting or ratemaking because the particular territories have no actuarial relevance. The State asserts that actuarial relevance is required to meet the [transfer or spreading of risk] prong of the Pireno “business of insurance” test. It acknowledges that there are no cases with substantially similar facts in which courts have found the exemption unavailable. In light of the paucity of authority on horizontal market allocation agreements in the insurance industry, the State suggests that the court utilize the “peculiar to the insurance industry” standard employed by other courts. The State submits that most insurance activities which are unique to the industry involve risk spreading or underwriting. The State submits that market allocation is not unique to the industry and that it does not involve risk spreading.

Defendants disagree with the State for several reasons. First, they submit that underwriting considerations do not have to underlie a challenged policy in order for the exemption to apply. They point out that the statutory language exempts the “business of insurance” not the “business of underwriting.” Second, they argue that actuarial relevance of the particular boundary is not required. They submit that territorial allocation is always related to risk spreading because it defines the pool of insureds. Whether the particular pool created is optimal should not be the concern of a court. The caselaw merely requires a relationship to risk spreading. Finally, if the court finds that Pireno does require that a challenged territorial allocation have actuarial relevance, the defendants contend that the particular territories at issue here have actuarial significance.

In weighing the arguments, noting in fairness that the BCBSA’s practices were longstanding, the court ultimately concluded that “[i]t is difficult to reconcile the Blues’ argument with the Supreme Court’s admonition in Pireno and Royal Drug that contractual arrangements with health care providers designed solely to reduce costs are not sufficient to meet the business of insurance requirement.” Although stopping short of granting the State’s motion for partial summary judgment on the McCarran issue, because it believed the parties’ affidavits nonetheless raised material factual issues for trial, the court held that “in order to meet the [transfer or spreading of risk] Pireno requirement the defendants must show the challenged territorial allocation is related positively to underwriting and ratemaking; that is, that exclusive geographic territories directly facilitate risk


29 Id. at 917.
spreading and transfer through the provision of insurance.” 30 The court added, “[t]his holding is consistent with the State’s position.” 31

On the question whether market allocation is exempt under the McCarran Ferguson Act, the Blue Cross court’s holding is cryptic and perhaps unhelpful. Although siding with the State, it refused to grant the State’s partial summary judgment motion. Although suggesting that the defendants’ arguments attempting to reconcile their market allocation scheme with the spreading of risk were too attenuated, it allowed that those same arguments could prove sufficient upon further factual inquiry. Ultimately, whether it is possible for insurance companies to make a showing that market allocation is “positively” related to underwriting and ratemaking remains an open question in the District of Maryland. At a minimum, the court’s holding does suggest that to make such a showing, insurers will have to prove that any allocation of markets at least has “actuarial significance” or “actuarial relevance.” 32

The Third Circuit also had occasion to address whether a market allocation scheme could constitute the business of insurance in Owens v. Aetna Life & Casualty Co. 33 In Owens, the plaintiff was an insurance broker who sued Aetna and certain affiliates for allegedly withdrawing from the medical malpractice insurance market pursuant to a market allocation agreement with other insurance companies, as well as conspiring to give another insurance company a monopoly in medical malpractice insurance, boycotting plaintiffs, and conspiring to drive plaintiffs out of business, all in violation of the Sherman Act. The district court granted the defendants’ motion for summary judgment, holding broadly that the McCarran-Ferguson Act was a valid defense to all of the plaintiff’s federal antitrust allegations. 34 While the majority affirmed on the alternative ground that the plaintiff had failed to present any evidence from which an inference of concerted action by defendants could be drawn, dissenting Judge Sloviter took the majority to task for affirming on grounds not cited by the district court or argued by defendants, and specifically for skirting “the difficult legal issue” of whether McCarran exempted plaintiffs’ market division allegations, “a question of first impression.” 35 As Judge Sloviter explained, “the district court, without specifically

30 Id. (emphasis added).

31 Id.; compare In re Ins. Brokerage Antitrust Litig., 2006 U.S. Dist. LEXIS 73055, 66 (D.N.J. 2006); but see Slagle v. ITT Hartford Ins. Group, 904 F. Supp. 1347 (N.D. Fla. 1995), aff’d, 102 F. 3d. 494 (11th Cir. 1996) (characterizing plaintiff’s allegations that defendants, as members of a joint underwriting association, which was established pursuant to a Florida enabling statute as an insurer of last resort against windstorm risk for coastal Florida consumers who were unable to obtain such insurance by ordinary methods, had unlawfully allocated markets, customers and territories, instead as price fixing by concerted refusal to deal with plaintiff individually, and holding that defendants’ conduct pertained to the setting of premium rates and terms and was thus exempt as “the business of insurance”).

32 The court ultimately denied both the State’s motion for partial summary judgment and the defendants’ motion to dismiss and for judgment on the pleadings, which it treated as a motion for partial summary judgment, and none of the parties appealed. No subsequent, published opinions reveal whether the issue was addressed at trial, or whether the case perhaps settled and never made it that far.

33 654 F.2d 218 (3d Cir. 1981).

34 The district court opinion was not published in any major reporter and is not available electronically.

35 Owens, 654 F.2d at 236-237.
referring to the types of market division involved, concluded that it was the ‘business of insurance,’ that it was effectively regulated by the state of New Jersey, and consequently that the alleged market division conspiracy was exempted from the antitrust laws under [the McCarran-Ferguson] Act. Because I believe there was an inadequate basis for the court to have reached the legal conclusions on which it based its judgment, I would vacate the entry of summary judgment and remand for further proceedings ....”36

Judge Sloviter then went on to state why a market division agreement of the sort contemplated by Aetna should not be considered the business of insurance, namely because it does not facilitate the transfer or spreading of risk. He explained,

It appears ... unlikely that [in passing the McCarran-Ferguson Act] Congress thought it was protecting agreements whereby an insurance company would completely withdraw from writing one type of insurance within the state. Aetna’s argument seems to turn protection of the “business of insurance” into the “business of non-insurance ....” An agreement whereby a competitor leaves the market entirely entails an avoidance of risk by the departing company rather than a spreading of risk, which the Royal Drug Court held to be a “critical determinant.” In relating the business of insurance to risk spreading, the Court stated, “there is an important distinction between risk underwriting and risk reduction.” It would follow that complete risk avoidance is not encompassed within the exemption .... When the McCarran-Ferguson Act was originally debated, those who favored broad exemption from the Sherman Act proposed that there should be specific enumeration of the practices which would be exempt from the antitrust laws .... Although these proposals were defeated in favor of a narrower exemption, the conspicuous absence from such proposals of ... division of markets and withdraw from markets suggests that these were not deemed to be activities meriting protection.37

Still, despite these strong words, even Judge Sloviter would not go so far as to categorically condemn market allocation as outside the scope of the McCarran-Ferguson Act exemption. Though he believed the lower court was erroneous in concluding that Aetna’s market division scheme was the business of insurance, he allowed:

I would be reluctant to suggest that no agreement between insurance companies which may result in withdrawal from a market can ever be the business of insurance, because we do not know enough of the economic and business stuff out of which these arrangements emerge to be certain .... Aetna should have the opportunity to make a convincing showing that the realities of the insurance business support a conclusion that joint action with regard to geographic areas of coverage or types of insurance offered is of the same genre as joint action such as pooling of risks or joint underwriting which are concededly the business of insurance. Aetna may be able to show that because of the special characteristics of the medical malpractice insurance industry, division of markets for such

36 Id. at 237.
37 Id. at 242-43 (emphasis added and internal citations omitted).
insurance is necessitated by the same considerations that underlie granting an exemption for other joint action.\textsuperscript{38}

Much like the \textit{Blue Cross} court’s holding, Judge Sloviter’s dissent illustrates the degree to which judges have eschewed bright lines in ruling on categories of joint activity as within or outside the scope of the McCarran-Ferguson exemption. The few judges that have reached the question of whether market allocation is exempt seem inclined to think it not, but they took pains to allow arguments to the contrary, in deference to the complexities of, and their own unfamiliarity with, the insurance industry.

\textbf{B. Between the Insurer and the Insured}

If the transfer or spreading of risk is the Supreme Court’s surrogate for the term “insurance” in the phrase “business of insurance,” the Court’s second \textit{Pireno} requirement, that the activity in question be between insurer and insured, answers the question of just what “business” is the “business of insurance.” In \textit{Group Life & Health Insurance Co. v. Royal Drug}, the Court noted that the relationship between insurer and insured is “commonly understood” to be central to the business of insurance.\textsuperscript{39} It explained:

\begin{quote}
In enacting the McCarran-Ferguson Act, Congress was concerned with ... [t]he relationship between insurer and insured, the type of policy which could be issued, its reliability, interpretation and enforcement – these were the core of the business of insurance. 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.\textsuperscript{40}
\end{quote}

Put another way, the statutory language exempts “the business of insurance and not the business of insurance companies.”\textsuperscript{41}

\textit{Royal Drug} involved a group of pharmacies who sued Blue Shield of Texas, an insurance company, alleging that the company had fixed prices upon entering into agreements with other pharmacies for the provision of prescription drugs to Blue Shield of Texas policyholders. In discussing whether the pharmacy agreements were “between the insurer and the insured,” the Court stated that “The Pharmacy Agreements are not ‘between insurer and insured.’ They are separate contractual arrangements between Blue Shield and pharmacies engaged in the sale and distribution of goods and services other than insurance.”\textsuperscript{42} However, Blue Shield argued that “nonetheless the Pharmacy Agreements so closely affect the reliability, interpretation and enforcement of the

\begin{flushright}
\textsuperscript{38} Id. at 244.
\textsuperscript{40} Id.
\textsuperscript{41} Id. at 217.
\textsuperscript{42} Id. at 216-217.
\end{flushright}
insurance contract and relate so closely to their status as reliable insurers as to fall within the exempted area." Though it rejected Blue Shield’s argument, the Court did not do so purely on the basis of contractual form. Discounting the fact that only the insurer and not the insured was a party to the agreements, it emphasized instead that “At most, [Blue Shield has] demonstrated that the Pharmacy Agreements result in costs savings to Blue Shield which may be reflected in lower premiums if the costs savings are passed on to policyholders. But, in that sense, every business decision made by an insurance company has some impact on its reliability, its ratemaking, and its status as a reliable insurer.”

In *Pireno*, on analogous facts, the Court reiterated this reasoning. Where the plaintiff, a chiropractor, sued an insurer alleging price fixing by way of the insurer’s reliance on a peer review committee to establish the reasonable and customary fees charged by chiropractors generally, the Court held that the insurer’s use of the peer review committee was too far removed from the relationship between insurer and insured. The Court explained that, as regards agreements like those in *Royal Drug* and here, these decisions are entirely the insurer’s and “a matter of indifference to the policyholder, whose only concern is whether his claim is paid, not why his claim is paid.” As in *Royal Drug*, the insurer had shown “at the most, that the challenged peer review practices result in cost savings to [the insurer] which may be reflected in lower premiums if the cost savings are passed on to policyholders ... [but] to grant the practices [an exemption] on such a showing would be plainly contrary to the statutory language, which exempts the business of insurance and not the business of insurance companies.”

The upshot of the Court’s reasoning in *Royal Drug* and *Pireno* is that market allocation agreements would not necessarily fail the second *Pireno* requirement – that the activity in question be between insurer and insured – even if the parties to such agreements would be only horizontal competitors, i.e. the conspiring insurance companies, and not policyholders. However, if a given market allocation agreement was viewed as an insurer cost-savings measure that does not inure to the rights of the insured, then such an agreement may well be outside the scope of the exemption.

In the *Blue Shield* case discussed above, the District of Maryland reached this very question. The State argued that market allocation is not an integral part of the policy relationship between insurer and insured, and that “to meet this criterion, a practice must involve the type of coverage or benefits available to an insured or insurance rates. A tangential relationship to the insured/insurer relationship that does not affect a benefit conferred is insufficient.” The defendants countered that any suit alleging antitrust injury to the insured satisfies the second *Pireno* criterion, and that “territorial allocation goes to the core of the relationship between the insured and the insurer because it determines to whom the insurer will offer a policy.”

43 *Id.* at 216.

44 *Id.* at 216-217.


46 *Id.* (internal quotations and citations omitted).


48 *Id.* at 918.
The court rejected the defendants’ argument. It explained, “The court believes the decision not to market at all in a particular geographic area is one step removed from the aspects of the insured/insurer relationship .... Accordingly, it does not believe defendants have demonstrated that the exclusive marketing areas meet the criterion.”49 However, just as with the parties’ arguments on whether market allocation effectuates the transfer or spreading of risk, the court sided with the State yet refused to rule. Continued the court, “the defendants also suggest that the exclusive marketing areas have an impact on insurance rates which in turn affect the insured/insurer relationship. There is both contradictory and insufficient evidence on this point for the granting of summary judgment.”50 Once again, the court seemed too committed to fact-based, case-by-case analysis to ever allow for a categorical classification of market allocation as within or outside the scope of the McCarran Act exemption under the second Pireno criterion.

C. Limited to Entities Within the Insurance Industry

With regard to market allocation or in any other context, the third and final Pireno criterion, that the activity in question should be limited to entities within the insurance industry, is less consequential than the first two.51 As the Pireno Court explained, “We may assume that the challenged peer review practices need not be denied the ... exemption solely because they involve parties outside the insurance industry. But the involvement of such parties, even if not dispositive, constitutes part of the inquiry mandated by the Royal Drug analysis.”52 It is fair to suggest that if a market allocation scheme involves an entity not in the business of providing insurance, there is a decreased likelihood that the scheme will benefit from the exemption, particularly if the scheme has anticompetitive effects in non-insurance markets.

In Blue Cross, which involved a market allocation scheme between insurance companies as well as BCBSA, a trade association that does not underwrite insurance policies, the District of Maryland examined whether BCBSA’s involvement would detract from an argument that the scheme was exempt. The court held that it did not. Recognizing that BCBSA was a nonstock, nonprofit association composed of local Blue Cross/Blue Shield plans, and that it performs a number of functions including negotiating the federal employee program and performing various trade association functions such as education, representation and support services for its members, the court believed it was “intimately related” to the insurance companies.53 The court found it was

49 Id.; compare In re Ins. Brokerage Antitrust Litig., 2006 U.S. Dist. LEXIS 73055, 66 (D.N.J. 2006) (holding that defendants’ bid rigging and steering practices were not the business of insurance and thus not exempt under McCarran because, among other things, “the challenged practices are, at most, only tangentially related to the relationship between an insurer and insured ... [and] are not an integral part of the policy relationship between the insurer and the insured”) (emphasis in original) (internal quotation and citation omitted).

50 Id.

51 Maryland v. Blue Cross and Blue Shield Assoc., 620 F. Supp. 907 (D. Md. 1985) (“the court notes that this last criterion should be given somewhat less weight than the previous two”).

52 Pireno, 458 U.S. at 133 (arrangements between insurance companies and parties outside the insurance industry “may prove contrary to the spirit as well as the letter of [the exemption], because they have the potential to restrain competition in noninsurance markets”).

53 Blue Cross, 620 F. Supp. at 919.
satisfied that “the BCBSA is sufficiently related to the insurance company parties to be considered an entity in the insurance industry.”

Although short on analysis, the court’s opinion suggests that form will not dictate an outcome on the third Pireno criterion. As noted in Pireno, the court could have held that BCBSA was not an entity in the insurance industry without foreclosing the availability of the exemption. It chose instead to recognize BCBSA as an entity in the industry, notwithstanding its not having underwritten insurance policies. The court did not address the related question of whether BCBSA’s involvement in the scheme had any potential to affect competition in non-insurance markets.

IV. Regulated By State Law

Even if an activity satisfies all three Pireno criteria and therefore constitutes “the business of insurance,” the activity must nonetheless be regulated by state law in order to be exempt under the McCarran Ferguson Act. The state regulation requirement is notable primarily for the ease with which it is met. If the requirement were more stringent, much of the MFA exemption might be superfluous, in as much as it would be subsumed within the State Action Doctrine, which immunizes activity the antitrust laws might prevent where a state has articulated an express policy to displace the federal competition laws, and it actively supervises the conduct at issue.

Put simply, “If a state statute can be read as directly or indirectly regulating an aspect of the business of insurance, this second requirement [under McCarran Ferguson] is met.” Thus, while it is very unlikely that any state will have enacted any regulation specifically encouraging the allocation of insurance markets, the state regulation requirement is nonetheless met if the state has merely acted to regulate any other aspect of the business of insurance.

Given the widespread regulation of insurance throughout most U.S. states, perhaps the only threat to the exemption posed by the state regulation requirement is that the actors must be within the jurisdictional reach of the state. Thus, where a market allocation scheme involves foreign actors, the scheme might lose the exemption for failing to meet the state regulation requirement.

V. Conclusion as to MFA’s Applicability to Market Allocation

54 Id.


57 See Owens v. Aetna Life & Casualty Co., 654 F.2d 218, 244 (3d Cir. 1981) (where plaintiff alleged allocation of markets by defendants, holding that the state regulation requirement was met where the State of New Jersey had evidenced its intent to occupy the insurance business field); In re Workers’ Compensation Ins. Antitrust Litig., 867 F.2d 1552, 1558-9 (8th Cir. 1989) (a state unfair methods of competition statute is sufficient to meet the McCarran state-regulation requirement); Hovenkamp, Federal Antitrust Policy 666 (“[The state] need only pass a statute that purports to regulate.”).

If the dicta and tangential holdings of the opinions discussed above can be cobbled together to stand for any proposition, it is that courts will examine the facts underlying the question of whether market allocation is exempt from federal antitrust scrutiny under the McCarran-Ferguson Act at a level of granularity that makes predictions and categorical classifications next to impossible. As *Pireno* and *Royal Drug* make clear, the gravamen of any complaint will reside in whether the particular market allocation scheme alleged is truly related, or at least related “positively,”59 to the transfer or spreading of risk and the policy relationship between insurer and insured, or if it is better classified as an insurer cost-savings measure, the benefits of which do not directly inure to the policyholder. If any of the participants in the market allocation scheme are not in the business of underwriting insurance policies, particularly if the market allocation scheme also has potentially anticompetitive effects in a non-insurance market, then the scheme’s likelihood of receiving protection under the exemption is decreased, though not altogether eliminated. Finally, it is unlikely that the state regulation requirement would deprive a market allocation scheme of the exemption unless the scheme involved foreign actors.

VI. Market Allocation and BCBS Companies

BCBS companies have been allocating markets using geographical boundary restrictions nearly since the BCBSA’s inception in the late 1920s. They have done so openly, and the practice has not escaped DOJ or FTC attention. Indeed, the federal antitrust enforcement agencies have evidenced their awareness of the BCBS territorial restrictions on multiple occasions,60 though no focused investigation or action has resulted nor has either agency publicly challenged the practice as anticompetitive.

Several considerations complicate the analysis. First, there is likely to be disagreement over whether the restraints should properly be viewed as horizontal or vertical, which might affect whether they are properly reviewed under the *per se* or rule of reason standard. Even if they are properly categorized as horizontal, the rule of reason standard may nonetheless be appropriate.61

Second, BCBSA has argued that allowing member plans to compete head-to-head within service areas would create confusion among consumers, who would have to distinguish between different companies offering different products using the same trade name and symbols.62 The ensuing confusion might threaten to dilute the value of BCBSA’s intellectual property to the extent head-to-head competition among BCBS companies would yield multiple performance standards in a


60

61

62 BCBSA has also suggested that this confusion would be exacerbated by a common consumer misperception that Blue Cross/Blue Shield plans form a single entity. If this is true, segregating the “Blue Cross” and “Blue Shield” names and symbols, or otherwise distinguishing plans by name within a given service area, may be insufficient to resolve consumer confusion.
given service area. With multiple performance standards, BCBSA has suggested, would come loss of consumer loyalty, trust and goodwill attaching to the BCBS name and symbols.

Allocating service areas can also work to prevent a “free rider” effect, whereby a newly entering BCBS plan would unfairly take advantage of the advertising and promotional activities of an existing BCBS plan in a given service area. Courts have recognized “that reasonable territorial arrangements in trademark license agreements serve several legitimate trademark objectives consistent with the antitrust laws,” and BCBSA might argue from its perspective that territorial arrangements are ancillary restraints to the primary purpose of protecting its trade names.

Still, if these potential points of contention by the BCBSA can be successfully challenged, there is evidence that Blue-on-Blue competition would inure to the benefit of consumers. In Central Pennsylvania, for example, one of the rare places where Blues have been competing with one another since 2002, the State Insurance Commissioner noted upon concluding a 21-month investigation of a proposed merger of two BCBS plans that “[o]ur experts concluded that [the Central Pennsylvania] region produced the best results for consumers and this was backed up by the overwhelming weight of testimony from providers, competitors, consumer groups, and others who submitted comments.” He further noted that his office would have considered allowing the merger if expanded Blue-on-Blue competition could be made a condition of approval, but that the participating companies refused.

If the BCBS system of market allocation is indeed exempt from federal antitrust scrutiny under the MFA, as BCBSA has argued, repealing the MFA would remove a primary obstacle preventing interested BCBS plans from expanding their market share at the expense of other BCBS plans. As the situation in Pennsylvania, along with a few other states, including North Carolina, Virginia and Ohio, makes clear, certain BCBS companies have shown a willingness to compete with other BCBS companies. Of course, in other regions, individual BCBS plans may believe it is in their best interest to maintain a system of regional monopolies over the cachet that comes with the BCBS name and symbols, even absent a formal agreement to allocate markets. Thus, to induce nationwide Blue-on-Blue competition, more than MFA repeal may be required. Perhaps a legal action demonstrating a continuing agreement not to compete between Blues in adjacent markets could lead a court to issuance of a mandatory injunction requiring mutual market entries, although this calls to mind the ease of leading a horse to water and the difficulty of making it actually imbibe.

63

64

65 This problem is likewise exacerbated by the “single entity” consumer misperception, if it exists.

66

67

68