

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

I.	Background .....	891
A.	The BCBSA, the BCBS Companies, and Allocation of Markets .....	891
B.	Scope of the MFA Exemption.....	894
II.	Insurer Market Allocation and Courts’ Reading of the MFA .....	895
A.	The “Business of Insurance” Requirement .....	896
1.	Transferring or Spreading Policyholder Risk.....	896
2.	Between the Insurer and the Insured .....	903
3.	Limited to Entities Within the Insurance Industry ...	907
4.	Is Market Allocation, Generally, the “Business of Insurance”? In Particular, Is the BCBS Scheme?.....	908
B.	The “Regulated by State Law” Requirement .....	911
	Conclusion.....	913

**I**t is not often that obscure 1940s antitrust 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

---

\* Randy Stutz is Director of Special Projects and a Senior Fellow at the American Antitrust Institute (AAI), a nonprofit research, education, and advocacy organization devoted to advancing the role of competition in the economy, protecting consumers, and sustaining the vitality of the antitrust laws. The author wishes to thank AAI Research Intern Matthew Grierson for his invaluable assistance researching the activities of the Blue Cross and Blue Shield Association and its member plans and AAI Research Fellow James Hurwitz for contributing research assistance, guidance, and original thinking that helped shape this Article.

to repeal the insurance industry's exemption from the federal antitrust laws. The McCarran-Ferguson Act (MFA) exempts the "business of insurance" from the federal antitrust laws to the extent it is "regulated by State Law"<sup>1</sup> and does not constitute "boycott, coercion, or intimidation."<sup>2</sup> The MFA was passed in 1945 in response to the Supreme Court's opinion in *United States v. South-Eastern Underwriters Ass'n*, which, in keeping with then-recent, expansive interpretations of the Commerce Clause, held that insurance transactions were interstate commerce.<sup>3</sup> Were it not for the MFA, 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-twentieth-century wisdom. In a trilogy of opinions beginning in the late 1970s, the Court explicated the definition of "insurance" for purposes of the MFA, 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.<sup>4</sup>

For its part, Congress has for many years considered the continuing vitality of the exemption through a number of bills proposing to repeal the MFA in whole or in part.<sup>5</sup> 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 the Senate in September 2009 (the September Bills) that would have repealed the MFA only to the extent it exempts bid rigging, price

---

<sup>1</sup> 15 U.S.C. § 1012(b) (2006).

<sup>2</sup> *Id.* § 1013(b).

<sup>3</sup> *United States v. Se. Underwriters Ass'n*, 322 U.S. 533, 553 (1944).

<sup>4</sup> *See Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982); *Grp. Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205 (1979); *St. Paul Fire & Marine Ins. Co. v. Barry*, 438 U.S. 531 (1978).

<sup>5</sup> *See, e.g.*, H.R. 1081, 110th Cong. (2007); S. 618, 110th Cong. (2007); H.R. 2401, 109th Cong. (2005); S. 1525, 109th Cong. (2005). For a detailed discussion of prior efforts to modify the MFA, see Chris Sagers, *Much Ado About Possibly Pretty Little: McCarran-Ferguson Repeal in the Health Care Reform Effort*, 28 *YALE L. & POL'Y REV.* 325 (2010).

fixing, and market allocation in the health and medical malpractice insurance industries.<sup>6</sup>

Although the September Bills sought lesser reform than subsequent bills introduced in November 2009 and February 2010,<sup>7</sup> 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.<sup>8</sup> 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 antitrust 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 U.S. Department of Justice.

---

<sup>6</sup> 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 October 2009, the House passed a sweeping health care reform bill, including language that would have repealed the MFA 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 2010, 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. See Sagers, *supra* note 5, at 329.

<sup>7</sup> Both the November 2009 bill and the February 2010 bill would have repealed the MFA in its entirety as to the health insurance industry, whereas the September Bills would have repealed the Act only as to bid rigging, price fixing, and market allocation in the health insurance industry. See Sagers, *supra* note 5, at 329. However, the September Bills also would have impacted the medical malpractice insurance industry, whereas the November 2009 bill and the February 2010 bill applied only to health insurance. *Id.* at 325–29.

<sup>8</sup> The stated purpose of the September Bills was “[t]o ensure that health insurance issuers . . . cannot engage in price fixing, bid rigging, or market allocations . . .” S. 1681 (emphasis added). Because of the broad statutory language found in the MFA, it is not always clear whether conduct is exempt prior to careful, fact-based analysis. See *infra* notes 40–41 and accompanying text.

It may seem unlikely that courts would read the broad statutory language of the MFA to suggest that Congress sought to immunize conduct by health insurers that is otherwise presumptively unlawful and possibly criminal under the Sherman Act, without expressly stating as much.<sup>9</sup> Indeed, one federal court has held that a bid-rigging scheme involving commercial property and casualty insurers was not protected by the exemption.<sup>10</sup>

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 MFA and the fact that it was passed in response to *United States v. South-Eastern Underwriters Ass'n* strongly suggest that cooperative ratemaking was to form the core of the statutory phrase, "business of insurance."<sup>11</sup> Accordingly, courts have held that cooperative ratemaking practices are exempt under the MFA.<sup>12</sup>

Market allocation, however, remains something of an open question. If Congress passes 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. Blue Cross and Blue Shield Association (BCBSA), the national organization that licenses the Blue Cross and Blue Shield trade names and symbols, has a history replete with statements that could support claims of market allocation being a fundamental strategy of BCBS companies, and in

---

<sup>9</sup> To be sure, Congress does sometimes exempt conduct that would otherwise be per se illegal and possibly criminal, but often it does so by delineating that which would be exempt with some specificity. See, e.g., Shipping Act of 1984, 46 U.S.C. app. § 1706, amended by Ocean Shipping Reform Act of 1998, Pub. L. No. 105-258, 112 Stat. 1902 (1998).

<sup>10</sup> *In re Ins. Brokerage Antitrust Litig.*, Nos. 04-5184 & 05-1079, 2006 WL 2850607, at \*10 (D.N.J. Oct. 3, 2006) (concluding that defendants' bid-rigging and steering practices were not the business of insurance and thus were not exempt under the MFA).

<sup>11</sup> See *Owens v. Aetna Life & Cas. Co.*, 654 F.2d 218, 244 (3d Cir. 1981) (Sloviter, J., dissenting) ("Certainly the fixing of rates is part of this business; that is what South-Eastern Underwriters was all about." (quoting *SEC v. Nat'l Sec., Inc.*, 393 U.S. 453, 460 (1969))).

<sup>12</sup> *In re Workers' Comp. Ins. Antitrust Litig.*, 867 F.2d 1552, 1556 (8th Cir. 1989) (identifying examples of cooperative ratemaking conduct that courts have held to be exempt, including joint use of reimbursement formulas for insurance claims, joint rate setting and risk classification, cooperative fixing of automobile insurance premiums, cooperative fixing of title insurance sellers' charges, and cooperative fixing of agent commissions).

fact there are few examples of BCBS companies competing against one another like distinct manufacturers of insurance products normally compete.<sup>13</sup> This might not matter significantly if the health insurance industry had a competitive market structure, but in most geographic markets, it is highly concentrated such that the absence of “Blue-on-Blue” competition could be costly to consumers.<sup>14</sup>

If market allocation were not exempt, either in the event of MFA repeal or because the MFA is found not to protect it, the next questions become (1) would holding BCBS companies to an antitrust standard result in prohibiting such companies from agreeing not to enter one another’s market? and (2) can competition in the health insurance field be increased by this result? 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

---

<sup>13</sup> The BCBS companies are independent corporations that are not economically integrated, except to the extent that each is individually bound to the applicable terms of a BCBSA licensing agreement. U.S. GEN. ACCOUNTING OFFICE, BLUE CROSS AND BLUE SHIELD: EXPERIENCES OF WEAK PLANS UNDERSCORE THE ROLE OF EFFECTIVE STATE OVERSIGHT app. II at 28 (1994), available at <http://archive.gao.gov/t2pbat3/151562.pdf>. Pursuant to the licensing agreement, each BCBS company must submit to performance monitoring, participation in coordinating programs, and enumerated BCBSA membership standards to the extent they are enforced. See *id.* at 28–33; see also *id.* at 14 (noting that from 1987 through 1990, twenty member plans failed to comply with BCBSA financial standards for at least two consecutive years, but from 1982 through April 1994, the BCBSA terminated only one trademark license for this reason). However, in most respects the Blues plans operate independently, at least to the extent that they are separately owned. *Id.* at app. III at 34 (“Our study found that Blues plans differ considerably in organization, operations, and regulation.”). Furthermore, the BCBSA governance structure seems set up largely to allow the individual BCBS companies to act collectively, rather than to create an independent authority overseeing the plans. See *id.* at app. II at 24–25.

As members of the [BCBSA], Blues plans collectively govern the [BCBSA’s] affairs pursuant to written bylaws. Under these bylaws, the [BCBSA] is governed by a board of directors. The board of directors consists of the CEOs of most plans and the [BCBSA] president. . . . For practical purposes, meetings of the [BCBSA’s] board of directors and its membership comprise largely the same individuals.

*Id.* (emphasis added).

<sup>14</sup> See *Health Insurance Industry Enforcement Act of 2009: Hearing on H.R. 3596 Before the Subcomm. on Courts and Competition Policy of the H. Comm. on the Judiciary*, 111th Cong. 116–35 (2009) (statement of David Balto, Senior Fellow, Center for American Progress); COMPETITION IN HEALTH INSURANCE: A COMPREHENSIVE STUDY OF U.S. MARKETS, 2009 UPDATE, available at <http://www.ama-assn.org/ama1/pub/upload/mm/363/chi-09-web.pdf> (“We find that 99 percent of [Metropolitan Statistical Areas] are highly concentrated. In 92 percent of the MSAs, one or more insurers had a share of 30 percent or greater, while 54 percent of the markets had an insurer with a share of at least 50 percent.”).

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?

No court has categorically classified insurer market allocation as either within or outside the scope of the MFA exemption. Two state attorneys general and one private plaintiff have challenged individual insurer market allocation schemes on federal antitrust grounds and been met with an MFA exemption defense.<sup>15</sup> The three combined challenges yielded only two federal court opinions, and they split. In *Garot Anderson Marketing, Inc. v. Blue Cross & Blue Shield United of Wisconsin*, the Northern District of Illinois held that a challenged market allocation scheme was not exempt under the MFA.<sup>16</sup> In *Maryland v. Blue Cross & Blue Shield Ass'n*, the District of Maryland allowed that a challenged market allocation scheme could be exempt on a better evidentiary showing, but it was not prepared to rule at the time.<sup>17</sup> The remaining challenge, *Blue Cross & Blue Shield Ass'n v. Community Mutual Insurance Co.*, was resolved by the parties prior to a judicial decision.<sup>18</sup>

In *Blue Cross* and *Community Mutual*, the attorneys general in Maryland and Ohio in fact challenged the BCBS market allocation scheme in particular, alleging in nearly identical claims that the national scheme's deployment in their respective states constituted a violation of Section 1 of the Sherman Act.<sup>19</sup> Because of the *Blue Cross* court's equivocal holding and the absence of an opinion in *Community Mutual*, whether the BCBS market allocation scheme is

---

<sup>15</sup> See *Garot Anderson Mktg., Inc. v. Blue Cross & Blue Shield United*, 772 F. Supp. 1054 (N.D. Ill. 1990) (private plaintiff); *Maryland v. Blue Cross & Blue Shield Ass'n*, 620 F. Supp. 907 (D. Md. 1985) (Maryland Attorney General); 5 HEALTH CARE & ANTITRUST LAW app. E96 (John Miles ed., 2010), available at Westlaw HTHATRL APP E96 (discussing *Blue Cross & Blue Shield Ass'n v. Cmty. Mut. Ins. Co.*, No. C85-7872 (N.D. Ohio 1985) (Ohio Attorney General)). Two other private plaintiffs have also challenged conduct that they deemed market allocation, but in both cases, the court recharacterized their allegations and found them to be protected as the business of insurance. In *Owens v. Aetna Life & Casualty Co.*, the majority recharacterized the conduct as cooperating in the decision to file a rating schedule. *Owens*, 654 F.2d at 232. In *Slagle v. ITT Hartford*, the court recharacterized the conduct as price fixing by concerted refusal to deal. *Slagle v. ITT Hartford*, 102 F.3d 494, 496 (11th Cir. 1996).

<sup>16</sup> *Garot Anderson Mktg., Inc.*, 772 F. Supp. at 1063.

<sup>17</sup> *Blue Cross*, 620 F. Supp. at 922.

<sup>18</sup> 5 HEALTH CARE & ANTITRUST LAW, *supra* note 15 (discussing *Blue Cross & Blue Shield Ass'n v. Cmty. Mut. Ins. Co.*, No. C85-7872 (N.D. Ohio 1985)).

<sup>19</sup> See *id.* ("The goal in each case was to foster statewide competition with respect to Blue Cross and Blue Shield insurance products.").

indeed exempt from federal antitrust scrutiny under the MFA remains unclear.

This Article 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, including the BCBS market allocation scheme. This Article concludes that whether any market allocation scheme 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. A clear determination that the BCBS market allocation scheme is not exempt, or congressional action to repeal the MFA as to the health insurance industry, would remove a primary obstacle to a challenge of the scheme, but it is not clear whether this would affect competitive dynamics among BCBS companies.

## I

### BACKGROUND

#### *A. The BCBSA, the BCBS Companies, and Allocation of Markets*

For several decades, BCBS health insurance companies, facilitated by the BCBSA, have operated nationwide under agreements not to compete in each other's geographical territories. They have done so openly, and the practice has not escaped U.S. Department of Justice (DOJ) or Federal Trade Commission (FTC) attention. Indeed, the federal antitrust enforcement agencies have evidenced their awareness of the BCBS territorial restraints on multiple occasions,<sup>20</sup> though no focused investigation or action has resulted, nor has either agency publicly challenged the practice as anticompetitive.

The origins of the BCBS territorial restraints are perhaps traceable to the benign fact that early BCBS plans were largely local, prepaid hospital and physician services plans. As such, each naturally catered to geographically distinct customers. However, conscious division of territories likely was not purely an accident of circumstance that evolved over time. In 1936, the Committee on Hospital Services of

---

<sup>20</sup> EXHIBIT A: APRIL 1985 BCBSA SUBMISSION TO JUSTICE DEPARTMENT REGARDING ENFORCEABILITY OF GEOGRAPHIC RESTRICTIONS 24–25 (1985) (on file with author) (referencing inquiries made into territorial restrictions through subpoenas and document requests issued to the BCBSA or BCBS member plans by the FTC or the Antitrust Division of the DOJ during the late 1960s and late 1970s).

the American Hospital Association, a precursor to the BCBSA, adopted seven principles governing its philosophy toward nonprofit health care plans. One such principle was to “establish[] plans [that] were not in competition with other plans.”<sup>21</sup>

As was true during the first half of the twentieth century, modern BCBS plans do not formally agree with each other not to enter one another’s market. Rather, they achieve territorial divisions through the BCBSA, which licenses the Blue Cross and Blue Shield trade names and symbols individually to member plans. Pursuant to these licensing agreements, and as a condition of affiliation, plans agree not to compete with other plans within prescribed service areas.<sup>22</sup>

Several considerations would complicate an antitrust analysis of this arrangement. Most immediately, there is likely to be disagreement over whether the territorial restraints should properly be viewed as horizontal or vertical, which might affect whether they are properly reviewed under the per se standard or the rule of reason standard. Even if they are properly categorized as horizontal, the rule of reason standard may nonetheless be appropriate.<sup>23</sup>

In a rule of reason analysis, the BCBSA and BCBS companies can offer several arguments as to procompetitive effects. For example, the 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 similar or nearly identical trade names and symbols.<sup>24</sup> The ensuing confusion might threaten to

---

<sup>21</sup> ODIN W. ANDERSON, BLUE CROSS SINCE 1929: ACCOUNTABILITY AND THE PUBLIC TRUST 40 (1975).

<sup>22</sup> U.S. GEN. ACCOUNTING OFFICE, *supra* note 13, at 28.

To use the Blue Cross and Blue Shield names and trademarks, each Blues plan must sign a license agreement with the Association. . . . The license agreement restricts plans from using the trademark outside their prescribed service area to prevent competition among plans using the Blue Cross and Blue Shield names and trademarks.

*Id.*

<sup>23</sup> See *NCAA v. Bd. of Regents of Univ. of Okla.*, 468 U.S. 85 (1984); *Broad. Music, Inc. v. CBS, Inc.*, 441 U.S. 1 (1979); *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210 (D.C. Cir. 1986).

<sup>24</sup> EXHIBIT A: APRIL 1985 BCBSA SUBMISSION TO JUSTICE DEPARTMENT REGARDING ENFORCEABILITY OF GEOGRAPHIC RESTRICTIONS, *supra* note 20, at 10–13. BCBSA has also suggested that this confusion would be exacerbated by a common consumer misperception that BCBS plans together form a single entity. *Id.* If this is true, segregating the “Blue Cross” and “Blue Shield” names and symbols, or otherwise



dilute the value of the BCBSA's intellectual property to the extent head-to-head competition among BCBS companies would yield multiple performance standards in a given service area.<sup>25</sup> With multiple performance standards, the BCBSA has suggested, would come loss of consumer loyalty, trust, and goodwill attaching to the BCBS name and symbols.<sup>26</sup> The territorial restraints arguably preempt this loss.

Allocating geographic territories 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 territory.<sup>27</sup> 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.<sup>28</sup>

However, 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. For example, in central Pennsylvania, which is one of the rare places where Blues have been competing with one another since 2002, the State Insurance Commissioner noted upon concluding a twenty-one-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."<sup>29</sup> 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 the participating companies had refused.<sup>30</sup>

---

distinguishing plans by name within a given service area, may be insufficient to resolve consumer confusion.

<sup>25</sup> *Id.*

<sup>26</sup> *Id.*

<sup>27</sup> *Id.* at 13–15. This problem is likewise exacerbated by the "single entity" consumer misperception, if it exists.

<sup>28</sup> *Id.* at 10; *see also* *Edwin K. Williams & Co. v. Edwin K. Williams & Co.-East*, 542 F.2d 1053, 1061 (9th Cir. 1976).

<sup>29</sup> STATEMENT OF PENNSYLVANIA INSURANCE COMMISSIONER JOEL ARIO ON HIGHMARK AND IBC CONSOLIDATION 3 (2009), *available at* [http://www.portal.state.pa.us/portal/server.pt/gateway/PTARGS\\_0\\_2\\_496354\\_0\\_0\\_18/Statement\\_final.pdf](http://www.portal.state.pa.us/portal/server.pt/gateway/PTARGS_0_2_496354_0_0_18/Statement_final.pdf).

<sup>30</sup> *Id.*

### B. Scope of the MFA Exemption

The MFA introduces a threshold inquiry before any court would reach the balancing of competitive effects in a hypothetical federal antitrust challenge to the national market allocation scheme of BCBS companies. The MFA provides that the Sherman Act, the Clayton Act, and the Federal Trade Commission Act “shall be applicable to the business of insurance to the extent that such business is not regulated by State Law.”<sup>31</sup> Thus, any form of insurer market allocation, including the BCBS national market allocation scheme, would be exempt from scrutiny under the federal antitrust laws if it constitutes “the business of insurance” and is “regulated by State Law.”<sup>32</sup>

The Supreme Court has identified three criteria for determining whether insurer conduct constitutes the business of insurance. The practice (1) must have the effect of transferring or spreading a policyholder’s risk, (2) must be integral to the policy relationship between the insurer and the insured, and (3) should be limited to entities within the insurance industry.<sup>33</sup>

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.<sup>34</sup> As Professor Herbert Hovenkamp has explained, “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 [state regulation] requirement is met.”<sup>35</sup>

In the next section, this Article examines the Supreme Court’s interpretation of the MFA’s statutory language in the context of

---

<sup>31</sup> 15 U.S.C. § 1012(b) (2006).

<sup>32</sup> Because the “boycott, coercion, or intimidation” exception to the exemption is not relevant to discussing the MFA’s impact on market allocation by insurers, it is left out of the MFA analysis in this Article. *See Hartford Fire Ins. Co. v. California*, 509 U.S. 764 (1993).

<sup>33</sup> HERBERT HOVENKAMP, *FEDERAL ANTITRUST POLICY: THE LAW OF COMPETITION AND ITS PRACTICE* 730–31 (3d ed. 1999) (citing *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119, 129 (1982), and *Grp. Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205 (1979)).

<sup>34</sup> *Id.* at 732.

<sup>35</sup> *Id.*

insurer market allocation, including the BCBS national market allocation scheme.

## II

### INSURER MARKET ALLOCATION AND COURTS' READING OF THE MFA

Judicial interpretation of the MFA has created hierarchies of significance among the components of an MFA exemption inquiry, regardless of the insurer conduct at issue. With respect to the two broad statutory requirements—the “business of insurance” requirement and the “regulated by state law” requirement—the former is more significant than the latter. This is reflected in courts’ having often found the “business of insurance” requirement determinative of whether conduct is exempt,<sup>36</sup> while the “regulated by State Law” requirement has evolved to become easily met.<sup>37</sup> And within the “business of insurance” requirement, there are further hierarchies of significance. The first two of the Supreme Court’s criteria for satisfying the statutory definition are more significant than the third. This is reflected in the fact that conduct can fail to be solely among entities within the insurance industry and survive the exemption inquiry, while conduct apparently never survives if it does not accomplish the transfer or spreading of risk or is not integral to the policy relationship between insurer and insured.<sup>38</sup>

Case law addressing whether market allocation is exempt under the MFA has conformed to this pattern. Three court opinions have analyzed the issue, and each focused primarily on the business of insurance requirement, particularly the first two of the Supreme Court’s three “business of insurance” criteria. The opinions suggest that courts remain reluctant to rule categorically on whether market

---

<sup>36</sup> See, e.g., *Pireno*, 458 U.S. at 134; *Royal Drug Co.*, 440 U.S. at 232–33; *In re Ins. Brokerage Antitrust Litig.*, 618 F.3d 300, 361 (3d Cir. 2010); *Garot Anderson Mktg., Inc. v. Blue Cross & Blue Shield United*, 772 F. Supp. 1054, 1063 (N.D. Ill. 1990); *Maryland v. Blue Cross & Blue Shield Ass’n*, 620 F. Supp. 907, 914–15 (D. Md. 1985). The definition of the “business of insurance” has also generated extensive case law outside the antitrust context. See Susan Beth Farmer, *Competition and Regulation in the Insurance Sector: Reassessing the McCarran-Ferguson Act*, 89 OR. L. REV. 915, 937–38 (2011).

<sup>37</sup> See *infra* Part II.B.

<sup>38</sup> See U.S. GEN. ACCOUNTING OFFICE, LEGAL PRINCIPLES DEFINING THE SCOPE OF THE FEDERAL ANTITRUST EXEMPTION FOR INSURANCE 4–5 (2005), available at <http://www.gao.gov/decisions/other/304474.pdf>.

allocation is exempt. Rather, the particular facts and circumstances of a market allocation scheme will dictate the outcome.

A. *The “Business of Insurance” Requirement*

1. *Transferring or Spreading Policyholder Risk*

Because the text of the MFA does not make any attempt to delineate the “business of insurance,” the Supreme Court has had to ascribe meaning to the phrase, and it has identified the transfer or spreading of risk as an “indispensable characteristic” of that meaning.<sup>39</sup> 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 term “insurance” in the MFA context. According to the Court, the quality of transferring or spreading risk is what separates insurance from similar but distinct endeavors: “It 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.”<sup>40</sup>

If it is a seemingly clear and meaningful criterion in the abstract, in reality, the “transfer or spreading of risk” is usually elusive and intangible. It is perhaps only directly accomplished in a fleeting moment during the execution of a policy agreement. Because very little activity can squarely fit such a description, 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.<sup>41</sup> Courts have held that 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.<sup>42</sup>

---

<sup>39</sup> *Royal Drug Co.*, 440 U.S. at 212.

<sup>40</sup> *Id.* at 211 (quoting 1 GEORGE J. COUCH, *CYCLOPEDIA OF INSURANCE LAW* § 1:3 (2d ed. 1959)); see also *SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65 (1959).

<sup>41</sup> See *Fed. Trade Comm’n v. Mfrs. Hanover Consumer Servs., Inc.*, 567 F. Supp. 992, 994 (E.D. Pa. 1983) (“The first criterion is whether the practice is to spread the risk. The answer to this inquiry depends largely upon how one defines the ‘practice.’”); see also *In re Ins. Brokerage Antitrust Litig.*, 618 F.3d at 356 (“As the disagreement between the majority and dissent in *Owens* illustrates, the precise characterization of the defendants’ conduct can be dispositive.”).

<sup>42</sup> See *Owens v. Aetna Life & Cas. Co.*, 654 F.2d 218, 247 (3d Cir. 1981) (“The tests applied by the Supreme Court in its two recent opinions interpreting the McCarran-

*Maryland v. Blue Cross & Blue Shield Ass'n* is the only federal court opinion involving a direct antitrust challenge to the BCBS national market allocation scheme met with an MFA defense, and the court labored over whether the scheme sufficiently accomplished the transfer or spreading of risk in satisfaction of the first *Pireno* criterion.<sup>43</sup> The State of Maryland brought suit against (1) Blue Cross and Blue Shield of Maryland, Inc. (BCBSM), an insurance provider licensed in Maryland; (2) Group Hospitalization and Medical Services, Inc. (GHI), another insurance provider licensed in Maryland; and (3) the BCBSA.<sup>44</sup> BCBSM and GHI were BCBSA member plans.<sup>45</sup> The State alleged, among other things, that the BCBSA's licensing agreements with BCBSM and GHI impermissibly allocated the insurance market in Maryland in violation of Section 1 of the Sherman Act.<sup>46</sup> The defendants "admitted the existence of the territorial allocation agreements,"<sup>47</sup> but submitted that the agreements were "exempt from federal antitrust scrutiny under the [MFA]."<sup>48</sup> Ruling on cross-motions for partial summary judgment on whether the MFA barred the State's claim, the court held that material factual issues remained for trial as to whether the BCBS market allocation scheme satisfied the first *Pireno* criterion.<sup>49</sup>

The evidence submitted by both sides on whether allocating markets accomplishes the transfer or spreading of risk belies the clarity of this criterion in defining the business of insurance. BCBSM

---

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.'" (quoting Sullivan & Wiley, *Recent Antitrust Developments: Defining the Scope of Exemptions, Expanding Coverage, and Refining the Rule of Reason*, 27 UCLA L. REV. 265, 288 (1979)).

<sup>43</sup> See *Maryland v. Blue Cross & Blue Shield Ass'n*, 620 F. Supp. 907 (D. Md. 1985). A nearly identical case challenging the BCBS national market allocation scheme was brought in the Northern District of Ohio, but it was resolved by the parties prior to a judicial decision. See 5 HEALTH CARE & ANTITRUST LAW, *supra* note 15 (discussing *Blue Cross & Blue Shield Ass'n v. Cmty. Mut. Ins. Co.*, No. C85-7872 (N.D. Ohio 1985)); *infra* notes 112–15 and accompanying text.

<sup>44</sup> *Blue Cross*, 620 F. Supp. at 909.

<sup>45</sup> *Id.*

<sup>46</sup> *Id.* The defendants had agreed that GHI would operate in Prince George's County and Montgomery County, while BCBSM would operate throughout the rest of the state. *Id.*

<sup>47</sup> *Id.* Indeed, BCBSA asserted that it imposed 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 912.

<sup>48</sup> *Id.* at 909.

<sup>49</sup> *Id.* at 917, 922.

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.”<sup>50</sup> He further stated that BCBSM was not familiar “with the health care costs charged in the D.C. metropolitan area” allocated to GHI and speculated that “if BCBSM were to market in the GHI area, it would have to charge higher rates.”<sup>51</sup> GHI’s expert, its vice president for actuarial services, stated in his affidavit that “provider charges and patient utilization vary among geographic areas . . . [and] [p]rovider charges and utilization rates determine insurance rates.”<sup>52</sup> 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 in those communities.”<sup>53</sup>

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.”<sup>54</sup> 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.<sup>55</sup> The State argued that “ASO contracts do not constitute the business of insurance because the insurance company assumes no risk.”<sup>56</sup>

Clearly, none of the parties could speak directly to whether the market allocation scheme actually accomplished the transfer or

---

<sup>50</sup> *Id.* at 910.

<sup>51</sup> *Id.* at 911.

<sup>52</sup> *Id.*

<sup>53</sup> *Id.*

<sup>54</sup> *Id.*

<sup>55</sup> *Id.*

<sup>56</sup> *Id.*

spreading of risk, so they reverted to “one-off” arguments that were designed to create (in the defendant’s case) or sever (in the State’s case) a link between market allocation and risk spreading. For their part, the defendants sought to intertwine the territorial allocations with the practice of cooperative ratemaking, which is a form of joint activity clearly recognized to be part of transferring risk and squarely within the business of insurance.<sup>57</sup> The State, meanwhile, sought to distinguish the market allocation scheme from the practice of cooperative ratemaking, alluding to cross-territorial incursions that imply that market allocation is ancillary to cooperative ratemaking and to the fact that territorial boundaries were observed for activities outside the business of insurance, which suggested 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. . . .<sup>58</sup>

. . . 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.<sup>59</sup>

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

---

<sup>57</sup> See *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119, 129 (1982); *Owens v. Aetna Life & Cas. Co.*, 654 F.2d 218, 225–26 (3d Cir. 1981) (“[D]eciding 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.”).

[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.” . . . This was so because of “the widespread view that it [was] very difficult to underwrite risks in an informed and responsible way without intra-industry cooperation.”

*Pireno*, 458 U.S. at 129 (quoting *Grp. Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205, 221–22 (1979)).

<sup>58</sup> *Blue Cross*, 620 F. Supp. at 914.

<sup>59</sup> *Id.* at 915.

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.<sup>60</sup>

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."<sup>61</sup> Although it stopped short of granting the State's motion for partial summary judgment on the MFA issue because the court believed the parties' affidavits raised material factual issues for trial, it 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 spreading and transfer through the provision of insurance."<sup>62</sup> The court added, "[t]his holding is consistent with the State's position."<sup>63</sup>

In *Garot Anderson Marketing, Inc. v. Blue Cross & Blue Shield United*, another federal court, under different circumstances, went further than the *Blue Cross* court and ruled that a market allocation scheme was not the business of insurance.<sup>64</sup> Although the challenged market allocation scheme in *Garot Anderson* involved two BCBS insurers, it did not concern the BCBS national market allocation scheme. The BCBSA was not named as a defendant, and the challenged allocation of markets was not achieved through the BCBSA licensing agreement. Here, the two BCBS insurers were accused of violating section 1 of the Sherman Act by conspiring directly with one another to allocate the market for one particular insurance plan.<sup>65</sup>

---

<sup>60</sup> *Id.* at 914–15.

<sup>61</sup> *Id.* at 917.

<sup>62</sup> *Id.* (emphasis added).

<sup>63</sup> *Id.*

<sup>64</sup> *Garot Anderson Mktg., Inc. v. Blue Cross & Blue Shield United*, 772 F. Supp. 1054, 1063 (N.D. Ill. 1990).

<sup>65</sup> *Id.* at 1057.



The Midwest Farm Program was an insurance plan marketed to Illinois farmers that was underwritten by Blue Cross and Blue Shield United of Wisconsin (BCBS-WI) but administered by Blue Cross and Blue Shield of Rockford (Illinois) (BCBS-IL) pursuant to an agreement between the insurers.<sup>66</sup> After BCBS-IL merged with another Illinois health insurance company, Health Care Services Corporation (HCSC), representatives from HCSC and BCBS-WI met to discuss problems with the Midwest Farm Program.<sup>67</sup> They then agreed to terminate the plan to avoid competition between the Midwest Farm Program and other comparable plans.<sup>68</sup>

Judge Roszkowski of the Northern District of Illinois needed only one paragraph to condemn the defendants' argument that their division of markets was exempt under the MFA.<sup>69</sup> Without reaching the remainder of the inquiry, the court held that defendants' conduct was not the business of insurance because it failed to meet both of the first two *Pireno* criteria.<sup>70</sup> In ruling that the defendants' conduct did not have the effect of transferring or spreading risk, the court noted only that the defendants had failed to make any showing that terminating the Midwest Farm Program shifted subscribers' risk from the subscribers to either defendant. With no evidentiary showing at all, as compared to the robust expert testimony put forth by the defendants in *Blue Cross*, the court ruled easily that the market allocation scheme in question failed to meet the first *Pireno* criterion.

The Third Circuit also had occasion to address whether a market allocation scheme accomplished risk spreading in *Owens v. Aetna Life & Casualty Co.*<sup>71</sup> In *Owens*, the plaintiff was an insurance broker who accused Aetna and certain affiliates of committing multiple Sherman Act violations, including withdrawal from the medical malpractice insurance market pursuant to a market allocation

---

<sup>66</sup> *Id.*

<sup>67</sup> *Id.*

<sup>68</sup> *Id.* The court could infer an agreement in part from a letter from BCBS-WI to HCSC, in which a BCBS-WI representative stated,

[T]here has been some concern by your marketing staff that the Midwest Farm Program . . . is competing with other Illinois Blue Cross programs in the Northern Illinois area. . . . In an attempt to eliminate the competitive nature of this program, we would propose to transfer the existing 831 subscribers now enrolled . . . .

*Id.*

<sup>69</sup> *See id.* at 1063.

<sup>70</sup> *Id.*

<sup>71</sup> *Owens v. Aetna Life & Cas. Co.*, 654 F.2d 218 (3d Cir. 1981).

agreement with other insurance companies.<sup>72</sup> The district court granted the defendants' motion for summary judgment, holding broadly that the MFA was a valid defense to all of the plaintiff's federal antitrust allegations.<sup>73</sup> 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,<sup>74</sup> dissenting Judge Sloviter took the majority to task for affirming on grounds that were neither cited by the district court nor argued by the defendants. She further chastised the majority for skirting "the difficult legal issue" of whether the MFA exempted plaintiffs' market division allegations, "a question of first impression" that she believed was decided on an inadequate legal basis.<sup>75</sup>

Although her dissenting opinion had no impact on the outcome in *Owens*, Judge Sloviter undertook a detailed analysis of whether market allocation should be exempt under the MFA, including whether it had the effect of transferring or spreading risk. She concluded that a market division agreement of the sort contemplated by Aetna did not:

It appears . . . unlikely that [in passing the MFA] 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 prior 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 withdrawal from markets suggests that these were not deemed to be activities meriting protection.<sup>76</sup>

---

<sup>72</sup> *Id.* at 220–21.

<sup>73</sup> The district court opinion was not published.

<sup>74</sup> *Owens*, 654 F.2d at 233.

<sup>75</sup> *Id.* at 236–37.

<sup>76</sup> *Id.* at 242–43 (Sloviter, J., dissenting) (emphasis added) (citations omitted).

The dissent seemed to be speaking categorically in noting broadly that an insurer who leaves a market avoids risk, rather than spreads it. Despite these strong words, however, Judge Sloviter did not go so far as to categorically condemn all market allocation as outside the scope of the MFA exemption. Believing the lower court was erroneous in *de facto* concluding that Aetna's particular market division scheme accomplished risk spreading, she nonetheless stated:

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 “[w]e 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 insurance is necessitated by the same considerations that underlie granting an exemption for other joint action.<sup>77</sup>

Ultimately, whether it is possible for insurance companies to make a showing that market allocation is positively related to risk spreading is an open question, at least in the District of Maryland and likely in the Third Circuit. In the Northern District of Illinois, a market allocation scheme by itself is not sufficiently related to risk spreading absent any evidence to the contrary. At a minimum, the opinions suggest that insurers will have to prove that any allocation of markets at least has “actuarial significance” or “actuarial relevance” to have the effect of transferring or spreading risk.

## 2. *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 *Pireno* requirement, that the activity in question be integral to the policy relationship between insurer and insured, attempts to clarify just what “business” is the “business of insurance.” In *Group Life & Health Insurance Co. v. Royal Drug Co.*, the Court

---

<sup>77</sup> *Id.* at 244 (quoting *White Motor Co. v. United States*, 372 U.S. 253, 263 (1963)).

noted that the relationship between insurer and insured is “commonly understood” to be central to the business of insurance.<sup>78</sup> It explained:

In enacting the McCarran-Ferguson Act, Congress was concerned with: “The 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.”<sup>79</sup>

Put another way, the statutory language exempts only the business of insurance and not any business in which an insurance company happens to engage.<sup>80</sup>

*Royal Drug* involved a group of pharmacies that sued Blue Shield of Texas, alleging that the insurer had fixed prices upon entering into agreements with other pharmacies for the provision of prescription drugs to Blue Shield of Texas policyholders.<sup>81</sup> In discussing whether the pharmacy agreements were between the insurer and the insured, the Court stated that “[t]he 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.”<sup>82</sup> However, Blue Shield argued that “nonetheless the Pharmacy Agreements so closely affect the ‘reliability, interpretation, and enforcement’ of the insurance contract and ‘relate so closely to their status as reliable insurers’ as to fall within the exempted area.”<sup>83</sup>

The Court rejected Blue Shield’s argument but not purely on the basis of contractual form. Discounting the fact that only the insurer and not the insured was a party to the pharmacy agreements, it emphasized instead that,

---

<sup>78</sup> Grp. Life & Health Ins. Co. v. Royal Drug Co., 440 U.S. 205, 215 (1979).

<sup>79</sup> *Id.* at 215–16 (quoting SEC v. Nat’l Sec., Inc., 393 U.S. 453, 460 (1969)).

<sup>80</sup> *Id.* at 217.

<sup>81</sup> *Id.* at 207. Although *Royal Drug* and *Pireno*, discussed *infra*, are price-fixing cases and do not involve market allocation, their facts are nonetheless useful in understanding the “integral part of the policy relationship between insurer and insured” criterion in the market allocation context.

<sup>82</sup> *Id.* at 216.

<sup>83</sup> *Id.*

[a]t the most, [Blue Shield has] demonstrated that the Pharmacy Agreements result in cost savings to Blue Shield which may be reflected in lower premiums if the cost 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.<sup>84</sup>

And as the Court alluded, business decisions by insurance companies are not always the business of insurance.<sup>85</sup>

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.<sup>86</sup> The Court explained that, regarding agreements like those in *Royal Drug* and here, such 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* it is paid."<sup>87</sup>

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] [t]o 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.'"<sup>88</sup>

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 integral to the policy relationship between insurer and insured—even if the parties to such agreements were entirely conspiring insurance companies, and not policyholders. However, if a given market allocation agreement is 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 *Maryland v. Blue Cross & Blue Shield Ass'n*, the District of Maryland had to wrestle with this question in the context of the BCBS

---

<sup>84</sup> *Id.* at 216–17.

<sup>85</sup> *Id.* at 217.

<sup>86</sup> *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119, 134 (1982).

<sup>87</sup> *Id.* at 132.

<sup>88</sup> *Id.* (quoting *Royal Drug Co.*, 440 U.S. at 216–17).

national market allocation scheme. 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.”<sup>89</sup> 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.”<sup>90</sup>

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.”<sup>91</sup> However, just as with the parties’ arguments on whether market allocation effectuates the transfer or spreading of risk, the court sided with the State but refused to rule. The court continued, “[t]he 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.”<sup>92</sup> Much like the *Owens* dissent’s risk-spreading analysis on the first *Pireno* criterion, the court seemed too committed to fact-based, case-by-case analysis to allow for a categorical classification of market allocation as integral or not integral to the policy relationship between insurer and insured.

On distinguishable facts in *Garot Anderson Marketing, Inc. v. Blue Cross & Blue Shield United*, the Northern District of Illinois was comfortable ruling that the market allocation scheme in question was

---

<sup>89</sup> *Maryland v. Blue Cross & Blue Shield Ass’n*, 620 F. Supp. 907, 917–18 (D. Md. 1985).

<sup>90</sup> *Id.* at 918.

<sup>91</sup> *Id.*; *cf. In re Ins. Brokerage Antitrust Litig.*, Nos. 04-5184 & 05-1079, 2006 WL 2850607, at \*10 (D.N.J. Oct. 3, 2006) (holding that defendants’ bid-rigging and steering practices were not the business of insurance and thus were not exempt under the 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” (quoting *Pireno*, 458 U.S. at 129)).

<sup>92</sup> *Blue Cross*, 620 F. Supp. at 918.

not integral to the policy relationship between insurer and insured. In reaching this conclusion, the court noted that the agreement between the two defendants was “the [primary] conduct at issue,” whereas the relationship between subscribers and Blue Cross-WI was “secondary.”<sup>93</sup> Importantly, the defendants in *Garot Anderson* apparently did not argue, as the defendants in *Blue Cross* did, that their market allocation scheme impacted ratemaking, which in turn impacted the insurer-insured relationship. It was this argument that prevented the *Blue Cross* court from definitively ruling on the second *Pireno* criterion.

### 3. Limited to Entities Within the Insurance Industry

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 criteria.<sup>94</sup> 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.”<sup>95</sup> 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 noninsurance markets.<sup>96</sup>

In *Blue Cross*, the BCBSA, which the court characterized as a trade association that does not underwrite insurance policies, was named as a participant in the market allocation scheme, and the District Court of Maryland examined whether BCBSA’s involvement would detract from an argument that the scheme was exempt. The court held that it did not.<sup>97</sup> The court believed that BCBSA was “intimately related” to the insurance companies because it was a nonstock, nonprofit

---

<sup>93</sup> *Garot Anderson Mktg., Inc. v. Blue Cross & Blue Shield United*, 772 F. Supp. 1054, 1063 (N.D. Ill. 1990).

<sup>94</sup> *Blue Cross*, 620 F. Supp. at 918 (“[T]he court notes that this last criterion should be given somewhat less weight than the previous two.”).

<sup>95</sup> *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119, 133 (1982) (“Arrangements between insurance companies and parties outside the insurance industry . . . may prove contrary to the spirit as well as the letter of [the MFA exemption], because they have the potential to restrain competition in noninsurance markets.”).

<sup>96</sup> *See id.*

<sup>97</sup> *Blue Cross*, 620 F. Supp. at 919.

association composed of local BCBS plans and because 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.<sup>98</sup> It held that “BCBSA is sufficiently related to the insurance company parties to be considered an entity in the insurance industry.”<sup>99</sup> The court was not dissuaded by the fact that the BCBSA does not actually underwrite insurance policies.

*4. Is Market Allocation, Generally, the “Business of Insurance”? In Particular, Is the BCBS Scheme?*

Both the *Blue Cross* holding and the *Owens* dissent illustrate the degree to which judges have eschewed bright lines in ruling categorically on whether market allocation, generally, is within or outside the scope of the MFA exemption.<sup>100</sup> If the dicta found in these opinions 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 the business of insurance at a level of granularity that makes categorical prediction next to impossible. This is perhaps as the drafters of the MFA intended, having used exceedingly broad language in the applicable portion of the statute without taking any steps to define it.<sup>101</sup> It is certainly in keeping with dissenting Judge Sloviter’s admonition in *Owens* that the business of insurance requirement demands a full factual inquiry before it can be definitively applied.<sup>102</sup> The few judges who have undertaken this inquiry with respect to market allocation schemes seem inclined to think they are not the business of insurance, but they took pains to allow arguments to the contrary unless, as in *Garot Anderson*, such arguments were not sufficiently made. Their approach seems to afford great deference to the complexities of, and their own unfamiliarity with, the economics of the insurance industry.

As *Pireno* and *Royal Drug* make clear, the crux of the analysis resides in whether the particular market allocation scheme alleged is

---

<sup>98</sup> *Id.*

<sup>99</sup> *Id.*

<sup>100</sup> *Id.* at 917–18; *Owens v. Aetna Life & Cas. Co.*, 654 F.2d 218, 234–47 (3d Cir. 1981) (Sloviter, J., dissenting).

<sup>101</sup> See 15 U.S.C. § 1012 (2006).

<sup>102</sup> *Owens*, 654 F.2d at 247 (Sloviter, J., dissenting).



truly related (or is “related positively”<sup>103</sup>) 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 noninsurance market) then the scheme’s likelihood of receiving protection under the exemption is decreased, though not altogether eliminated.

*Garot Anderson* and *Blue Cross*, both of which were decided in the summary judgment phase, pose an interesting contrast. Confronted with what it characterized as a paltry evidentiary showing by defendants as to the first two *Pireno* criteria, the *Garot Anderson* court had little difficulty in casting market allocation outside the scope of the business of insurance.<sup>104</sup> Yet, confronted with a complex evidentiary showing replete with testimony from multiple experts and, importantly, an argument that market allocation is intertwined with ratemaking (which the *Garot Anderson* defendants apparently failed to make), the *Blue Cross* court found it necessary to exercise perhaps excessive caution by denying both parties’ motions for summary judgment.<sup>105</sup>

The *Garot Anderson* court likely had it right, and the *Blue Cross* court erred in failing to rule for the State. Indeed, commentators have suggested that the two cases should be read together to assume that the question of whether market allocation is exempt has been sufficiently answered in the negative.<sup>106</sup> Although this

---

<sup>103</sup> *Blue Cross*, 620 F. Supp. at 917.

<sup>104</sup> See *Garot Anderson Mktg., Inc. v. Blue Cross & Blue Shield United*, 772 F. Supp. 1054, 1060–61 (N.D. Ill. 1990).

<sup>105</sup> *Blue Cross*, 620 F. Supp. at 922.

<sup>106</sup> See, e.g., James M. Burns, *Insurer Relationships with Third Parties—Agents, Brokers and Providers: The Antitrust Issues* (May 17, 2006), available at <http://www.abanet.org/antitrust/at-committees/at-ins/pdf/05-17-06/burns-james-05-17-06.pdf> (“Agreements among competing insurers or agents to allocate customers along territorial or product lines are *not* McCarran exempt and have been held to constitute *per se* unlawful conduct.”). Likewise, in a report on the scope of the MFA to the House Committee on Financial Services, the U.S. General Accounting Office divided agreements among insurers not related to ratemaking conduct into categories of exempt and nonexempt, and it listed agreements between insurers to allocate markets among the nonexempt. U.S. GEN. ACCOUNTING OFFICE, *supra* note 38, at 4, 26 (concluding that courts have denied antitrust immunity in cases involving agreements between insurers to allocate markets but noting that the *Blue Cross* court found there were material factual issues on the question of whether market allocation was the business of insurance). And in an exhaustive, recently issued opinion where defendant insurers asserted the MFA as a defense to allegations that

characterization might hold true under future facts, at present it is more accurate to suggest that the sparse case law leans toward answering in the negative but ultimately remains indeterminate. *Garot Anderson* stands for the proposition that a market allocation scheme, with no evidence that the scheme accomplishes risk spreading and no argument that its affect on ratemaking makes it integral to the policy relationship between insurer and insured, is not the business of insurance. But the *Blue Cross* court's denial of both parties' motions for summary judgment suggests that a market allocation scheme, coupled with plausible expert testimony, could be the business of insurance. No other cases refute this latter proposition. And because the BCBS scheme in particular was the backdrop against which this proposition was formed, we cannot be clear on whether it is the business of insurance and thus exempt under the MFA.

*Blue Cross* is the only extant federal court opinion addressing whether the BCBS national market allocation scheme, specifically, is the business of insurance, and its holding is cryptic. Although clearly siding with the State, the court refused to grant the State's partial summary judgment motion.<sup>107</sup> As to the first *Pireno* criterion, the court suggested that the defendants' arguments attempting to reconcile the BCBS scheme with the spreading of risk were too attenuated, but it decided that those same arguments could prove sufficient upon further factual inquiry.<sup>108</sup> The court also affirmatively concluded that the defendants' allocation of markets was "one step removed" from being integral to the policy relationship between insurer and insured, but at the same time, it determined it could not rule on the second *Pireno* criterion.<sup>109</sup> The court cited insufficient and contradictory evidence on whether the conduct in question affected ratemaking, which in turn could have affected the insurer-insured relationship.<sup>110</sup> Finally, on the third *Pireno* criterion, the court held that the BCBSA was an entity in the insurance industry,

---

they conspired not to compete for customers in violation of the Sherman Act, the Third Circuit cited frequently and often approvingly to the dissent in *Owens*, analogizing the facts of its case to the market allocation allegations in *Owens* and holding that the conduct in question was not the business of insurance for failing to meet the second *Pireno* criterion. *In re Ins. Brokerage Antitrust Litig.*, 618 F.3d 300 (3d Cir. 2010).

<sup>107</sup> *Blue Cross*, 620 F. Supp. at 922.

<sup>108</sup> *See id.* at 917.

<sup>109</sup> *Id.* at 918.

<sup>110</sup> *Id.*

and thus the conduct was sufficiently limited to entities in the insurance industry.<sup>111</sup>

In the same year that the State of Maryland brought its claim leading to the *Blue Cross* opinion, the State of Ohio brought a separate but nearly identical action in the U.S. District Court for the Northern District of Ohio. In *Blue Cross and Blue Shield Ass'n v. Community Mutual Insurance Co.*, the Ohio Attorney General accused the BCBSA and two BCBS member plans of violating section 1 of the Sherman Act by allocating markets pursuant to the BCBS national market allocation scheme.<sup>112</sup> The Ohio case never generated a published opinion and the Maryland case never garnered any further opinions because both cases were settled on similar terms through consent judgments.<sup>113</sup> The attorneys general were able to extract commitments from the defendants not to enforce the exclusive territorial provisions pursuant to the BCBSA licensing agreement in their respective states.<sup>114</sup>

### B. The “Regulated by State Law” Requirement

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 MFA. 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 that antitrust laws might prevent when a state has articulated an express policy to displace the federal competition laws and when it actively supervises the conduct at issue.<sup>115</sup>

---

<sup>111</sup> *Id.* at 918–19. 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 also failed to address the related question of whether BCBSA’s involvement in the scheme had any potential to affect competition in noninsurance markets. Still, the court at least was clear in finding for the defendants on the third criterion.

<sup>112</sup> See 5 HEALTH CARE & ANTITRUST LAW, *supra* note 15.

<sup>113</sup> See *id.*

<sup>114</sup> *Id.*

<sup>115</sup> Cal. Retail Liquor Dealers Ass’n v. Midcal Aluminum, Inc., 445 U.S. 97, 105 (1980); HOVENKAMP, *supra* note 33, at 732 (“Importantly, ‘regulated by state law’ for McCarran purposes means much less than the kind of state regulation necessary to qualify for the ‘state action’ immunity . . .”).

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 the MFA] is met.”<sup>116</sup> 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.<sup>117</sup> A state insurance commissioner or other state agency must merely have jurisdiction and authority over the conduct in question.<sup>118</sup> For example, courts have held that a state unfair insurance practices act, which prevents unfair or deceptive practices in the insurance business, is sufficient to trigger MFA protection for purposes of the state regulation requirement.<sup>119</sup> As of 1992, the House Judiciary Committee reported that not a single court had ever held any form of state regulation insufficient to trigger the MFA antitrust exemption.<sup>120</sup>

An insurer seeking cover under the MFA exemption has two primary obstacles to consider in meeting the state regulation requirement: the consequences of interstate conduct and the consequences of conduct involving foreign participants. In 1960, the Supreme Court held that, where interstate conduct is concerned, the state regulation must be applicable in the state where the conduct is practiced and its impact felt.<sup>121</sup> Thus, if a Nebraska insurer doing business in Virginia sought MFA protection for conduct practiced and felt in Virginia, a *Nebraska* statute governing the conduct would be insufficient to meet the state regulation requirement.<sup>122</sup>

Given the widespread regulation of insurance throughout most U.S. states, perhaps the only serious threat to the exemption posed by the state regulation requirement is the involvement of foreign actors. The state regulation requirement demands that participants in the conduct

---

<sup>116</sup> LAWRENCE A. SULLIVAN & WARREN S. GRIMES, *THE LAW OF ANTITRUST: AN INTEGRATED HANDBOOK* 729–30 (2000).

<sup>117</sup> *See Owens v. Aetna Life & Cas. Co.*, 654 F.2d 218, 244–45 (3d Cir. 1981) (holding that the state regulation requirement was met where the State of New Jersey had evidenced its intent to occupy the insurance business field); HOVENKAMP, *supra* note 33, at 732 (“[The state] need only pass a statute that purports to regulate.”).

<sup>118</sup> ABA SECTION OF ANTITRUST LAW, *INSURANCE ANTITRUST HANDBOOK* 25 (2d ed. 2006).

<sup>119</sup> *Id.* at 26.

<sup>120</sup> *Id.* (citing H.R. REP. NO. 102-1036, at 27 (1992)).

<sup>121</sup> *Fed. Trade Comm’n v. Travelers Health Ass’n*, 362 U.S. 293 (1960).

<sup>122</sup> *Id.*

be within the jurisdictional reach of the applicable state.<sup>123</sup> Thus, where a market allocation scheme involves foreign actors, the scheme might lose the exemption for failing to meet the state regulation requirement.

#### CONCLUSION

It is obvious that courts have struggled mightily in determining whether market allocation is exempt from federal antitrust scrutiny under the MFA, particularly in determining whether it can satisfy the business of insurance requirement. While a categorical conclusion from the courts that market allocation is or is not exempt is not impossible, existing case law suggests it is unlikely. If clarity is to come at all, it would likely have to come from legislative changes to the MFA.

Without more, this would be a very minor problem. In the sixty-five-year history of the statute, the number of federal antitrust challenges to insurer market allocation schemes that were met with an MFA defense can be counted on one hand. But the BCBS national market allocation scheme lends the problem tremendous gravity. Indeed, it may lend the problem central relevance to the national health care debate, which has turned largely on how rising health insurance costs can be addressed.

BCBS health insurance companies insure one of every three Americans,<sup>124</sup> and together they dominate the U.S. health insurance market. Yet, through the BCBSA, which they control,<sup>125</sup> BCBS companies have managed to avoid competition with one another by allocating markets geographically for most of the eighty-year history of the BCBS concept. It is true that, on balance, this arrangement might be procompetitive, and BCBSA has argued that its territorial divisions help it protect its intellectual property and prevent free riding.<sup>126</sup> But there is also evidence that Blue-on-Blue competition would inure to the benefit of consumers.<sup>127</sup>

At a minimum, repealing the MFA would remove a primary obstacle preventing interested BCBS plans from expanding their

---

<sup>123</sup> See *Hartford Fire Ins. Co. v. California*, 509 U.S. 764 (1993).

<sup>124</sup> *History of Blue Cross Blue Shield*, BLUE CROSS BLUE SHIELD ASS'N, <http://www.bcbs.com/about/history> (last visited Feb. 10, 2011).

<sup>125</sup> See *supra* note 13.

<sup>126</sup> See *supra* Part II.A.

<sup>127</sup> See *supra* note 29 and accompanying text.

market share at the expense of other BCBS plans. As the situation in central Pennsylvania<sup>128</sup> and a few other states, including California, North Carolina, Ohio, and Virginia, makes clear, certain BCBS companies have shown a willingness to compete with other BCBS companies. Of course, in other regions, it may be in the best interest of individual BCBS plans 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 a repeal of the MFA exemption may be required. Perhaps a legal action demonstrating a continuing agreement not to compete between Blues in adjacent markets could lead a court to issue 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.

---

<sup>128</sup> See *supra* note 29 and accompanying text.