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Jason C. Blackford



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# *Competition as a Means of Regulating Insurance*

*Jason C. Blackford**

THE SOLE THESIS of this paper is that competition among insurers, tempered by state supervision of their financial control, is a workable alternative to active state control of the business of insurance. It is not the purpose of this analysis to question the basic concept and the workability of affirmative government control of insurance. To test this thesis, a case study will be made of the rating process used in the business of automobile liability insurance in the State of Ohio.

## I.

## Historical Perspective

A historical perspective is necessary in order to understand how the issue of competition versus active state regulation developed. All early insurance companies, beginning with the Insurance Company of North America in 1794,[1] were incorporated by special charters granted by the state legislatures. These charters generally contained some regulatory provisions, such as requiring deposits of securities with state officials, directing how funds should be invested, and requiring a disclosure of relevant financial information. The fundamental reasons for these charter requirements were to provide a means for public disclosure of financial data and to protect the ability of the insurer to meet his obligations.[2] Due to the constant financial failures of the early insurance ventures, the states enacted many general regulatory laws directed at protecting the solvency of the insurers.[3] The thrust of state regulation remained directed toward the protection of the solvency of the insurer until the decision of the Supreme Court in *United States v. South East-*

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* Of the Ohio Bar; of the law firm of Weston, Hurd, Fallon, Sullivan & Paisley, of Cleveland.

1 The Insurance Company of North America began doing business in 1792 but was not incorporated until April 14, 1794, by an act of the Pennsylvania Legislature. Mowbray & Blanchard, Insurance 452 (4th ed. 1955). It was not until 1898, that Travelers Insurance Company wrote the first automobile liability policy on the car of a Buffalo, New York doctor. Crane, Automobile Insurance Rate Regulation, 8 (1962).

2 Kimball, Purpose of Insurance Regulation: A Preliminary Inquiry in the Theory of Insurance Law, 45 Minn. L. Rev. 471-472 (1961); Oppenheimer, Insurance and the Anti Trust Laws, 1961 Ins. L. J. 807 at p. 809; Mowbray & Blanchard, *supra* n. 1, at 452-454.

3 To increase the expertise and the efficiency of state regulation, the responsibility tended to gradually become centralized in separate board of insurance commissioners. The state legislatures began to create and to define the powers of these specialized boards. New Hampshire 1851—N. H. Laws, Ch. 1111; Massachusetts 1852 —Mass. Acts and Resolves 1852, ch. 231; Vermont 1852—Vt. Laws 1852, No. 45 SS 15, 16; Rhode Island 1855—R.I. Laws 1854 (Oct. Sess.), p. 17 SS 17; New York 1859—N.Y. Laws 1859, ch. 366.

*ern Underwriters' Association* (S.E.U.A.).[4] Since that decision and the subsequent legislation, many states have attempted to expand the scope of their regulation by assuming the control function over policy forms, trade practices, services rendered to the insured and over-the-market structure of the industry. The underlying reason for the increased scope of state regulation has been generally to prevent federal control of these areas.

To understand this alteration in emphasis, a brief inquiry should be made into the conflict over the relative roles of the federal and state governments in the regulation of the business of insurance.

**State-Federal Conflict**

*Prior to U.S. v. S.E.U.A., supra,* the courts uniformly had held that the business of insurance was an intra-state transaction by focusing on the concept of insurance as a contractual distribution of the risks.[5] The holding of the Supreme Court in *U.S. v. S.E.U.A.* overruled this long line of precedent[6] and stated that insurance was commerce which was interstate in character, and therefore the insurance industry was subject to the restrictions of the Sherman Act.[7] The majority opinion did

[4] 322 U.S. 533 (1944); See Sawyer, Insurance as Interstate Commerce, 41-49 (1945); Beach, The South Eastern Underwriter's Decision and Its Effect, 1947 Wis. L. Rev. 321; Highsaw, Insurance as Interstate Commerce: An Analysis of the Underwriters Case, 6 La. L. Rev. 24 (1944); Powell, Insurance as Commerce, 57 Harv. L. Rev. 937 (1944); Note, 44 Colum. L. Rev. 772 (1944).

[5] The main and often cited case is Paul v. Virginia, 8 Wall 168 (1858) where an agent of a non-resident fire insurance company, which had not fulfilled the Virginia statutory requirements, was charged with a criminal violation of the Virginia insurance code. The Supreme Court rejected the defendant's contention that insurance was interstate commerce and upheld the Virginia State statute as it regulates intrastate commerce. See also: Hooper v. California, 155 U.S. 648 (1895); New York Life Insurance Company v. Peer Lodge County, 231 U.S. 495 (1913); Liverpool Insurance Company v. Massachusetts, 10 Wall. 566 (1870); Ducat v. Chicago, 10 Wall. 410 (1870); Philadelphia Fire Association v. New York, 119 U.S. 110 (1886); Noble v. Mitchell, 164 U.S. 367 (1896); Orient Insurance Co. v. Doggs, 172 U.S. 389 (1899); New York Life Insurance Co. v. Cravens, 178 U.S. 389 (1901); Nutting v. Massachusetts, 183 U.S. 533 (1902); Colgate v. Harvey, 296 U.S. 404 (1935). In the above cases, the insurance companies argue that the business of insurance was interstate commerce and therefore not subject to state regulation. See generally Sawyer, *supra* note 2 at 33-40.

[6] One view states that although these numerous decisions were overruled, the underlying theories were not specifically rejected. Note, 23 Chi-Kent L. Rev. 317 at 319 (1945).

[7] In U.S. v. S.E.U.A., *supra,* n. 4, a majority of four reversed the District Court which sustained the demurrer of the defendant rating bureau to the indictment which had alleged (1) a criminal conspiracy to restrain trade and commerce by fixing and maintaining non competitive premium rates on fire and allied lines of insurance in six Southern states and; (2) a conspiracy to monopolize the trade and commerce of fire insurance in the six state area. Mr. Justice Black writing for the majority held that insurance was commerce, stating "Interrelationships, interdependence, and integration of activities in all states in which they operate are practical aspects of the insurance companies' method of doing business." At p. 541. Since the business of insurance was interstate commerce, the prohibitions of the Sherman Act were applicable.

not concern itself with the analysis of what should be the proper institution for regulating the business of insurance or how the industry should be structured, but merely stated that Congress had plenary power over the field of insurance.[8] This decision not only rocked the insurance industry to the core but undermined the existing state regulatory structure which was based on cooperation among insurers. Many of the ordinary actions of the state insurance commissioners were considered overnight to be violations of federal law.[9] The insurance companies immediately were faced with the important problem of what to do about their membership in rating bureaus which were then essential to the gathering of experience data, but which were not subject to the Sherman Anti-Trust condemnation of all price fixing agreements.

While *U.S. v. S.E.U.A.* was pending before the Supreme Court, there were companion bills[10] introduced into both Houses of Congress to exempt the business of insurance from federal antitrust legislation. There were extensive hearings and debate on these bills, but both proposals died in a Senate committee.[11] After the decision in *U.S. v. S.E.U.A.*, Congress awakened from its slumber by cries of anguish from the insurance industry, particularly that the application of the federal anti-trust laws to the field of insurance would prevent the collection of accurate experience data.

The original version of S. 340,[12] which was known as the McCarran-Ferguson Act, evolved from a proposal prepared by the National Association of Insurance Commissioners.[13] The basic policy of P.L. 15, as

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8 "The first part of this argument is buttressed by opinions expressed by various persons that unrestricted competition in insurance results in financial chaos and public injury. Whether competition is a good thing for the insurance business is not for us to consider. Having the power to enact the Sherman Act, Congress did so; if exceptions are to be written into the Act, they must come from Congress, not this Court." *Id.* at 561.

9 Dineen, Gardner, Proctor, The Economics and Principles of Insurance Supervision, Insurance and Government 10 (1962).

10 On September 20, 1943, s. 1362, 78th Cong., 1st Sess., known as the Bailey-Van Nuys Bill, was introduced. On May 1, 1944, the committee reported on S. 1362 favorably, but on May 15, 1944, the bill was referred back to the Senate Subcommittee for further study, and there the bill died. On September 21, 1943, H.R. 3269; H.R. 3270, 78th Cong., 1st Sess., known as the Walter-Hancock Bill was introduced. On June 22, 1944, the House passed this bill by a vote of 283 to 54. Note that the passage was after the decision in U.S. v. S.E.U.A. which was handed down on June 5, 1944.

11 One of the main reasons advanced for the failure of S. 1362 to pass was a survey conducted by the Department of Justice which revealed that in about half of the states, which had rating organization, there were insufficient provisions and inadequate mechanisms for coping with price fixing conspiracies. See, Hearings before the Subcommittee on the Study of Monopoly Power of the Joint Committee on the Judiciary, 78th Cong., 1st Sess. (1943) 55-57; and Comment, 58 Mich. L. Rev. 730 at 732 (1960).

12 79th Cong., 1st Session (1945).

13 90 Cong. Rec. 8482, 9628, A 4403 (1944). The final bill was also approved by the National Association of Insurance Commissioners, 91 Cong. Rec. 479 (1945). For an excellent analysis of the legislative history of P.L. 15 see Comment, 67 Yale L. J. 452 at 454 n. 4 (1958).

the final bill became known, was to indicate clearly that Congress desired that the business of insurance be subject to state laws and state taxes.[14] It was not the intention of Congress to clothe the states with more power to regulate or to tax than the states had prior to the decision in *U.S. v. S.E.U.A.*[15] The Act instituted a moratorium until January 1, 1948[16] on the applicability of the federal anti-trust laws to the business of insurance, and after the moratorium the federal antitrust laws were to apply to the insurance industry to the extent that it was not regulated by state law. Congress justified this partial exemption for the business of insurance from the federal antitrust laws on the grounds that a certain degree of cooperation among the insurers was necessary for the gathering of sufficient experience data and effective rate making.[17] The congressional debates on the bill indicate that Congress primarily was concerned with the allocation of Federal-State responsibility for regulating the business of insurance rather than determining the proper institution of social control.[18]

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[14] 59 Stat. 33 (1945), as amended 15 U.S. (§§ 1011-1015 [1958]).

1) Congress declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several states.

2) (a) The business of insurance, and every person engaged therein shall be subject to the laws of the several states which relate to the regulation or taxation of such insurance business.

(b) No Act of Congress shall be construed to invalidate, impair or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: Provided, that after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is regulated by state laws.

3) (a) Until June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of Oct. 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, and the Act of June 19, 1936, known as the Robinson-Patman Anti-Discrimination Act, shall not apply to the business of insurance or to acts in conduct thereof.

(b) Nothing contained in this chapter shall render until the said Sherman Act inapplicable to any agreement to boycott, coerce, or intimidate, or act of boycott, coercion, or intimidation.

The last two sections are not quoted. See Sen. Rep. No. 1112, 79th Cong. 1st Sess.

[15] H.R. Rep. No. 134, 79th Cong., 1st Sess.

[16] P.L. 238, 80th Cong., 1st Sess. (1947) extended the moratorium until July 1, 1948.

[17] Sen. Rep., *supra* n. 14, at 5; Dineen, Gardner and Proctor, *supra* n. 9, at 35-36.

[18] 91 Cong. Rec. 1444 (1945) remarks of Senator White and Senator McCarran; McConnell, State Regulation v. State Regulation Plus Regulation by Multiple Decentralized Independent Federal Agencies, 1956 Ins. L. J. 697.

**Basis for State Regulation**

After the passage of P.L. 15 and the subsequent Supreme Court decisions in *Prudential Insurance Company v. Benjamin*[19] and in *Robertson v. California,*[20] the legal basis for continued state regulation was established firmly. The judicial arm of the government stated its intention to support state regulation and state taxation until the time when Congress decided to occupy the area.

The immediate problem that confronted the insurance industry and the state insurance commissioners was what action had to be taken to prevent the application of federal laws, particularly the antitrust laws. The crux of this problem was the proviso[21] that the Sherman Act, the Clayton Act, and the Federal Trade Commission Act would be applicable to the business of insurance to the extent that such business is not "regulated" by state law. Two interpretations of the word "regulated" have been championed vigorously: One view is that the passage of state insurance legislation is all the regulation necessary to satisfy this proviso; the other view is that the only active and affirmative regulation by state administrative bodies under state statutes would fulfill the requirements of the proviso.[22]

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19 328 U.S. 408 (1946). In this case, an insurance company domiciled in New Jersey claimed that the South Carolina tax of 3% on all premiums written in that state by a foreign insurance company, was an unconstitutional discrimination against interstate commerce. The Supreme Court held that P.L. 15 had effectively delegated to the states the authority to impose such a tax. Mr. Justice Rutledge writing for the majority declared: "Obviously Congress' purpose was broadly to give support to the existing and future state systems for regulating and taxing the business of insurance. This was done in two ways. One was by removing obstructions which might be thought to flow from its own power, whether dormant or exercised, except as otherwise expressly provided in the Act itself or in future legislation. The other was by declaring expressly and affirmatively that continued state regulation and taxation of this business is in the public interest and that the business and all who engage in it shall be subject to the laws of the several states in these repects." At 429-430.

20 328 U.S. 440 (1946). The Supreme Court rejected the appeal by Robertson from a conviction for violating a California statute which made it a misdemeanor to act as an agent for a non-admitted insurer. Robertson had been acting as an agent in California for an Arizona benefit society which was not licensed in California and which could not be licensed because it could not meet the California financial qualifications. The Court upheld the power of California to regulate the business of insurance conducted in that state and that this power existed independent of the McCarran-Ferguson Act which had not been enacted at the time of the conviction of Robertson. Mr. Justice Rutledge in the majority opinion wrote:

> "Furthermore, here as in the cited cases, unless one measure of local control is permissible," the activities and their attendant evils 'must go largely unregulated,' unless or until Congress undertakes that function. California v. Thompson, *supra* (313 U.S. at p. 115). And in review of the well-known conditions of competition in this field, such a result would not only free out of state insurance companies and their representatives of the regulations effect, thus giving them advantages over local competitors, but also by so doing would tend to break down the system of regulation in its purely local operation."

Note that the opinion makes specific reference to the effect of unrestrained competition on the business of insurance. Compare this to the analysis in U.S. v. S.E.U.A., 59 Stat. 33 (1945).

21 U.S.C. §§ 1012 (b) (1958).

22 An excellent statement of the two positions is found in Kimbal & Boyce, The

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The Congressional debate does not indicate a uniform understanding of the meaning of "regulated." [23] Several Senators expressed a fear that the states might enact passive legislation which would merely shield the business of insurance from the Federal anti-trust laws and which would fail to provide protection from predatory combinations of the type prohibited by the Federal anti-trust laws.[24] Senator McCarran, one of the sponsors of P.L. 15, in giving the explanation of the bill, confused the problem by his continual reference to state legislation rather than state regulation.[25]

After the enactment of P.L. 15, several federal officials announced that the separate states must take an active role in regulating the business of insurance in order to avoid application of the federal anti-trust laws.[26] The states were well aware of the position of the federal gov-

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Adequacy of State Insurance Regulation: The McCarran-Ferguson Act in Historical Perspective, 56 Mich. L. Rev. 545, at 567. The authors conclude that adequate regulation is necessary to insulate the insurance from the application of the federal anti-trust laws.

23 *Id.* at 571-576.

24 91 Cong. Rec. 1444 (1945) (remarks of Senator O'Mahoney), "I do not conceive this to be a grant of power to the States to authorize by permissive legislation obviously adverse combination which would be against the public interest." *Id.* (question by Senator Barkley): "I should like to ask in this connection, whether, where States attempt to occupy the field—but do it inadequately—by going through the form of legislation so as to deprive the Clayton Act, the Sherman Act, and the other acts of their jurisdiction, it is the Senator's interpretation of the conference report that in a case of that kind, where the legislature fails adequately even to deal with the field it attempts to cover, these acts would apply?" (Answer by Senator McCarran) "That is my interpretation." 91 Cong. Rec. 1488 (1945) (remarks by Senator Barkley): "But I wish it to be understood that in voting for approval of the conference report I am accepting the interpretation placed upon it by the conferees, namely that if any State, through its legislature undertakes to go through the form of regulation merely in order to put insurance companies within that State on an island of safety from congressional legislation that effort will be futile and not only can Congress deal with any phase of the insurance business not dealt with by a State legislature, but even in the case in which a State legislature deals with any phase of it, but does not deal with adequately in the opinion of Congress, Congress is not in any way barred by the conference report from dealing with the subject and with any phase of it which Congress deems to have been inadequately dealt with by the State; so that thereafter we can enact such legislation as we may deem proper and wise to have enacted in connection with the regulation of this business which clearly is interstate commerce."

25 91 Cong. Rec. 1442 (1945) (question by Senator Murdock): "And it is intended that on the expiration of the moratorium the Sherman Act, and the Clayton Act and the other acts mentioned will again become effective except—" (answer by Senator McCarran) "Except as far as the States themselves have provided regulations."; 91 Cong. Rec. 1443 (1945) (remarks of Senator McCarran); 91 Cong. Rec. 1481 (1945) (remarks of Senator Ferguson).

26 "After the moratorium period, the anti-trust laws and certain related statutes will be applicable in full force and effect to the business of insurance except to the extent that the states have assumed the responsibility, and are effectively performing that responsibility, for the regulation of whatever aspect of the insurance business may be involved. It is clear that Congress intended no grant of immunity for monopoly or for boycott, coercion or intimidation. Congress did not intend to permit private rate fixing, which the anti-trust act forbids, but was willing to permit

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ernment when the legislatures approached the problem of "regulating" the insurance industry.[27] The National Association of Insurance Commissioners, acting through its Federal Legislative Committee, created the All Industry Committee which was composed of various representatives of the insurance industry. The All Industry Committee drafted several model bills[28] which were thought to conform to the intent of Congress and to provide the states with a workable statutory mechanism for the task of regulating the business of insurance. The State of Ohio, as well as most other states, adopted the basic structure of many of these model bills. It is important to note that these model bills were designed so that competition neither was to be encouraged nor discouraged.[29] The main motivation for the adoption by the states of these model bills was to avoid the heavy hand of federal regulation and not to determine whether competition or active state regulation was the appropriate means for the control of insurance.[30]

**Interpretation of State Regulation**

Faced with the problem of how to interpret the McCarran-Ferguson Act in specific situations, the courts have failed to adopt a uniform meaning of "state regulation." The Supreme Court in *FTC v. National Casualty Company* (FTC v. American Hospital Life Insurance Company) [31] held that mere enactment of legislation by state legislatures, to prohibit

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actual regulation of rates by affirmative action of states." President Franklin D. Roosevelt on signing P.L. 15 on March 9, 1945.

". . . the view we hold toward insurance is not unlike our policy toward railroad rates, that fixing of rates by private groups in either field without active and definite state approval, is a clear contravention not only of the act, the theory that competition should be free unless it is specifically regulated by the appropriate body." Attorney General Biddle, on November 11, 1945 to Drafting Committee of the Council of State Governments.

[27] "Revision of State Systems for Insurance Regulation," Report and Recommendations of the Insurance Committee of the Council of State Governments (1946).

[28] The main model bills that were drafted by the All Industry Committee are: Model Fire, Marine and Island Marine Rate Regulatory Bill; Model Casualty and Surety Rate Regulatory Bill; Unfair Trade Practices Bill; Unauthorized Insurers Service of Process Bill. For a compilation of the states that have enacted various modifications of the model laws, see Donovan, Regulation of Insurance under the McCarran Act, 15 Law & Contemp. Prob. 473 at 485 n. 52 (1950); Comment, *supra* n. 11, at 735 n. 23. The basic provisions of the Model Casualty and Surety Rate Regulatory Bill provide: 1. Rates must be adequate, not excessive, and not unfairly discriminatory, 2. Insurers may combine to fix and file rates or may file their own rates, but are subject to review by state supervisors to see if the statutory standards are satisfied, 3. Rating bureaus are permitted but strict safeguards such as licensing and examination. There is also protection afforded to subscribers and minority members.

[29] Joint Report of the Committee on Federal Legislation and the Committee on Rates and Rating Organizations of the N.A.I.C. (December 5, 1945) N.A.I.C. Proc. 94.

[30] Boyce & Kimball, *supra* n. 22, at 555; McHugh, Rate Regulation Revisited, in, Insurance and Government, 385, at 387 (1962).

[31] 357 U.S. 560 (1948).

unfair and deceptive advertising by insurance companies, was sufficient to preclude the FTC from asserting jurisdiction. In a per curiam opinion, the Court stated:

> Petitioner (FTC) also argues in a different vein that even if the McCarran-Ferguson Act bars federal regulation where state regulation has been effectively applied, the exercise of the Commission's authority in these cases should be upheld because the States have not "regulated" within the meaning of Section 2(b) proviso. This argument is not persuasive in the instant case. Each state in question has enacted prohibitory legislation which prescribes unfair insurance advertising and authorizes enforcement through a scheme of administrative supervision. Petitioner does not argue that the statutory provisions here under review are merely pretense. Rather it urges that general prohibition designed to guarantee certain standards of conduct are too inchoate to be regulation until that prohibition has been crystallized into "administrative elaboration of standards and application in individual cases." However, assuming there is some difference in the McCarran-Ferguson Act between "legislation and regulation," nothing in the language of that Act or its legislative history supports the distinctions drawn by the petitioner. So far as we can determine from the records and arguments in these cases, the proviso in Section 2(b) has been satisfied.[32]

This was in line with the Court's earlier dicta in *Robertson v. California.*[33]

The lower federal courts generally have refused to delve into effectiveness of the state regulatory system if applicable legislation was in existence. In *Northern Little Rock Transportation Company v. Casualty Reciprocal Exchange,*[34] the defendants moved for summary judgment on the grounds that there was "regulation" under the Arkansas statute. The court granted a summary judgment after noting the state statutory mechanism for rate filings by rating bureaus. The mere existence of a legislation governing the premiums charged was sufficient to preclude the application of the federal anti-trust laws. Similar holdings were made in *California League of Independent Insurance Producers v. Aetna Casualty & Surety Company*[35] and *Miley v. John Hancock Mutual Life Insurance Company.*[36]

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[32] *Id.* at 564-565.

[33] *Supra,* n. 20.

[34] 181 F.2d 174 (CA-8, 1950). The facts of this case were that the plaintiff, a taxi cab company, was unable to obtain liability insurance because of poor accident experience, and applied to the Arkansas Automobile Assigned Risk Plan. Plaintiff was assigned to Aetna Casualty & Surety Company, which charged the plaintiff premiums as determined by the National Bureau of Casualty Underwriters, a licensed rating bureau in Arkansas. Plaintiff filed a private treble damage action under the Sherman Act claiming that such actions constitute price fixing and were in restraint of trade.

[35] 175 F.Supp. 857 (N.D. Cal. S.D. 1959).

[36] 148 F.Supp. 299 (D.C. Mass., 1957) aff'd. 242 F.2d 758, cert. denied 355 U.S.

The most recent judicial approval of state regulations of insurance came in a decision of *Allstate Insurance Company v. Lanier.*[37] Allstate challenged the North Carolina law that required all insurers authorized to do business in that state to be members of a rating bureau. The basic rate of this bureau was the minimum rate as only upward deviations by insurers were permitted by state law. The plaintiffs contended that a private group (the rating bureau, not the state) was setting the insurance rates. Judge Sobeloff rejected this contention by stating, that under North Carolina law, the final authority over premiums was vested in a state regulatory body. The existence of a state administrative review validated the private price fixing which would have been illegal under federal law.

The widely publicized decision of *United States v. Chicago Tile & Trust Company*[38] was the first instance where there was state regulatory law and the state law did not displace the federal anti-trust law. There the government sought to nullify Chicago Title's acquisition of 90% of the stock of Kansas City Title Insurance Company. Government attorneys claimed that section 7 of the Clayton Act was violated as the acquisition eliminated the possibility of competition between Chicago Title (the nation's second largest title company) and Kansas City Title (the nation's seventh largest title company). To the defendant's defense of existing state regulation, the government filed a motion for partial summary judgment stating that the state legislation must cover the "same ground" as the federal legislation.[39] In granting a partial summary judgment the court refused to accept the defendant's contention that rate regulation accomplished the same results as the federal antitrust laws. The only authority for this holding was a student's note[40] and a confusing finding of fact in another federal district court.[41] This District Court decision is an anomaly and should be confined to the facts in that case. The recent case of *Transnational*

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[37] 361 F.2d 870 (CA-4, 1966).

[38] 242 F.Supp. 56 (N.D. Ill. E.D. 1965). The final consent decree was filed against the defendants wherein divestiture of certain acquisitions was ordered. ATTR No. 250, A-18, 4/26/66.

[39] In support of its motion, the government attorneys produced the depositions of three successive Superintendents of Insurance of Missouri which stated that they knew of no Missouri statute or regulation regulating the acquisition by a foreign title insurance company of the stock of a domestic title insurer.

[40] Note, Application of Federal Antitrust Laws to the Insurance Industry, 46 Minn. L. Rev. 1088 (1962).

[41] Maryland Casualty Company v. American General Insurance Company, 232 F.Supp. 620 (1964), Finding of Fact No. 2 (Para. 71-188 CCH, 1964 Trade Cases):

> "No regulation of the proposed acquisition of control of Maryland Casualty Company or its agencies under Texas or Maryland statutes can be adequate or effective because of territorial limitation of Texas and Maryland regulation. Texas and Maryland statutes do not provide for adequate or effective regulation of the proposed acquisition of control of Maryland or its agencies and there is no such regulation as precludes this suit under anti-trust laws."

*Insurance Co. v. Rosenland*[42] is more probably in line with the purpose of the McCarran-Ferguson Act. There the court held that a state statutory framework, though not a verbatim repetition of the federal antitrust laws, was substantial compliance for the insurance exemption. No inquiry was made as to the adequacy of enforcement. As a prerequisite to evaluating properly the adequacy of state regulations or the application of antitrust principles to insurance, the nature of insurance must be thoroughly understood.

## II.

## Economic Character of Automobile Liability Insurance

It is extremely difficult to have a meaningful analysis of competition as an institution for social and economic control unless there is an understanding of the product and the character of the industry. Automobile liability insurance is a mechanism by which the risk of loss arising from claims of those injured and damaged in motor vehicle accidents are distributed throughout society. The contract of risk distribution, the policy, is a complex legal document specifically outlining the respective rights and obligations of the insured and the insurer. Most of these policies are difficult for the average person to understand and to comprehend.[43] The insured must depend in purchasing insurance upon the integrity of the agent and upon the reputation of the company.

Any analysis of the automobile liability insurance industry must be made with an understanding of its inherent economic characteristics. First, there is a relatively low fixed cost of operation for the individual companies. Approximately eighty per cent of all costs in the industry are variable, in other words, vary with the value of the policies in effect.[44] The main variable costs are losses, claim expenses, state premium taxes, and commissions to sales agents. This low proportion of fixed costs to variable costs indicates that economics of scale are theoretically either minimal or non-existent in any increase in volume of outstanding policies. There is some debate among the experts as to whether actually there are economies with an increase in business.

Second, closely related to costs is the relative ease of entry into the business. The statutory requirements in most states are low and there is little need for a special technological background as a prerequisite to entry. The necessary rating experience for rate preparation can be obtained from one of several organizations. The main barrier to entry of new companies involves the access of the insurer to the individual con-

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42 261 F.Supp. 12 (D.C. Ore., 1966).

43 There has been a trend among certain "independent" insurers to simplify the policy into terms which are understandable by the public.

44 Crane, *supra*, n. 1, pp. 18-19.

sumer. An effective sales organization cannot be created overnight but must be developed by gaining the confidence of the public and hiring top-flight agents.

Of critical importance from the regulatory standpoint is the structure of a market model for the industry. The model is characterized by a highly inelastic demand curve and an elastic supply curve. This inelastic demand curve arises from the fact that there is no substitute for insurance, particularly because of the compulsory insurance laws of some states. The inelastic character of the demand curve is demonstrated by the constant volume of auto liability insurance written during the depression years of 1929 to 1933.[45] The supply curve of the automobile liability insurance business is considered elastic as any increase in the demand for insurance generates but a minor price increase. Any substantial increase in demand (from an increase in the driving population) shifts the entire supply curve to the right as the capacity of the industry may be increased by either the entry of additional insurers or the expansion of additional insurers. This theoretical analysis is complicated by the consumers' impressions of the rates charged by the various insurers. Several consumer surveys have shown that a substantial number but a decreasing percentage of automobile policy holders believe that all companies charge the same premium for the same coverage. A comprehensive survey conducted in 1956 by the National Bureau of Casualty Underwriters indicated that 43% of those interviewed thought that all automobile insurers have the same rates. The consensus in other surveys indicates that automobile policy holders consider the premium more important than other factors in purchasing insurance coverage. The National Bureau study found that approximately seventy per cent of the policyholders of rate bureau companies believed that they were obtaining the lowest possible rates. These results can be interpreted to mean that good salesmanship on the part of the agents of the bureau companies has shifted the attention of the public to the nonprice competition. This means also that the rate bureau companies are vulnerable to "discount" price advertising of the direct writers or bureau companies which have filed lower rate deviation.[46]

To summarize, the economic characteristics of the business of automobile liability insurance are:

1. The product being sold is risk distribution.
2. The product is in the form of a complex legal document not fully understood by the public. The public is dependent upon the intelligence of the agents.

[45] Best's Fire and Casualty Aggregates and Averages (Alfred M. Best Co., 1960) p. 21.

[46] Crane, *supra,* n. 1, p. 49.

3. The demand for automobile liability is growing due to the increased number of drivers. The demand for such insurance is relatively inelastic to price changes due to lack of a substitute.
4. The consumer claims to be interested in the premium rate but he is relatively uninformed as to rate structure throughout the industry. This has led to vigorous non-price competition in such fields as (a) coverage, (b) advertising, and (c) service.

## III.

## Objectives of Social Control

Before an evaluation can be made of the institutions for social control, the objectives for social control of the industry must be outlined. The equalization of the cost of a loss by a distribution of risks is achieved primarily through private means but regulated by state administrative agencies. The increasing demand that all automobiles and all automobile drivers should be insured is gradually altering this basic focus of automobile insurance from a controlled private socialization of the risk to a public enterprise. The objectives of rate making under the private system of distribution of risks may be separated into two general categories—solvency and reasonableness.[47]

### Solvency

Solvency is the financial ability of an insurer to meet not only its current obligations but also satisfy any future claims under existing policies.

The role of capital in the solvency of a going insurance company is relatively minor because the business operates on a risk distribution basis; however in the early days of any insurance company, capital plays a vital role until the "law of large numbers" permits the insurer to function with safety as a risk distributor.[48] The key to a determination of an "adequate" rate is an accurate estimate of future liabilities with respect to the present coverage. This means that adequate rates for one insurer might not be the same for another insurer if there is a different risk of loss covered.[49]

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[47] Kimball, *supra*, n. 2, at 486. Professor Kimball, one of the foremost authorities in the field of insurance regulation, used the term, "reasonable" in a far broader sense in his analysis than the term is used in this paper. Professor Kimball stated that: "The objective of *acquum et bonum* is present in some degree in most systems of insurance law and regulation. It has many facets: It is equity. It is morality. It is fairness, equality, reasonableness. It may even be efficiency, economy, parsimony."

[48] *Id.*

[49] In the field of transportation, the Interstate Commerce Commission and the federal courts have held that a "reasonable" rate was not dependent on the rate of return. Board of Railroad Commissioners of Iowa v. Illinois Central Railroad Company, 20 I.C.C. 181 (1911); Hooker v. Interstate Commerce Commission, 188 F.2d 242 (1911), reversed on other grounds 225 U.S. 302 (1912). In both of these cases, the courts assumed a competitive situation in reaching their determination.

**Reasonableness**

The nebulous term, "reasonableness," in relation to automobile liability insurance rates primarily means that the rates to the insured should not be "excessive" and that there should be a fair classification of the risks. The reason for the policy against "excessive" rates is that since insurance is essentially a risk distribution process, others than the risk takers should not reap inordinate profits from the rates. It is extremely difficult to define the word "excessive." One rather circular approach is to determine what is a "reasonable rate of return" for the owners of the company. Most statutory definitions have attempted to measure "excessiveness" by subjective standards.[50] It has been left to the discretion of the insurance commissioner of the various states to interpret "excessive." The result has been that the meaning of "excessive" has varied according to the views and backgrounds of the insurance commissioners and according to the tradition and precedents of his office.[51]

The concept of fairness is that the policyholders should be classified in valid categories[52] so that each insured will carry the cost of his own insurance.[53] This requires an accurate refinement of the risk calculations as balanced against the cost of the classification.

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[50] Cal. Ins. Code, Art. 2 § 1852(a) (1947) "No rate shall be held to be excessive unless (1) such rate is unreasonably high for the insurance provided, and (2) a reasonable degree of competition does not exist in the area which the rate is applicable."

The definition of "inadequate" under California law also refers to the institution of competition for meaning. Cal. Ins. Code Act § 1852(a) (1947): "No rate shall be held to be inadequate unless (1) such rate is unreasonably low for the insurance provided and (2) the continued use of such rate endangers the solvency of the insurer using the same, or unless (3) such rate is unreasonably low for the insurance provided and the use of such rate by the insurer using same has, or if continued will have, the effect of destroying competition or creating a monopoly."

Ohio, which has no statutory definition of excessive, has a court developed law that a policyholder may recover from the insurer "excessive" premiums if the rates bear no relationship to the risk insured against. Hartford Life Insurance Co. v. Douds, 103 Ohio St. 398 (1921), affirmed 261 U.S. 476 (1923); Hartford Life Insurance Co. v. Langdale, 103 Ohio St. 433 (1921), affirmed 261 U.S. 476 (1923). There have been no cases in Ohio involving this principle under Ohio law. See 30 Ohio Jur.2d §§ 394-397, at 366-7.

[51] Onfield, Improving State Regulation of Insurance, 32 Minn. L. Rev. 219 at 244 (1948).

[52] Most states prohibit insurance companies from making any distinction or discrimination on the basis of race or color as to rates charged. Ohio has such a provision only with regard to life insurance companies. Ohio R.C. § 3911.16 (1953). There is in Ohio an informal racial discrimination process on the agent level in the field of automobile liability insurance. This is extremely difficult to prove and to ascertain to what degree there is such discrimination.

[53] For example, most automobile insurance companies have a special category for insureds under the age of twenty-five. Is there any specific reason for this arbitrary use of the age 25? One writer has observed: "The discovery and validation of the appropriate categories which reach to the heart of the risk variation is a difficult matter especially since the search gets so easily in unrealized biases of the rate makers." Kimball, *supra,* n. 2 at 496. Consider also the special automobile

(Continued on next page)

Other competing and often conflicting objectives of rate regulation that should be recognized are: (1) The ability of rates to be responsive to risk conditions; (2) the need for stability in the rate structure in order to create public confidence; and (3) the need to encourage the reduction of losses.[54]

## IV.

## Institutions of Social Control

The next step in this analysis is to evaluate the institutions as to their capability of attaining and of encouraging the attainment of the objectives of insurance. Under the present social and economic system, there are two primary means by which the business of insurance is regulated: (1) Government *control* or *supervision;* (2) *Competition* supplemented by a limited amount of government *supervision.* Neither of these two primary alternatives are absolute but rather are hybridizations of the two institutions of private competition and government control or supervision.

As stated at the outset, the purpose of this paper is not an attempt to compare or to evaluate the relative merits of active government regulations and of private competition, but to demonstrate that a system based on competition provides a workable framework for the social control of the business of insurance. So let us examine the arguments advanced by the opponents of an insurance industry based on competition.

### Arguments Against Competition

There are many within the insurance business and several academicians who believe that competition cannot be a workable means of achieving the objectives of insurance because of the basic nature of the competitive system. The main argument of these critics of competition is that premium rate competition among insurers tends to become destructive with a resulting impairment of the financial structure of the entire business of insurance. To substantiate their argument, they point to instances in the last century where rate competition among insurers supposedly was responsible for the financial collapse of many companies with resulting loss to many policyholders.[55] In the alternative, these

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(Continued from preceding page)

liability insurance policies for "clear risks." As a public policy should the accident-prone driver be forced off the highways unless that driver pays an extremely high "toll" in the form of insurance rates?

[54] Kupp, The Rate Making Process in Property and Casualty Insurance—Goals, Techniques and Limits, 15 Law & Contemp. Prob. 493 at 494-495 (1950).

[55] To the knowledge of this writer, there has never been a study conducted of the actual causes of the widespread failures in the insurance industry during the last century. It is possible that these failures could be attributed to other factors such as poor management, inaccurate estimation of liabilities or poor investments.

critics of competition reason further that since destructive competition or the threat of destructive competition is intolerable to the competitors, the insurers will cease to compete, and will seek the shelter of cooperation. In this collective hive, a monopoly would take root and seek to use its economic power to foist excessive rates upon the powerless public and to punish any recalcitrant insurer who would dare to attempt to disturb their profits.[56]

Another argument advanced against competition in the business of insurance is that competition by its nature encourages a greater fluctuation of rates which would lead to a misallocation of the economic cost of insurance. In other words, the fluctuation in rates due to market pressure would force the purchasers of insurance protection to pay different sums to the same insurer for the distribution of the same risk.[57]

Another fear expressed by these critics of competition is that a competitive situation might permit the stronger insurance companies to use their larger financial and organizational resources to obtain a larger percentage of the market and to force smaller and marginal insurers out of business.[58] This would erect not only barriers to entry, but would weaken the protection afforded by the smaller insurance companies to their policyholders.

A final argument advanced by these foes of insurance competition is that competition would breed a multitude of policies which tend to confuse the public. In more practical terms they state there is the possibility that the policy language, created by one insurer after much effort and work, would be appropriated by another insurer and altered to give the secondary insurer several "talking points" in favor of its form.[59]

After this enumeration of these theoretical evils of competition in the business of insurance, the next step of the analysis is to study the effects of competition in a practical setting in order to ascertain whether these predicted calamities come to pass.

**Method of Analysis**

To study the effects of competition as a means of regulating the rates of automobile liability insurers, an examination of the rating process of such insurers in Ohio will be made. Ohio was selected be-

[56] This assumes the present legal structure where the federal antitrust laws would not be applicable.

[57] This argument overlooks the fact that the insurer in fluctuating the rate is only changing his rate of return. The basic cost of distributing the risk remains the same, although the total cost to the consumer may vary. This argument depends on a specific definition of cost.

[58] Donovan, Rate Regulation Revisited, Insurance and Government, 291, at 314 (1962).

[59] Marryott, Twelve Years of Insurance as Commerce—Prospects for the Future, 1957 Ins. Counsel J. 191 at 193.

cause of the "file and use" law which permits insurers to change their rates in Ohio by filing new schedules with the Ohio Department of Insurance. This type of regulatory process is the type that will permit rate competition to exist. First, an examination must be made of the potential competitive forces and the operation of the rating process. Then an evaluation must be made as to whether competition does in fact exist.

**Ohio Rating Forces**

In Ohio, there are four major groups involved in automobile liability rating process. First is the National Bureau of Casualty Underwriters, a nationwide rating organization of stock insurance companies. Throughout the country, the National Bureau accounts for rate filings on approximately half of all automobile liability insurance premiums. It is comprised of several hundred members throughout the country whose premium constitute about eighty per cent of the organization's total volume. There are also numerous subscribers who utilize the rates filed by the National Bureau and are entitled to the other services of the organization. Effective January 2, 1968, there was a consolidation of the National Bureau and the National Automobile Underwriters Association into the Insurance Rating Board, which will have approximately 125 members and subscribers operating in Ohio.

The second nationwide rating organization is The Mutual Insurance Rating Bureau composed of non-stock or mutual insurers. The Mutual Bureau operates in 42 states and has approximately fifty members and fifty subscribers. While the National Bureau and the Mutual Bureau do not cooperate formally in establishing rates, the Mutual Bureau adds the experience data of the National Bureau to its own data in the computation of rates. The National Bureau utilizes its own experience in the computation of its rates.

The third rating organization, which operates only in Ohio, is the Ohio Bureau of Casualty Insurers which has 28 members and subscribers.[60] The Ohio Bureau does not restrict its experience data just to its own members and subscribers although its members include some of the largest automobile liability insurers in the state. The Ohio Bureau pursues an independent course from the other two rating bureaus.

The fourth force among Ohio automobile liability insurers is the "independents" or the companies that are not affiliated with any of the rating organizations. Although classified as "independents," most of these insurers are either members or subscribers to the National Association of Independent Insurers (NAII). It is not a rating bureau as the insurers affiliated with the association make and file their own rates

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60 Letter from John C. Winchell, Secretary-Manager of Ohio Bureau of Casualty Insurers to author dated August 23, 1966.

independently. Nineteen of the NAII's members are domiciled in Ohio and over 150 other members do business in Ohio.[61] Two of the largest automobile liability insurers in Ohio are NAII members—Nationwide and Allstate. These independents do not appear to operate with unity of purpose, rather each company pursues its own goals and selects its own rates. The degree of cooperation and the operation of these rating organizations is regulated by the Ohio Revised Code.

**Ohio Statutory Regulation of Rating Bureaus**

The Ohio statute requires that all rating bureaus operating in Ohio must obtain a license.[62] The superintendent of insurance must grant a license when the applicant is:

> competent, trustworthy, and otherwise qualified to act as a rating bureau and that its constitution, its articles of agreement or association or certificate of incorporation, and its bylaws, rules and regulations governing the conduct of its business conform to the law.[63]

If any insurer's application to become a subscriber in a rating organization is not granted or rejected by the bureau, the applicant may request a review by the Ohio superintendent of insurance. If the superintendent finds that the denial of an application was without "justification," the rating bureau will be required by the superintendent of insurance to admit that insurer as a subscriber.[64] The rating bureau is required not to discriminate in furnishing its services to members or subscribers.[65] Investigation has failed to reveal a reported instance of a bureau's refusal to grant an Ohio automobile insurer membership to an applicant or of a bureau's discrimination in furnishing services to Ohio members and subscribers.

As to the degree of cooperation among the rating organizations, all cooperative activity is subject to the supervision of the Superintendent of Insurance. Either upon a complaint or upon his own initiative, the Superintendent may order hearings on the alleged illegal cooperation. If it is determined after a hearing that the cooperative activity is "unfair, unreasonable, or otherwise inconsistent" with the provisions of the insurance code, a written order may be issued directing the discontinuance of the cooperation.[66] To date, the cooperative actions of the insurers in sharing experience data has not been challenged by the Ohio Department of Insurance.

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[61] Letter from Charles J. Lorenz, of the National Association of Independent Insurers to author dated September 12, 1966.

[62] Ohio R.C., § 3935.06 (1933).

[63] *Ibid.*

[64] *Id.*

[65] *Id.*

[66] *Id.*

### Criteria for Reviewing Rates

In addition to regulating the degree of cooperation among rating organizations and insurers, the main task of the Ohio Department of Insurance is to review rates submitted by the bureaus and by individual insurers. The statute outlines in detail the elements which are to be considered in the formulation of casualty rates. Section 3937.02 of the Ohio Revised Code states that:

> All casualty rates shall be made in accordance with the following:
>
> (A) Due consideration shall be given to:
>
> (1) Past and prospective loss experience within and outside this state;
>
> (2) The experience or judgment, or both, of the insurer or rating organization making the rate;
>
> (3) The experience of other insurers or rating organizations;
>
> (4) Physical hazards;
>
> (5) Catastrophe hazards;
>
> (6) A reasonable margin for underwriting profit and contingencies;
>
> (7) Dividends, savings, or unabsorbed premiums, deposits allowed or returned by insurers to their policyholders, members, or subscribers;
>
> (8) Past and prospective expenses both countrywide and those specially applicable to this state;
>
> (9) All other relevant factors within and outside this state.

It must be re-emphasized that the Superintendent of Insurance *does not set* premiums but merely *approves* on the basis of the above criteria the rates submitted by the rating bureaus and the insurance companies. It is the responsibility of the insurers to formulate their own premium rates for submission to the Superintendent of Insurance.

### Method of Calculating Rates

The method of calculation of automobile liability rates is generally uniform among the rating organizations and the insurers who file independently or who file rates that deviate from the rates submitted by their rating organization. First, a system of classifying the risks is developed. This is done by a careful evaluation of the experience data. Categories are devised on the basis of geographical area, age of the driver, use, mileage and other hazards.[67] Once the classification is determined, the dollar value of the loss exposure is calculated. Then, the insurer allocates to each classification the applicable expense and the

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[67] A complete outline of the system used by the National Bureau is National Bureau of Casualty Underwriters, Manual of Automobile Insurance Rules and Rates—Ohio (1966).

profit requirements.[68] The insurers then utilize the "pure premium" method in determining the final rate. In its simplest terms, the pure premium method involves ascertaining the dollar-and-cents cost for losses per unit of exposure, through a review of experience data, and then adding to the proposed pure premium, the expenses, underwriting profit and reserves for contingencies.[69] It should be re-emphasized that this entire process is dependent upon an accurate and wide collection of experience data.

**Filing Procedure**

The party filing the rate is not required to submit supporting data unless the Superintendent does not possess "sufficient" information.[70] In major rate changes, a vast quantity of actuarial data accompanies the filing. For the minor filings, such as small classification and rate alterations, a minimum of substantiating evidence is presented. The rating organizations or the actuarial department of individual insurers prepare this supporting material.

Once filed, the rate becomes effective automatically after fifteen days; although the superintendent may extend this period an additional fifteen days.[71] At any time after filing, the superintendent has the authority to hold a hearing on whether the rate complies with the standards of

[68] Ohio R.C. § 3937.02. (B) The system of expense provisions included in the rates for use by any insurer or group of insurers may differ from those of insurers of groups of other insurers to reflect the requirements of the operating methods of any such insurer or group with respect to any kind of insurance, or with respect to any subdivision or combination thereof for which separate expense provisions are applicable.

(C) Risks may be groups by classifications for the establishment of rates and minimum premiums. Classification rates may be modified to produce rates for individual risks in accordance with rating plans which establish standards for measuring variation in hazard or expense provisions, or both. Such standards may measure any difference among risks that can be demonstrated to have probable effect on losses or expenses.

Classifications or modifications of classifications, or any portion or division thereof, of risks may be predicated upon size, expense, management, individual experience, purpose of insurance, location or dispersion of hazard, or any other reasonable considerations, providing such classifications and modifications apply to all risks under the same or substantially the same circumstances or conditions. Classification rates may also be modified to produce rates for individual or special risks which are not susceptible to measurement by any established standards.

[69] "Suppose for example, that the pure premium from a review of the experience is $1.50, and the expense provision (including the profit factor) is forty per cent; then the final rate would be $1.50 ($1.50 divided by 1.00 — .40) or $2.50. Then 60 per cent of this rate, or $1.50, is for losses, and the remaining 40 per cent, or $1.00 is the expense provision." Michelbacher, Multiple Life Insurance 84 (1957); an excellent analysis is found in Zoffer, The History of Automobile Liability Insurance Rating (1959). See generally, Stern, Current Rate Making Procedures for Automobile Liability Insurance (Casualty Actuarial Society 1961).

[70] See Ohio R.C. § 3937.02(A) (1953).

[71] Ohio R.C. § 3935.04. There is also a provision which permits the superintendent to authorize a filing which has been reviewed to become effective before the end of waiting period or any extension of the waiting period.

the law. If the standards of the statutes are not satisfied, then the Superintendent can issue an order rendering the rate ineffective after a reasonable period of time. The standard by which the Superintendent is to analyze the proposed rate is contained in Ohio Revised Code, Section 3937.02(D) which states that, "Rates shall not be excessive, inadequate or unfairly discriminatory," nor have the Ohio courts had the opportunity to render an interpretation of these words. The Insurance Department also has failed to give any public clarification of the exact meaning of these statutory requirements. In recent years there have been several formal hearings on the rates filed by insurers. One of the more recent hearings concerned the proposed automobile rate of Allstate Insurance Co. and whether the rates were excessive in light of the profits earned by the company in the preceding years.[72] Another well publicized hearing was on the rates proposed by the National Bureau of Casualty Underwriters and National Automobile Underwriters Association.[73]

The Department of Insurance, in lieu of the formal proceedings, has adopted an informal screening device of refusing to accept the filing or indicating in advance that the proposed filing would be rejected. This informal proceeding has been invoked only a "few" times when the rate filing was so inadequate as to endanger the solvency of the insurer.[74] This informal procedure has reduced the financial and resource burden on the department which a statutory hearing would entail.

After the rate has become effective, the filing and any supporting information are subject to public inspection. After the effective date of the rate, any person who is "aggrieved" by the filing may file an application for a hearing. Note that this standard of private parties differs from that given by statute to the Superintendent (i.e., "excessive, inadequate, or unfairly discriminatory").

These procedural requirements apply to all companies engaged in the business of insurance in Ohio. An insurer may satisfy these filing requirements by being a member or a subscriber in a licensed rating bureau which makes the rate filings. The member or subscriber must submit to the superintendent a written authorization to accept any rates filed by the bureau on its behalf.[75] Every member and subscriber of a licensed rating organization must adhere to the rate made on its behalf

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[72] The Allstate rates amounted a 7% increase on automobile liability rates and a 4% increase on collision rates. William Morris, the Ohio Superintendent of Insurance, noted that Allstate had made a 6.7% underwriting profit in 1966.

[73] The rates were proposed on November 30, 1966 and in response to a complaint by the AFL-CIO, a hearing was held on February 14, 1967 through February 16, 1967. The proposed rates were for companies comprising 16.9% of the automobile liability insurance volume. The proposed rates were accepted.

[74] This information was obtained through conversations and interviews with various members of the insurance business and with certain state officials.

[75] Ohio R.C. § 3935.04(B).

by the bureau; however, any member or subscriber may make a written application for a uniform percentage deviation from any rates proposed by the bureau.[76] If the deviations are approved by the superintendent, then the deviation rates will become effective for one year.

**Deviations**

This deviation process could be easily adopted to placing substantial roadblocks in the paths of deviators or potential deviators.[77] First, the rating bureau could subject the deviator to a long and costly hearing when the application for deviation is first filed. Second, even if the rating bureau does not protest the deviation rate, the superintendent could demand a vast array of supporting data and statistics, which could stall the matter for many months. Finally, the standards by which the superintendent is to evaluate the deviation rate are far from clear.[78] The exact number of deviation rate filings in Ohio is not readily available but informed sources say that there are a substantial number of deviation rate filings each year.[79] Investigation has failed to reveal any instance where a rating organization has attempted to harass a deviator by means of filing a protest and insisting on a formal hearing.

In summary, the policy of the Superintendent of Insurance[80] and the rating section of the Department of Insurance has been to permit the rates for automobile liability insurance. What have been the results of regulating insurance in Ohio by permitting competition?

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[76] Ohio R.C. § 3935.07 which states in part: Such application shall specify the basis for the modification and a copy thereof shall be sent simultaneously to such rating bureau. The superintendent shall set a time and place for a hearing at which the insurer and such rating bureau may be heard, and shall give them not less than ten days' written notice thereof. If the superintendent is advised by the rating bureau that it does not desire a hearing, he may, upon the consent of the applicant, waive such hearing. . . . The superintendent shall issue an order permitting the deviation for such insurer to be filed if he finds it *justified*, and it shall thereupon become effective. He shall issue an order denying such application if he finds that the resulting premiums would be *excessive, inadequate*, or *unfairly discriminatory*. . . . (Emphasis added.) See also, 30 Ohio Jur.2d § 55, p. 89.

[77] Dirlam and Stelzer, Insurance Industry: A Case Study in the Workability of Regulated Competition, 107 U. Pa. L. Rev. 199 (1958); Stone, Rate Regulation v. Rate Making, 1955 Ins. L. J. 107.

[78] ". . . the policy of the Ohio insurance department. In determining whether or not a rate deviation is justified, the Ohio department recognizes loss experience in the following order of importance: (1) Ohio loss experience of the insurer; (2) Ohio loss experience of other insurers or rating bureaus; and (3) Loss experience of the insurer or other insurers or rating bureaus outside the State. Thus the primary importance is attached to the experience of the particular insurance company in filing the new rate. In addition it is significant to note that the regulations of the Ohio Department of Insurance contain specific sections informing the insurance companies of the procedures to follow in filing deviations as to rules, coverage and form." Ohio Department of Insurance Rating Section General Bulletin No. 26, Filing Requirements—Rates, Rules and Coverage, § II (Jan. 17, 1958).

[79] This was confirmed by an examination, which was made of the Department of Insurance Newsletters for the past six years.

[80] Ninety-Eighth Annual Report of the Director of Insurance 1965. Statement of William R. Morris, p. 1.

## V.
## Analysis

### Concentration in Ohio Liability Insurance

The next inquiry must be whether the market for automobile liability insurance in Ohio is competitive and whether this competition does accomplish the goals of rate regulation—solvency and reasonableness. The question of whether a given market is competitive is a matter of definition and degree. One of the key guidelines to determining the degree of competition is the absence of a monopoly power by one or more firms.

Table I presents the nine major automobile liability insurers in Ohio in the period of 1962-1965. This four-year period was selected since all financial data of the companies for these years is available to the public. During the 1962-1965 period there were over 450 insurers in Ohio which were authorized to sell automobile liability insurance.

TABLE I

Premiums of Automobile Liability Insurance
(Bodily Injury) For the State of Ohio
1962-1965

1962

| Company | TOTAL PREMIUMS Volume of Automobile Liability Insurance | Rank | Percent of Market |
|---|---|---|---|
| Aetna Casualty & Surety Company | $ 4,075.323 | 7 | 2.988 |
| Allstate Insurance Company | 9,128,773 | 2 | 6.694 |
| Buckeye Union Insurance Company | 7,978,447 | 4 | 5.851 |
| Grange Mutual Casualty Company | 7,996,540 | 3 | 5.863 |
| Motorist Mutual Insurance Company | 4,809,485 | 8 | 3.527 |
| Nationwide Mutual Insurance Company | 17,001,150 | 1 | 12.466 |
| State Auto Mutual Insurance Company | 7,539,370 | 5 | 5.528 |
| State Farm Mutual Company | 3,839,233 | 9 | 2.815 |
| Travelers Indemnity Company | 5,538,836 | 6 | 4.062 |
| Total of All Insurers in Ohio | $136,369,654 | | |

1963

| Company | TOTAL PREMIUMS Volume of Automobile Liability Insurance | Rank | Percent of Market |
|---|---|---|---|
| Aetna Casualty & Surety Company | $ 4,478,406 | 9 | 3.110 |
| Allstate Insurance Company | 9,347,284 | 2 | 6.491 |
| Buckeye Union Insurance Company | 7,888,994 | 5 | 5.479 |
| Grange Mutual Casualty Company | 9,260,822 | 3 | 6.430 |

*(Continued next page)*

TOTAL PREMIUMS

| Company | Volume of Automobile Liability Insurance | Rank | Percent of Market |
|---|---|---|---|
| Motorist Mutual Insurance Company | 5,153,573 | 8 | 3.579 |
| Nationwide Mutual Insurance Company | 17,813,222 | 1 | 12.369 |
| State Auto Mutual Insurance Company | 8,037,571 | 4 | 5.581 |
| State Farm Mutual Company | 6,757,016 | 6 | 4.692 |
| Travelers Indemnity Company | 5,878,339 | 7 | 4.082 |
| Total of All Insurers in Ohio | $144,010,786 | | |
| **1964** | | | |
| Aetna Casualty & Surety Company | $ 5,043,171 | 9 | 3.927 |
| Allstate Insurance Company | 10,346,735 | 3 | 6.763 |
| Buckeye Union Insurance Company | 8,276,777 | 5 | 5.411 |
| Grange Mutual Casualty Company | 11,061,528 | 2 | 7.231 |
| Motorist Mutual Insurance Company | 5,738,862 | 8 | 3.752 |
| Nationwide Mutual Insurance Company | 18,989,883 | 1 | 12.414 |
| State Auto Mutual Insurance Company | 8,277,524 | 4 | 5.411 |
| State Farm Mutual Company | 7,882,728 | 6 | 5.153 |
| Travelers Indemnity Company | 6,144,571 | 7 | 4.017 |
| Total of All Insurers in Ohio | $166,045,504 | | |
| **1965** | | | |
| Aetna Casualty & Surety Company | $ 6,233,839 | 9 | 3.754 |
| Allstate Insurance Company | 12,477,444 | 2 | 7.514 |
| Buckeye Union Insurance Company | 11,045,036 | 4 | 6.652 |
| Grange Mutual Casualty Company | 12,171,562 | 3 | 7.330 |
| Motorist Mutual Insurance Company | 7,057,179 | 7 | 4.250 |
| Nationwide Mutual Insurance Company | 19,743,813 | 1 | 11.891 |
| State Auto Mutual Insurance Company° | 9,583,967 | 5 | 5.772 |
| State Farm Mutual Company | 9,519,920 | 6 | 5.733 |
| Travelers Indemnity Company | 6,233,849 | 8 | 3.754 |
| Total of all Insurers in Ohio | $166,045,504 | | |

Source: Reports of the Superintendent of Insurance For the Years 1963, 1964, 1965 and 1966.

The largest insurer in the state did only 12.466 per cent of the total automobile liability insurance business and this percentage declined over the four-year period. At the same time the three closest competitors had a greater rate of growth than did Nationwide. Next, note that there was a change in the relative ranking of eight of the nine major insurers. It is evident from these statistics that no company is a monopoly as defined by the Sherman Antitrust Law,[81] absent any predatory practices. From an economic viewpoint, this market is relatively fragmented in relation to such industries as steel, autos, copper and computers.

**Adjustments**

Next, the rates of automobile liability insurance must be analyzed in relation to the increased number of vehicles and the inflation that has characterized this industry. An industry-wide approach is undertaken since company-by-company analysis would produce a distortion, because of the degree of coverage afforded by different policies and because the rate changes of many companies occur at different times. Table II shows the increase of motor vehicles registered in Ohio.

TABLE II

Motor Vehicles Registered in Ohio
(Excluding Government-Owned Vehicles)

| Year | No. of Vehicles | Total Increase (1962 = 100) | Annual Increase Per Cent |
|---|---|---|---|
| 1962 | 3,832,475 | 100 | -0- |
| 1963 | 3,982,192 | 103.906 | 3.906 |
| 1964 | 4,169,057 | 108.782 | 4.876 |
| 1965 | 4,404,095 | 114.915 | 6.133 |
| 1966 | 4,681,183 | 122.145 | 7.230 |
| 1967 | 4,840,000 (Est.) | 126.289 | 4.144 |

Source: U. S. Bureau of Public Roads, as reported in Automobile Facts & Figures published by Automobile Manufacturers Association, Inc. for the Years 1963 through 1968.

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[81] The three tests of monopolization were summarized by Judge Wyzanski in United States v. United Shoe Machinery Corp., 110 F.Supp. 295, at 342 (D.C. Mass., 1953), aff'd. per curiam 347 U.S. 521 (1954): (1) if the firm has acquired or maintained a power to exclude others as a result of an unreasonable restraint of trade; (2) if the firm has the power to exclude competition and has either exercised or has the purpose to exercise such power; (3) if the firm has an overwhelming show of the market and if this market share is not due to superior skill, products or other natural advantages. In that case the defendant had approximately 85% of the market.

Although it has been said that bigness is not per se illegal, 90% "is enough to constitute a monopoly; it is doubtful whether 60 or 64% would be enough; and certainly thirty-three per cent is not." United States v. Aluminum Company of America, 148 F.2d 416, at 424 (CA-2, 1945).

TABLE III

Adjustment for Inflation
(Consumer Price Index 1957-59 = 100)

| Year | Consumer Price Index |
|---|---|
| 1962 | 105.4 |
| 1963 | 106.7 |
| 1964 | 108.1 |
| 1965 | 109.9 |
| 1966 | 113.1 |

Source: Federal Reserve Bulletin, June, 1968 Table A-64.

When these two adjustments are applied to the total premium volume of automobile liability insurance, there should be an absolute premium per registered vehicle in Ohio.

TABLE IV

| Year | Total Premium For Automobile Liability Insurance | Total Vehicles Registered In Ohio | Premium Dollar Per Vehicle (Total Premium) (Total Vehicles) | Consumer Price Index | Adjusted |
|---|---|---|---|---|---|
| 1962 | $136,369,654 | 3,832,475 | $35.58 | 105.4 | 33.76 |
| 1963 | 144,010,786 | 3,982,192 | 36.16 | 106.7 | 33.89 |
| 1964 | 152,969,197 | 4,169,057 | 36.69 | 108.1 | 33.94 |
| 1965 | 166,045,504 | 4,681,183 | 35.47 | 109.9 | 32.27 |

It appears from these figures that the premium dollar per registered vehicle has remained approximately constant in 1962 through 1964 and decreased in 1965. One important assumption of this approach must be stated. This analysis has assumed that the percentage of uninsured vehicles has remained constant throughout this period. At this moment the writer has no statistical information to show that the number of uninsured motorists have increased. Furthermore, the uninsured vehicle should be accounted for by the premium charged for the uninsured motorist coverage which would be reflected in the total premium volume. In spite of the imperfections of this analysis, it refutes the generally accepted notion that insurance rates are always advancing. No effort is attempted herein to state categorically that real premiums for automobile rates did not rise in that four-year period. These statistics do permit the conclusion that the real price to the consumer is "reasonable" considering the increasing automobile congestion and the inflation.

One further point must be emphasized. During this four-year period, not one of the insurers domiciled in Ohio was declared insolvent or placed in any type of court receivership. It would appear that there is adequate protection in Ohio from insurer insolvency.

In summary, the policies of the Rating Section of the Ohio Department of Insurance have permitted the rates for automobile liability insurance to be set by competition among the insurers. The motives behind these policies is unclear. There are four reasons which could explain the attitude of this regulatory agency: (1) A deep philosophical belief that the less government interference the better; (2) an outright default of their regulatory responsibility; (3) the pressure of the industry forced abdication from their position as regulatory; and (4) the belief that competition is the best institution for supplementing the Department's supervisory approach to regulation.[82] Regardless of the motives, it is the results that are important to the central question of this paper.

**Summary of Analytical Findings**

Has the Ohio experience with competition substantiated the dire predictions made by the critics of the application of competition to insurance? First, the predicted destructive rate competition has not developed as evidenced by the fact that not one Ohio company writing automobile liability insurance under the present statutory structure has been forced into bankruptcy or reorganization.[83] It is uncertain whether this excellent record of financial solvency is due to the actions taken as a result of the close scrutiny by the Department of Insurance of the required quarterly financial reports or because of the self-interest of the insurer. Second, it is very difficult to ascertain whether the rates under competition have been excessive because of the necessity of evaluating the many variables of rate calculation. Normally, excessive rates can be charged only when there is a concentration of economic power or when there is an informal or formal agreement among competitors not to compete.[84] The lack of concentration among the writers of automobile liability insurance in Ohio has been mentioned previously. The rating bureaus' lack of economic power over rates is due primarily to the existence of several aggressive independent insurers. This would seem to indicate that the more competition, the less likely that concentration within the industry would develop.[85] Furthermore, there is little

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82 It is this writer's opinion that the last two reasons together are responsible for the existence of competition in Ohio. There is no evidence that can be introduced to substantiate this hypothesis except a general "feeling" that was generated by the various interviews with members of the insurance business and state officials.

83 This information was obtained through conversations with various members of the insurance industry and with certain state officials.

84 The phrase "informal or formal agreements among competitors not to compete" is meant to include all types of price fixing conspiracies, price leadership, and collusion.

85 The Ohio Department of Insurance assumes that competition will continue in the business of insurance as long as there is no concentration in the industry. The Ohio Department of Insurance also assumes that competition will in itself prevent excessive rates. See also Boyce & Kimball, *supra,* n. 22, at 2.

evidence of any agreement not to compete or to fix prices. The reason for the strength of the larger independent insurers in Ohio is probably due to their aggressive marketing including the development of selective risk programs and greater flexibility in tailoring problems to satisfy the needs of the public. The use of the new selected risk schemes by the independent insurers has been one of the main reasons for the growth of these companies. This experimentation in various types of coverages and classifications is encouraged by the Ohio Department of Insurance. The Ohio statutory scheme permits the insurers a high degree of flexibility in meeting the changing conditions of the market and in utilizing newly acquired data because a filing becomes automatically effective fifteen days after submission.

These facts clearly demonstrate that the competitive situation in Ohio provides a workable and a viable means of obtaining the basic objectives of insurance.

## Conclusions

If competition is able to function, as in the case of automobile liability insurance in Ohio, the entire basis of government regulation of the business of insurance and the possible application of the federal antitrust laws to the business of insurance deserve to be re-examined. It is not the basis of this analysis to challenge the basis of government regulation or the applicability of the federal antitrust laws. Our object is to show that active state regulation is not the only means by which the social goals of insurance may be attained. This analysis also should raise the important question of what makes the business of insurance so different from other businesses that a special set of laws has been enacted to govern the conduct of the business of insurance. Regardless of the many interesting and complex problems suggested, the Ohio experience with rate regulation by competition demonstrates an effective alternative to active government control of insurance rates.