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The Business of Insurance

Insurance involves the spreading of risks and is traceable to the insurance of slaves by Antigenes of Rhodes during the reign of Alexander the Great and the contracts made for supplies provided to the Roman government at the time of Livy.[1] Marine insurance, which originated in Italian commercial cities in the fourteenth century, is the oldest type of insurance available today.

The Philadelphia Contributionship for Insurance of Houses from Loss by Fire, the first mutual insurance company in the United States, was established in 1752 by Benjamin Franklin and other prominent Philadelphia citizens who banded together to insure their properties. Property and casualty insurance companies in the nineteenth century sold primarily fire insurance. Subsequently, life insurance became a major part of the industry, and companies today issue a wide variety of policies including health, life, property and casualty, and retirement insurance.[2]

Today, insurance products fall into two classes. Personal lines are the first class and include annuities, automobile insurance, health insurance, homeowner's liability, and life insurance. The latter differs in one major aspect from other types of insurance, that is, the risk increases with the life of the contract. Commercial lines are the second class and are primarily property and casualty insurance.

The business of insurance in recent years has undergone a fundamental transformation with the development of new communication and information technologies, new products, and increased competition. Today, the U.S. business of insurance is a $6 trillion worldwide industry that is essential for businesses and individuals, and is an important source of state revenue with approximately $12 billion in premium taxes and fees paid annually by insurance companies. In contrast, assets held by the banking industry total $12 trillion and assets held by the securities sector total $11 trillion prior to the worldwide financial crisis that emerged in 2008.

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Chief executive Therese M. Vaughan of the National Association of Insurance Commissioners (NAIC) testified in 2009 before a subcommittee of the U.S. House of Representatives investigating the financial crisis and explained: "The nature of the insurance market and its regulatory structure make the possibility of systemic risk originating in the industry less than in other financial industries. In general, the insurance industry is more likely to be the recipient of systemic risk from other economic agents rather than the driving force that creates systemic risk."[3]

The industry continuously is undergoing rapid changes with increasing globalization of financial markets and the removal of the last of the legal barriers between banks and insurance companies by the *Gramm-Leach-Bliley Financial Modernization Act of 1999*, which also authorizes a new type of financial institution: the financial holding company.[4] Approximately one-quarter of the approximately 700 financial holding companies are engaged in insurance agency activities and 5 percent are engaged in insurance underwriting.

The industry has premium revenues of more than $735 billion annually and provides policies for business firms, consumers, and governments in each state.[5] Life insurance coverage alone, for example, involves approximately 400 million policies with protection totaling $26 trillion 2009. In addition, citizens have retirement saving in excess of $2 trillion in the form of insurance companies' annuity products. Life insurance companies are one of the largest holders of long-term, fixed-rate commercial mortgages. The average life insurer in the mid-1970s received close to 87 percent of its premiums from the sale of life insurance compared to 13 percent from the sale of annuities. By 2004 the source of premiums changed to 70 percent coming from annuities and 30 percent from insurance. Life insurance companies currently administer approximately $2 trillion in retirement plan assets or more than one-quarter of the private retirement plan assets managed in the United States.

The number of licensed insurers in the 50 states exceeds 7,000, and the number of licensed domestic insurers and the number of licensed foreign insurers vary among states with the latter type of insurer constituting the bulk of the insurers. The number of insurance companies licensed to sell insurance in a particular state ranges from 900 to 2,000. Approximately 3.5 million persons are licensed by states to sell insurance, including independent agents who offer policies for two or more insurance companies, agents who sell policies only for specific companies, and brokers representing buyers who obtain the lowest premium prices for a given policy for their clients.

Numerous large insurance and other corporations established offshore global tax havens in small nations with a strong legal system to

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reduce their federal and state tax liabilities. Bermuda, the Cayman Islands, the Republic of Ireland, and Singapore are favorite locations with low tax rates. More recently, Vermont has been successful in inducing each of more than 500 large corporations to establish in Vermont a wholly-owned firm, which insures the corporation's risks and liabilities.[6]

Many states offer financial inducements to insurance firms to locate facilities in their respective states, but their respective offer is considerably less than the benefits of locating in Vermont, which promotes the state as a location preferable to one offshore. The state also benefits from the lawyers who relocate to the state to serve the firms. Numerous large corporations, including Archer Daniels Midland and Alcoa, secured U.S. Department of Labor approval to place various employee benefits, including life and medical insurance, with their respective captive insurance firm.

The 2008 worldwide financial crisis revealed the financial weakness of the Customer Asset Protection Company (CAPCO), a captive firm, which relocated to Vermont in 2004 when Charles Schwab filed a Freedom of Information Act request for the company's financial information with the New York State Insurance Department, which ordered the company to release the data.[7] Brokerage firms purchased account protection insurance from major insurance companies until 2003 when they ceased to offer policies. In response, Lehman Brothers and thirteen banks and brokerage firms created CAPCO. Standard and Poor's initially assigned the firm a high credit rating, but in December 2008 lowered it to junk status. CAPCO in 2009 had capital totaling $150 million and could be subject to approximately $11 billion in claims.

The *U.S. Constitution* established the first federal system in the world, an imperium in imperio, by dividing powers between the national government and state governments and authorizing exclusive and concurrent regulatory powers. Currently, all insurance companies are chartered by the states and must comply with a complex set of fifty state laws and administrative rules and regulations that often conflict and create additional compliance costs for multistate business firms. Interstate legislative cooperation and administrative cooperation have been employed since 1871 to make the state insurance regulatory system more harmonious, which will be explained in chapter 4. Nevertheless, nonharmonious regulation continues and is an increasing problem for several large multistate insurance firms that are pressuring Congress to establish a system of optional national insurance charters and uniform regulations throughout the United States for companies operating under such charters.

This volume examines the evidence relating to the following hypothesis to determine its validity: An optional federal insurance charter

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system, similar to the national bank charter system, provides policyholders and insurance company shareholders greater protection than the current state charter system.

A historical survey of the development of the federal system and state regulation of the business of insurance, including key U.S. Supreme Court decisions, will facilitate an understanding of the changing nature of national-state relations produced by congressional preemption statutes including six removing relatively minor insurance regulatory authority from the states. A central focus of this volume are two nearly identical and controversial bills—S 40 of 2007 and HR 1880 of 2009—authorizing issuance of a federal insurance charter to each insurance company applying for one, thereby establishing a dual charter system very generally emulating the dual charter banking system that dates to 1864 (see chapter 6).[8] The bills have been supported primarily by several large insurance companies operating throughout the nation. States and numerous insurance companies and associations favor state regulation and strenuously oppose a dual insurance regulatory system. This volume also examines actions that Congress could initiate as alternatives to authorizing optional national charters for insurance companies.

Constitutional Developments

The signing of the Declaration of Independence in 1776 officially dissolved the ties of thirteen former colonies to the United Kingdom and established them as nation-states that formed a loose military alliance. The Second Continental Congress, a unicameral body of composed of an equal number of members from each state, superintended the prosecution of the Revolutionary War.

Articles of Confederation

Recognizing the need for a more permanent governance structure uniting the thirteen states, the Second Continental Congress in 1777 proposed the *Articles of Confederation and Perpetual Union* providing for a league of amity, but interstate boundary disputes delayed ratification by the thirteenth state, Maryland, until 1781.

Article II emphasized "each State retains its sovereignty, freedom and independence, and every power, jurisdiction and right, which is not by this confederation expressly delegated to the united States in Congress assembled." A lower case "u" was used in "united" to emphasize

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a national government had not been established and the articles united the states for only expressed purposes.

Article IV contained three important provisions promoting harmonious interstate relations. Citizens of a state were entitled to the privileges and immunities of citizens in each state visited, the asylum state governor was directed to return fugitives from justice to the requesting state, and each state was required to give full faith and credit to the legislative acts, records, and judicial proceedings of other states. Article IV of the *U.S. Constitution* incorporates these provisions.

Article V of the articles authorized each state legislature to appoint two to seven delegates to the unicameral Congress, subject to recall, with each delegation collectively having one vote. A three-year term limit over a six-year period was established for delegates appointed annually in a manner determined by each state legislature. The delegates from each state collectively possessed a single vote. No executive branch or judicial branch was established.

The powers of Congress were few and limited: Borrow and coin money, declare war, establish a postal system and standards of weights and measures, negotiate treaties with foreign nations, regulate relations with Indian tribes, and set quotas for each state to furnish men and funds for the Army. These limited powers and the lack of authority to levy taxes predestined the confederacy to failure.

DEFECTS

Experience quickly exposed the defects of the articles and the weakness of the Congress. The specific defects were Congress's reliance on voluntary state contributions of funds, lack of authority to regulate interstate commerce and enforce its laws, difficulty in obtaining funds from foreign lenders, and inability to suppress disorders within states.

Congress authorized the printing of paper money, which almost immediately became worthless because Congress lacked authority to levy taxes to raise revenue. This problem was not the only serious one. Article VI forbade states to "lay any imposts or duties which may interfere with stipulations in treaties" entered into by Congress with foreign nations, but Article IX stipulated commerce treaties may not prevent a state "from prohibiting the exportation or importation of any species of goods or commodities whatsoever. . . ." Furthermore, the articles did not prohibit state-erected interstate trade barriers, illustrated by New York taxing cabbage from New Jersey and firewood from Connecticut, which soon brought commerce among the states to a near standstill.[9]

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Captain Daniel Shays, who served in the army during the Revolutionary War, hastened the end of the confederation by leading a rebellion of disgruntled farmers in western Massachusetts in 1786 that spread to within forty-five miles of Boston. The farmers demanded lower property taxes, cheap money, and suspension of the foreclosure of mortgages. The Commonwealth of Massachusetts was powerless to suppress the rebellion, which was suppressed only when wealthy residents of Boston raised funds for an army led by General Benjamin Lincoln.[10]

The seriousness of the articles' defects induced Maryland and Virginia boundary commissioners in 1785 to recommend that the states send delegates to a meeting in Annapolis in 1786 to develop remedies. Delegates from only five states participated in the conference and memorialized Congress to call a convention to meet in Philadelphia to consider drafting amendments to the articles. Reluctantly, Congress called a convention to meet in Philadelphia in 1787.

The Constitutional Convention

All states except Rhode Island sent delegates to the convention, which met in Philadelphia from March 25 to September 17, 1787. The states collectively appointed seventy-four delegates, but nineteen refused to accept appointments or did not attend the convention. Philosophical and sectional differences divided the convention with delegates representing the former view expressing the fear a stronger national government would be a threat to individual liberties. Sectional differences were products of the nature of the economy in each region. The delegates, after five days of negotiations, voted 6–1 to replace the *Articles of Confederation and Perpetual Union* with a new constitution. Delegates from five states had not arrived by the time of the vote.

Delegates debated whether the proposed Congress should be granted the power to review and invalidate state laws, but decided the Constitution should not delegate this power. The controversy over state representation in the proposed unicameral Congress, between states with large and small populations, was resolved by the Connecticut Compromise providing for a bicameral national legislature with a senate representing each state equally and a house representing each state in accordance with its population with the proviso each state would have a minimum of one representative.

Slavery was the subject of a third controversy with the northern states advocating the immediate termination of the importation of slaves. The agreed upon compromise clause provided slaves could be imported

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for twenty years and Congress could levy a tax of up to $10 on each slave imported.

Whether Congress should be authorized to impose import and export duties generated a fourth controversy with the northern states in favor as a source of national revenue and southern states opposed because they would be paying most of the duties due to exportation of the bulk of their products, which were chiefly agricultural, and importation of most of their needed manufactured products. The arrived-at compromise provided Congress could tax imports but not exports.

These divisions and compromises should not blind the reader to the fact no serious opposition was made to fifteen of the eighteen powers proposed to be delegated to Congress. In addition, there was near unanimous agreement regarding the various prohibitions placed on Congress and the requirement states must obtain the permission of Congress to initiate specified actions.

The delegates approved a constitution establishing a strong President, a Supreme Court, and a Congress possessing specific delegated powers (see the information following). The inclusion of checks and balances designed to protect the semisovereignty of the states and protect individual liberties from abuse reduced the fear of a centralized government. The proposed fundamental document would become effective upon ratification by nine states.

Ratification Campaign

The convention sent the proposed constitution, which was not a popular document, to the state legislatures with the stipulation each should arrange for the election of delegates to a special convention with the power to ratify or reject the document. It was met immediately by four major objections: (1) the convention was called to revise the *Articles of Confederation and Perpetual Union* and not to discard them, (2) the articles could be amended only with the unanimous consent of the states, (3) the proposed Congress either would be too strong or too weak, and (4) the new government either would be too independent of the states or too dependent on them. The opposition was strongest in the interior of the nation and regions with a small population. Farmers and imprisoned debtors not surprisingly favored cheap paper money issued by states over a strong currency issued by the proposed Congress.

The proposed fundamental law forbade Congress to suspend the writ of habeas corpus unless a rebellion or invasion threatens public safety. Congress and the states were forbidden to enact a bill of attainder

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declaring an individual guilty of a crime and imposing punishment or an ex post facto law (retroactive), and states were forbidden to impair the obligation of contracts. Opponents focused much of their criticism on the lack of a bill of rights, similar to ones in state constitutions, guaranteeing freedom of assembly, petition, press, religion, and speech. Proponents attempted to explain a bill of rights would be superfluous because the Constitution would grant Congress no powers to limit citizens' liberties.

The Delaware, New Jersey, and Pennsylvania conventions quickly ratified the proposed fundamental law and were followed soon thereafter by the approvals of the Connecticut and Georgia conventions. The proposed fundamental document continued to face strong opposition in Massachusetts, New York, and Virginia, and their rejections would doom the establishment of a federal system.

THE FEDERALIST AND ANTIFEDERALIST PAPERS

Alexander Hamilton, John Jay, and James Madison during the winter and spring of 1787–1788 wrote a series of eighty-five letters to editors of New York City newspapers designed to convince delegates to the state convention to ratify the proposed constitution. The first thirty-six letters were published as a book in late March 1788, forty-nine subsequent letters were published in book form in late May, and the two books subsequently were consolidated into one.[11] These excellent essays reveal the thinking of the proponents of the *U.S. Constitution* with respect to the intent and scope of most of the constitutional provisions.

Each letter explained and defended a provision of the proposed constitution and was signed "Publius." Federalist No. 39, written by Madison, noted the constitution would establish a governance system that would be "neither wholly national nor wholly federal" (confederate).[12] The words "confederation" and "federation" in the eighteenth century were used interchangeably. Proponents of the proposed fundamental law described themselves as federalists in an apparent attempt to appeal to persons opposing a strong national government.

Madison authored Federalist No. 45 emphasizing "the powers delegated by the proposed constitution to the federal government are few and defined" and added in Federalist No. 46 that "a local spirit will infallibly prevail much more in the member of Congress than a national spirit will prevail in the legislatures of the particular states."[13]

Opponents feared the supremacy of the laws clause in Article VI would permit Congress to convert the proposed federal governance system into a unitary one. Hamilton in Federalist No. 33 sought to allay

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this fear: "If a number of political societies enter into a larger political society, the laws which the latter must enact, pursuant to the powers intrusted [*sic*] to it by its constitution, must necessarily be supreme over those societies and individuals of whom they are composed. It would otherwise be a mere treaty, dependent on the good faith of the parties, and not a government, which is only another word for political power and supremacy."[14]

These letters were influential in swaying public opinion in general and the views of delegates to the New York convention in particular because many delegates lacked a complete understanding of the reasons why each provision was included in the proposed fundamental law.

Sixteen letters signed "Brutus" were published in the *New York Journal* from October 1787 to April 1788 and were designed to rebut the proponents' arguments. Although not proven conclusively, available evidence suggests the letters were written by Robert Yates, a delegate to the Constitutional Convention in Philadelphia and an associate of Governor George Clinton of New York. These letters were not published in book form until 1986, when they appeared as *The Antifederalist Papers and the Constitutional Convention Debates*.[15]

On October 18, 1787, Brutus attacked the necessary and proper clause and the supremacy of the laws clause and concluded:

> It is true the government is limited to certain objects, or to speak more properly, some small degree of power is still left to the States, but a little attention to the powers vested in the general government, will convince every candid man, that if it is capable of being executed, all that is reserved for the individual States must very soon be annihilated, except so far as they are barely necessary to the organization of the government. The powers of the general legislature extend to every case that is of the least importance—there is nothing valuable to human nature, nothing dear to free men, but what is within its power. It has authority to make laws which will affect the lives, the liberty, and property of every man in the United States; nor can the constitution or laws of any State, in any way prevent or impede the full and complete execution of every power given.[16]

The Federalist Papers, although influential, did not allay the fear of many citizens that the proposed constitution would create a strong national government. Thomas Jefferson wrote a letter to Madison implying the Virginia Convention would not ratify the proposed document

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until a bill of rights was incorporated.[17] To convince the conventions in the larger states to ratify the document, proponents promised the first action taken by Congress under the constitution would be the proposal of constitutional amendments guaranteeing citizens fundamental liberties in the form of a bill of rights.

The Constitution officially was ratified when the New Hampshire ratification convention approved the fundamental document in June 1788. In consequence, elections were held for presidential and vice presidential electors and members of the U.S. House of Representatives in 1788, each state legislature appointed two U.S. senators, and the new national government became effective in 1789.

The United States Constitution

The *U.S. Constitution* established the world's first federal system by incorporating elements of the unitary and confederate systems of governance to form simultaneously a compound republic and a unitary government with complete control over the District of Columbia and U.S. territories.[18] The fundamental law delegated specific powers to Congress including exclusive and concurrent ones. The *Tenth Amendment* to the Constitution reserved all nonprohibited powers to the states and the people.

Included in the reserved powers are the power to tax and the exclusive English common law police power, an exceptional broad regulatory power exercisable by all state legislatures, except the Louisiana State Legislature, to promote and protect public convenience, health, morals, safety, and welfare.[19] Exercise of the police power by state and local governments is subject to five *U.S. Constitution*al guarantees: Due process of law, equal protection of the laws, full faith and credit, interstate free trade, and privileges and immunities.

Delegated Powers

Article I, Section 8, of the Constitution delegates to Congress the following powers:

> To lay and collect taxes, duties, imposts and excises, to pay the debts and to provide for the common defence [*sic*] and general welfare of the United States, but all duties, imposts, and excises shall be uniform throughout the United States;
>
> To borrow money on the credit of the United States;

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To regulate commerce with foreign nations, and among the several States, and with the Indian Tribes;

To establish an uniform rule of naturalization, and uniform laws on the subject of bankruptcies throughout the United States;

To coin money, regulate the value thereof, and of foreign coin, and fix the standard of weights and measures;

To provide for the punishment of counterfeiting the securities and current coin of the United States;

To establish post offices and post roads;

To promote the progress of sciences and useful arts, by securing for limited times to authors and inventors the exclusive right to their respective writings and discoveries;

To constitute tribunals inferior to the supreme court;

To define and punish piracies and felonies committed on the high seas, and offenses against the law of nations;

To declare war, grant letters of marque and reprisal, and make rules concerning captures on land and water;

To raise and support armies, but no appropriation of money to that use shall be for a longer term than two years;

To provide and maintain a navy;

To make rules for the government and regulation of the land and naval forces, suppress insurrections, and repel invasions;

To provide for organizing, arming, and disciplining the militia, and for governing such part of them as may be employed in the service of the United States, reserving to the States respectively, the appointment of the officers, and the authority of training the militia according to the discipline prescribed by Congress;

To exercise exclusive legislation in all cases whatsoever, over such district (not exceeding ten miles square) as may, by cession of particular States, and the acceptance of Congress, become the seat of government of the United States, and to exercise like authority over all places purchased by the consent of the legislature of the State in which the same shall be, for the erection of forts, magazines, arsenals, dock-yards, and other needful buildings; and

To make all laws which shall be necessary and proper for carrying into execution the foregoing powers, and all other powers vested by this Constitution in the Government of the United States, or in any department or officer thereof.

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Implied Powers

An argument erupted between individuals supporting a narrow interpretation of the powers delegated to Congress and those favoring a broad interpretation. Hamilton, for example, maintained Congress was empowered to charter a national government bank and Jefferson countered the national legislature lacked such a power because chartering a bank was not among the delegated powers.

Jefferson and Madison were disturbed greatly by congressional enactment of the *Alien and Sedition Acts.* The latter expressed his strong opposition to the acts:

> The *Sedition Act* presents a scene which was never expected by the early friends of the Constitution. It was then admitted that the State sovereignties were only diminished by powers specifically enumerated, or necessary to carry the specified powers into effect. Now, Federal authority is deduced from implication; and from the existence of State law, it is inferred that Congress possesses a similar power of legislation; whence Congress will be endowed with a power of legislation in all cases whatsoever; and the States will be stripped of every right reserved, by the concurrent claims of a paramount legislature.[20]

Implied powers are essential for implementation of expressly delegated powers. The necessary and proper clause, also known as the elastic clause, is the basis of the doctrine of implied powers enunciated by the U.S. Supreme Court in *McCullough v. Maryland* in 1819: "Let the end be legitimate, let it be within the scope of the Constitution, and all means which are appropriate which are plainly adapted to the end, which are not prohibited, but consistent with the letter and spirit of the Constitution, are constitutional."[21]

Resultant Powers

Congress can use two or more expressly delegated powers to infer it possesses a resultant power. For example, the national legislature is authorized expressly "to establish a uniform rule of naturalization," but is not specifically delegated the power to regulate immigration. The Constitution also grants authority to Congress to regulate commerce with foreign nations. This power, combined with the power to regulate the naturalization of aliens and the power of the Senate to confirm treaties with

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foreign nations negotiated by the president, serves as the constitutional basis for regulation of immigration.

A second example is congressional use of the delegated powers to borrow funds and to coin money as the constitutional authority to issue paper money.

The Supremacy of the Laws Clause

This clause, in common with the necessary and proper clause, does not delegate a power to Congress. A compound republic, composed of a national legislature and state legislatures with each possessing concurrent powers, is faced with the problem of potential conflicts of laws. To solve such conflicts, Article VI of the Constitution stipulates: "This Constitution, and the Laws of the United States which shall be made in pursuance thereof; and all treaties made, or which shall be made, under the authority of the United States, shall be the supreme law of the land, and the judges in every State shall be bound thereby, any thing in the Constitution or Laws of Any state to the contrary notwithstanding."

State courts, lower U.S. courts, and the U.S. Supreme Court do not always invalidate a state constitutional provision or statute facially conflicting with an act of Congress by opining the conflict is not the type conferring jurisdiction on these courts. Courts also often negate only one or two sections of a state statute conflicting with a congressional enactment and the remainder of the state statute remains in effect unless it contains a provision for invalidation of the entire law in the event a section is found to be unconstitutional.[22]

A significant number of preemption statutes do not contain an expressed preemption provision and consequently state and U.S. courts are called on to rule whether these statutes are preemptive and whether they preempt the entire regulatory field or only part of it.

The General Welfare Clause

This clause often is misinterpreted. The clause does not delegate a power to Congress authorizing enactment of any law promoting the general welfare of the United States. Such an interpretation would mean the governance system of the United States is a unitary one in view of the supremacy of the laws clause that provides for the supersession of any provision in a state constitution or statute in direct conflict with a congressional act.

The Constitution authorizes Congress to provide only one service, the postal service, on other than federal property within states,

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and state and local governments provide all other services to citizens. Furthermore, Congress has not been granted authority to exercise the police power, which is the exclusive power of states to regulate individuals and property to promote and protect public health, safety, welfare, morals, and convenience. State exercise of this power is subject to *U.S. Constitution*al guarantees. The national legislature, however, influences the provision of services by subnational governments by means of conditional grants-in-aid and uses its interstate commerce regulatory power to protect public health, safety, welfare, and morals.

Preemption: Nature and Significance

Knowledge of the constitutional basis of preemption is essential to understanding its importance and the changes in the nature of the federal system produced by congressional enactment of statutes removing completely or partially regulatory powers from states and by extension local governments.

The *U.S. Constitution* devolves powers to Congress in broad terms to be employed in response to challenges and problems, domestic and international, thereby guaranteeing the fluid nature of the federal governance system. These powers are latent ones exercisable by Congress on a discretionary basis. The failure of Congress to enact a regulatory power based on its authority to regulate interstate commerce until 1887 led many writers and the U.S. Supreme Court to refer to the silence of Congress.[23] Additionally, Congress is free to devolve its legislative powers, except coinage, to state legislatures and has enacted many devolution statutes commencing with a 1789 act devolving to state legislatures the power to regulate marine port pilots.[24]

Nature of Preemption

The national legislature can use its delegated powers to enact at any time statutes removing partially or completely and prospectively and/or retrospectively the regulatory powers of subnational governments in a given field. Furthermore, Congress can enact a preemption statute not based on an expressly delegated power by enacting a statute implementing a treaty negotiated by the president with foreign nation and approved by the Senate in accordance with Article II, Section 2, of the *U.S. Constitution*. These statutes most commonly implement free trade agreements such as the *North American Free Trade Agreement*.[25] Occasionally, Congress includes a savings clause preserving some of the

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regulatory authority of states in what otherwise would be a complete preemption act.

Important preemption statutes are the product of interest group lobbying. The motor vehicle industry and its allies in other industries in the mid-1960s pressured Congress to preempt the authority of states to regulate emissions from motor vehicles because divergent state emission regulations might require the companies to build fifty different emission control systems. Responding to pressures to improve air quality, President Lyndon B. Johnson sent a message to Congress in 1967 recommending enactment of an air quality statute removing all regulatory powers from the states. Governor Nelson A. Rockefeller of New York led a campaign to forestall enactment of such a law and proposed as an alternative a series of interstate compacts including the Mid-Atlantic States Air Pollution Control Compact, which was enacted by Connecticut, New Jersey, and New York. The compact did not receive the constitutionally required consent of Congress, which decided to enact the *Air Quality Act of 1967* described later.[26]

Preemption statutes remove regulatory powers from states, yet the latter do not always oppose the enactment of such statutes and occasionally request Congress to enact a specific act. The National Governors Association, for example, requested Congress to enact the *Commercial Motor Vehicle Safety Act of 1986* because states could not solve the problem involving operators of commercial vehicles holding driver's licenses from more than one state and continuing to drive after revocation of their respective home state license for dangerous driving by using a license issued by a sister state.[27]

Most preemption statutes are based on the interstate commerce clause, but others are based upon the constitutional authority of Congress to enact laws regulating bankruptcy, copyrights, foreign commerce, naturalization, patents, and taxation. The coverage of a preemption statute may be broadened by enactment of amendments as illustrated by the *Clean Air Act Amendments of 1990*.[28] Each of a small number of preemption laws contains a sunset clause providing for the expiration of the law on a specified date unless Congress extends the law.[29] A statute may be less than one page or several hundred pages in length. Congress increasingly has been including preemption statutes or provisions in detailed and lengthy annual appropriations acts.

TYPES

The body of laws produced by preemption statutes is complex. Such statutes may be classified by type as complete, partial, and contingent.

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A complete preemption statute removes all state authority in a given regulatory field. An examination of such statutes, however, reveals eighteen subtypes including ones dependent on state assistance for the achievement of their respective goal(s). A nonpreemptive statute—*Do-Not-Call Implementation Act of 2003*—is becoming de facto a complete preemption act as state-initiated registries are transferred voluntarily to the federal registry.[30]

A partial preemption statute may remove part of the regulatory authority of states in a given field or establish minimum regulatory standards, illustrated by the *Air Quality Act of 1967*, while allowing a state to continue to regulate provided it submits a plan—containing standards at least as stringent as the national ones and evidence of adequately trained enforcement personnel and equipment—to the appropriate national department or agency, and it approves the plan by delegating regulatory primacy to the state. Such primacy allows only the state to regulate and the national department or agency is limited to monitoring state performance and providing financial and technical assistance. This type of partial preemption has had the greatest impact on the nature of the federal union.

A contingent preemption statute is a suspensive act with one or more provisions applying the act only to a given state or a local government if a specified condition or conditions exist within it. The *Voting Rights Act of 1965* is the first of three contingent preemption statutes and it subsequently was amended to broaden its coverage of blacks to include so-called foreign language minority groups.[31] One contingent preemption act pertaining to the business of insurance has been enacted (see below).

Enactment Pace

Congress enacted its first two preemption statutes in 1790: The *Copyright Act* and the *Patent Act.* The enactment pace subsequently was slow with only twenty-nine acts enacted by the end of the nineteenth century.[32] Such statutes continued to be enacted slowly during the first five decades of the twentieth century: 14 (1900–1909), 22 (1910–1919), 17 (1920–1929), 31 (1930–1939), 16 (1940–1949), and 24 (1950–1959). Subsequently, the enactment pace increased sharply commencing in 1965: 47 (1960–1969), 102 (1970–1979), 93 (1980–1989), 87 (1990–1999), and 129 (2000–2009). The pace of enactment increased slightly during the twelve years of Republican control of Congress in the period 1995–2006. The number of such acts totaled 616 on April 1, 2010.

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The reader should note the importance of these acts and the amount of governmental regulatory powers removed from state and local governments by each act vary considerably. A preemption act also may contain a mandate requiring subnational governments to initiate a specified action or a restraint forbidding them to take a specified action. The *Ocean Dumping Ban Act of 1988*, for example, prohibits dumping of sewage sludge in the ocean and requires municipalities located near an ocean to use the expensive alternative of incinerating the sludge or placing it in a landfill.[33]

The 104th Republican-controlled Congress reacted to state and local government officers' criticisms of unfunded mandates contained in preemption acts by enacting the *Unfunded Mandates Reform Act of 1995* establishing mandatory procedures each house of Congress must follow to enact mandates, but not forbidding the enactment of such mandates.[34] This Congress also enacted the *Safe Drinking Water Act Amendments of 1996* offering relief from expansive mandates forcing small local governments either to file for bankruptcy protection or abandon their drinking water supply systems and imposing major financial burdens on larger local governments.[35] No subsequent mandate relief act has been enacted.

Significance of Preemption

The *U.S. Constitution* does not contain a mechanism ensuring the initially established balance of power between the national government and the states will continue in the future. Congress was designed with the expectation it would employ its delegated regulatory powers and become the supreme regulator adjusting the nature of the federal economic union and the political union to meet emerging challenges and problems. Extensive congressional use of its preemption powers since 1965 has produced without constitutional amendments what may be labeled a major governance revolution silently transforming the nature of the two unions. Particularly noteworthy is that since 1978 Congress has enacted preemption statutes providing for increased regulation of states as polities, extensively deregulating the banking and communications industries, and providing for complete economic deregulation of air, bus, and rail transportation companies.

Democratic theory is premised on active and informed citizens participating in the governance process. Such participation is limited when Congress is considering enactment of preemption bills. Although public hearings are held on important preemption bills, few citizens possess the necessary funds and time to travel to Washington, D.C., and lack

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the detailed technical information and staff possessed by resource-rich special-interest groups.

Environmental minimum standards preemption statutes are examples of skeleton laws containing broad policy outlines and authorizing the Environmental Protection Agency administrator or the Secretary of the Interior to promulgate detailed implementing rules and regulations. The enhanced role of bureaucrats in determining public policy raises questions of the democratic adequacy of the policy-making process because citizens have limited opportunities to influence the rule-making process compared to interest groups.

In contrast to national decision-making, the local government plane, with its relatively small geographical scale, provides citizens with the greatest opportunity to exert effective influence during the policy-making process. Participatory democracy will suffer to the extent congressional preemption, directly or indirectly through the states in the form of minimum standards, limits the discretionary authority of general purpose local governments. Public opinion polls support this conclusion because they consistently reveal citizens generally have the highest respect for local governments and the least respect for the national government.

The fact regulatory decision-making has become more centralized in Congress, which has become a unitary government in fields it has completely preempted, should not obscure the fact states retain a broad range of regulatory powers and continue to enact innovative statutes subsequently enacted by Congress and sister states. Somewhat surprisingly, the national government directly administers few programs it did not administer prior to 1965 and continues to rely heavily on state and local governments for assistance in emergencies, inspections, and enforcement of national regulatory standards, planning, and technical assistance.

States continue to regulate effectively in partially preempted fields and occasionally demonstrate the inadequacy of enforcement by a national department or agency as illustrated by New York State Attorney General Eliot Spitzer who employed a decades old state law to sue successfully the ten largest Wall Street brokerage firms for fraud (see chapter 6).[36] The U.S. Securities and Exchange Commission, charged with administering ten regulatory statutes, was embarrassed by Spitzer's success in this and related suits.

Available evidence indicates Congress will continue to enact preemption statutes, some with innovative state opt-in and opt-out provisions, at a relatively rapid pace to cope with problems flowing from growing globalization of the U.S. economy, free trade agreements with foreign nations, interest group lobbying, and technological developments. The foci of such statutes probably will be consumer protection,

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banking, communications, environmental protection, financial services, and protection from terrorists. If state legislatures fail to harmonize their statutes levying taxes on interstate commerce, Congress will most likely break more frequently its silence on such taxation by enacting preemption statutes.

Preemption of State Regulation of Insurance

Congress enacted the *McCarran-Ferguson Act of 1945* devolving its power to regulate the business of insurance to states and exempting them from the antitrust laws and did not remove an insurance regulatory power from states until the enactment of the *Employee Retirement Insurance Security Act of 1974*, which preempts state regulation of health benefit plans offered by private firms.[37] Subsequently, Congress enacted five additional insurance preemption statutes, including two related to the threat terrorists pose and extended the one with a sunset provision on two occasions (see chapter 2).

The insurance industry is divided on the question of whether Congress should replace state regulation in part by authorizing the issuance of federal charters to insurance companies, thereby establishing a dual insurance system superficially similar to the dual banking system dating to the *National Currency Act of 1863*, which was viewed as defective and was replaced by the *National Banking Act of 1864*.[38] Continuation of nonharmonious state regulatory statutes and rules will increase the pressure on Congress to establish optional national charters for insurance companies and/or to enact additional insurance preemption statutes. To reduce such pressure, NAIC initiated a series of actions, including the *Interstate Insurance Product Regulation Compact* (see chapter 4), to harmonize state regulation of the business of insurance.

This volume specifically examines the proposed *National Insurance Act of 2007* (S 40), introduced in the Senate in 2006, and its replacement by HR 1880 of 2009 offering insurance companies the option of continuing to be regulated by the states or obtaining a national charter and becoming completely subject to regulation by a newly established federal regulatory agency.[39] Nationally chartered companies, however, will continue to be subject to state premium taxes until such a bill becomes law.

NAIC fully recognizes the threat to state regulation of the business of insurance posed by the bill and responded by drafting the *Interstate Insurance Product Regulation Compact*, which became operational in 2006, model acts for state legislatures to enact, and launching several other initiatives to persuade Congress neither to preempt the power of the

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states to regulate the business of insurance nor to establish an optional national charter for insurance companies (see chapter 4).

An Overview

Chapter 2 focuses principally on state insurance regulation in the post-1945 period subsequent to congressional devolution of power to states to regulate the business of insurance and specifically examines major pertinent major U.S. Supreme Court decisions involving the regulation of insurance and congressional insurance preemption statutes.

Chapter 3 overviews industry criticisms of state regulation of the business of insurance and agitation for congressional action in the form of a dual charter system for insurance companies and/or preemption of state insurance regulatory powers.

Chapter 4 reviews state efforts to establish uniform insurance regulatory policies by enacting uniform state laws, promulgating uniform state administrative rules and regulations, and entering into interstate insurance regulatory compacts. The chapter also examines criticisms of these efforts, particularly reports issued by the U.S. Government Accountability Office.

Chapter 5 explains the provisions of S 40 of 2007 and its replacement by HR 1880 of 2009 granting each company the option of a national charter, thereby establishing a dual insurance regulatory system. The chapter also presents the arguments for and against enactment of the bill.

Chapter 6 analyzes the arguments for and against establishing a dual insurance regulatory system, draws a conclusion relative to the validity of the hypothesis presented earlier, and offers alternatives to Congress and the states to improve regulation of the business of insurance.

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