Department of Justice

For Release
12:00 Noon, EDT (10:00 A. M., CDT)
Tuesday, October 15, 1957

IMPORTANT QUESTIONS OF THE DAY (ANTITRUST)

An Address

by

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Prepared for Delivery

Before the

NATIONAL ASSOCIATION OF MUTUAL INSURANCE AGENTS

Sherman Hotel

Chicago, Illinois

Tuesday, October 15, 1957

Ladies and Gentlemen, I am very pleased to be here with you this morning on the occasion of your 26th annual meeting. I understand that my predecessor in the Antitrust Division, Judge Stanley N. Barnes, had the pleasure of addressing your meeting in October of 1954. During the three year period which has elapsed, there have been several developments and, I believe, a general improvement in the competitive aspects of the national insurance scene.

It is vitally important that our private enterprise system have a mechanism for pooling the risks of accidental destruction and damage. Many would be unable to venture into business if insurance were not available to secure protection against accident, sickness, fire and other hazards.

Thus in a very real sense, insurance stands as a guardian of our economy by acting as a reassurance to new enterprise and a source of replacement capital. Its strength must be maintained so that it will continue its essential role in our competitive system.

Before discussing the current antitrust situation in the insurance field, let me review briefly with you the concept underlying our primary antitrust law, the Sherman Act. From the earliest days of our country there has existed the basic philosophy in America that the public interest is best served by the existence of competitive conditions in our economy. This philosophy was based upon the

conviction that competition would insure fair prices, would tend to eliminate inefficiency, and that the prospect of profits would attract new enterprises into the expanding economy. This theory of competition found expression in the passage of the Sherman Act in 1890. For more than sixty years this statute, with minor changes and supplementation, has continued to reflect the national policy. The Act states unequivocally that "every contract, combination in the form of trust or otherwise, or conspiracy in restraint of trade" is illegal and that "every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons to monopolize" trade shall be deemed guilty of a misdemeanor.1/

The success of our American philosophy of competition is well described in a report by a British study team organized by "The Anglo-American Council on Productivity." This Council was set up to study the reasons for the superior productivity of American industry. A New York Times headline in 1954 read as follows:

1/ 26 Stat. 209 (1890), as amended, 15 U.S.C. §1 et seq. (Supp. IV, 1957).

Productivity Team Lays U. S. Output
Supremacy Largely to Sherman, Clayton Acts

Hits Own Country's Law

Parliament Urged to Act on Manufacturer
Pacts That End Competition

The newspaper's account continued:

> The praise for the Sherman and Clayton Antitrust Acts was included in the industrial engineer's report because, according to the members of the group, "it was the answer we kept getting when we asked Americans what was the source of the competitiveness in their economy . . . ." The group's secretary . . . remarked that ". . . the monopolies issue has become a part of the public morality of the United States; it is enforced by public opinion." 2/

It may be of some interest that in 1956 Great Britain adopted a comprehensive restrictive trade practices act.

The constitutional provision giving our federal government the power to regulate interstate and foreign commerce provided the basis for the enactment of the Sherman Act, and means that the Act can only be applied where interstate or foreign commerce is involved. Prior to 1944 the business of insurance was not considered to be subject to the authority which Congress derives from the commerce clause of the Constitution. This exemption stemmed mainly from the ruling in Paul v. Virginia 3/ in 1869. An out-of-state insurance

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2/ N. Y. Times, Sept. 6, 1954, p.19, col. 1.

3/ 79 U.S. (8 Wall.) 168 (1869).

company had challenged Virginia's right to make it post a bond before issuing policies to Virginia citizens. The Supreme Court held that insurance policies were not articles of commerce and therefore state regulation did not interfere with any federal authority.

In the 70 years which followed the Paul decision, the states exercised varying degrees of regulation and supervision. Despite this, by 1942 the national insurance scene was characterized by concerted activities and restraints on competition which the states were either unwilling or unable to cope with. The request of the Attorney General of Missouri for the Department of Justice to intervene after his own attempts to deal with rate-fixing conspiracies had failed, 4/ together with the receipt of other complaints as to boycotts and other coercive activities in the southeastern states, resulted in the test case of United States v. Southeastern Underwriters Association. 5/

The membership of the Association, 198 private stock fire insurance companies and 27 individuals, had been indicted for conspiring to violate Sections 1 and 2 of the Sherman Act. It was charged in the indictment that the member companies of the Association controlled 90% of the fire insurance and "allied lines" sold by stock fire insurance companies in six states. The conspirators not only

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4/ Joint hearings Before Subcommittees of Committees on the Judiciary on S. 1362, H.R. 3269, and H.R. 3270, 78th Cong., 1st and 2d Sess. 25 (1943-1944).

5/ 322 U.S. 533 (1944).

fixed premium rates and agents' commissions, but employed boycotts, together with other types of coercion and intimidation, to force non-member insurance companies into the conspiracies and to compel persons who needed insurance to buy only from Association members on Association terms. Non-member companies were cut off from the opportunity to reinsure their risks, and their services and facilities were disparaged. Those independent sales agencies who continued to represent non-Association companies were punished by a withdrawal of the right to represent Association members. Persons purchasing insurance from non-Association companies were threatened with boycotts and with withdrawal of all patronage. Inspection and rating bureaus and local groups of insurance agents policed these conspiracies.

The conspirators defended on the ground that they were not required to conform to the standards of business conduct established by the Sherman Act because the business of fire insurance was not commerce. The United States District Court in Georgia upheld this defense on the authority of the Paul case. The Supreme Court reversed this decision, however, and held:

> No commercial enterprise of any kind which conducts its activities across state lines has been held to be wholly beyond the regulatory power of Congress under the Commerce Clause. We cannot make an exception of the business of insurance. 6/

6/ Id. at 553.

Determined efforts were made to persuade Congress to overrule this decision and to exempt insurance from the antitrust laws. Instead Congress passed the McCarran Act, 7/ assuring that state regulation would continue unimpaired, but on terms designed to evolve a coordinated system of state and federal control.

The Act provided for a three year partial moratorium for the insurance business from the operation of the Federal Antitrust Laws so that the states would have time to draft regulatory measures. At the termination of this moratorium, the Sherman and other antitrust acts became applicable to the business of insurance "to the extent that such business is not regulated by state law." 8/ Since some practices which are usually forbidden to businessmen, such as rating bureaus, may be essential to sound insurance, the McCarran Act declares such practices lawful if a state both authorizes and effectively supervises them.

This quoted section of the Act is the jurisdictional basis for the series of cease and desist orders issued by the Federal Trade Commission under the Federal Trade Commission Act, against certain health and accident insurance companies for alleged false and misleading advertising. Two Circuit Courts of Appeal have disagreed with the Commission claim that there must remain an

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7/ 59 Stat. 33 (1945), 15 U.S.C. §§ 1011-1015 (1952).

8/ 15 U.S.C. § 1012(b) (1952).

irreducible area of Commission jurisdiction over the interstate activities of insurance companies which cannot be reached by state law. 9/ These decisions are now being appealed to the Supreme Court.

Section 3(b) of the McCarran Act provides that:

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

The wording is directly derived from the Supreme Court's conclusion in the South-Eastern Underwriters' case that "no states authorize combinations of insurance companies to coerce, intimidate and boycott competitors and consumers in the manner here alleged." 10/ Thus, it is clear that coercion, intimidation and boycott remain subject to the Sherman Act irrespective of state regulation and supervision. While the language of Section 3(b) requires no clarification, a statement on the floor of the Senate by one of the legislative managers of the Act is helpful. Senator O'Mahoney said:

> Moreover, this proposed Act leaves wholly undisturbed, indeed, it fortifies the decision of the Supreme Court that insurance is commerce. It leaves the antitrust

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9/ Amer. Hosp. & Life Ins. Co. v. F.T.C., 243 F 2d 719 (5 Cir. 1957);
Nat'l. Casualty Co. v. F.T.C., 6th Cir., June 6, 1957.

10/ 322 U.S. 533, 562 (1944).

laws in full force and effect, even during the moratorium against boycotts and agreements to boycott. 11/

The antitrust cases which have been instituted by the Government in the insurance field since the passage of the McCarran Act in 1945 have been under this coercion section of the Act. In 1954, a consent decree terminated the case of United States v. Liberty National Life Insurance Co., et al. 12/ Our complaint in this case charged the insurance company and two subsidiaries with conspiring to restrain and to monopolize, attempting to monopolize and actually monopolizing commerce in funeral merchandise and burial insurance. The defendants had entered into contracts under which the funeral director agreed to purchase all of his funeral supplies through Liberty National and not to service funerals for policy holders of competing burial insurance companies. In return, Liberty National granted exclusive franchise rights within a specific territory to its contract undertakers and agreed that it would not contract with any other undertaker to service Liberty National burial insurance policies in such exclusive territories. The provisions of the consent decree are designed to end these restrictive arrangements and to restore competitive conditions in the sale of burial insurance and funeral merchandise in Alabama.

11/ 91 Cong. Rec. 1486 (1945).

12/ Civil No. 7719-S, D.C. Ala., June 29, 1954.

United States v. Investors Diversified Services 13/ which was filed in 1951 and terminated by a consent judgment in 1954 is one of our most widely publicized cases. The complaint charged that I.D.S., one of the largest residential mortgage companies in the United States, had entered into agreements with its residential mortgage loan borrowers which illegally required the borrower to agree that all hazard insurance maintained on the property secured by the mortgage would be written, placed and sold by the mortgagee.

These coercive tie-in agreements had four results: (1) the owner of the residential property who obtained a mortgage loan was prevented from placing his hazard insurance with insurance agents and companies of his own choice; (2) insurance agents and brokers who normally would compete with the mortgagee were prevented from competing for the sale of hazard insurance on property mortgaged to the lender; (3) insurance companies, other than those selected by the lender, were foreclosed from free access to a substantial market for hazard insurance; and (4) borrowers were prevented from obtaining hazard insurance at premium rates which might have been lower than those available through the mortgagee.

The consent judgment terminated the agreements which gave the defendants an exclusive right to place hazard insurance. It prohibits

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13/ Civil No. 3713, D.C. Minn., June 30, 1954

similar agreements in the future. Further, it requires the mortgagees to inform loan applicants and existing mortgagors of their right to select insurance of their own choice. This judgment recognizes that mortgage lenders have a right to insurance from a reputable and reliable insurance company. To protect the legitimate interest of the defendants on this score, the judgment permits them to require that hazard insurance be written by a company acceptable to them, so long as their standards of acceptability are not unreasonable, arbitrary or discriminatory. It likewise enables the defendants to place or write hazard insurance on property mortgaged to them if the borrower improperly fails to tender within a reasonable time the type policy judged acceptable under the foregoing standards.

The I.D.S. decree has been the subject of considerable comment in the mortgage and insurance fields, due in part to the wide publicity given by organizations such as yours, and I believe that it has been an important factor in educating lenders to avoid insurance tie-in practices. In fact, the Antitrust Division has been advised by insurance agents that this is the case - that doors are now open to them which formerly were closed. This is encouraging, as it confirms our opinion that responsible lenders will voluntarily seek to eliminate objectionable practices.

We continue, however, to receive considerable correspondence from insurance agents and mortgagors complaining that their selected policies have been rejected or that various obstacles have been raised by lenders. It is noteworthy that relatively few of these complaints

charge that the mortgagee has insisted on placing the insurance as a condition to granting the loan. The major portion of this correspondence deals with requirements adopted by mortgagees which, without more, do not indicate a scheme to channel insurance to an affiliated agency, but instead can be more readily interpreted as legitimate safeguards of the mortgagee's interest.

I believe that you will be interested to hear my views concerning complaints relating to lenders who refuse mutual insurance. First, I must state a general proposition of which you are undoubtedly aware, that is, that the purpose of the antitrust laws and this Division's enforcement of those laws is the protection of the paramount public interest in the preservation of free competition and not the championing of any particular group's private interests. It goes without saying that we take no part in the controversy of stock versus mutual insurance and, at this time, we are not aware of any factors which would lead us to believe that a substantial, well managed company organized under one of the above plans, offers any more protection to a mortgagor or mortgagee than a company organized under the other.

With this in mind how does the Division treat complaints relating to the refusal of mutual insurance? We treat these complaints just as we do other complaints of restrictive practices. We look for two elements in a particular situation: (1) intent, and (2) effect. Under "intent", we are interested to learn whether the fact of

refusing mutual insurance is simply a device to channel the borrower's insurance to an affiliated insurance agency or company. In this connection, we want to ascertain whether the officers of the lender are also officers of an insurance agency or an insurance company, to which they are steering business. We are very much interested in whether a substantial number of lenders with affiliated agencies in the particular area involved, also refuse all mutual insurance. This latter fact might indicate the existence of a conspiracy to refuse mutual insurance.

If it develops that a very substantial lender in a particular area refuses all mutual insurance or that a substantial number of smaller lenders refuse all mutual insurance, there would be a strong showing that the borrower has been unreasonably debarred from a reasonable choice of insurance.

When a pattern of complaints builds up against a particular lender, these may be handled in one of several ways. First, we have set up liaison procedures with other interested government bodies whereby we can consult with them to determine whether any administrative measures can and should be taken. Some of these bodies, such as the Veterans Administration, the Federal Housing Administration, the Federal National Mortgage Association, and the Federal Reserve Board, have cooperated in our program directed against mortgage insurance tie-in practices.

Second, these complaints become the subject of preliminary inquiries, full investigations by the FBI, and by federal grand juries. Several FBI investigations are pending or have been concluded, and additional ones are being planned for other areas of the country. We have currently one grand jury investigation in progress involving a large residential mortgage lender. This investigation is based upon complaints made to the Division by responsible representatives of insurance organizations as well as by complaints received from individuals and insurance agents. The complaints allege that a preponderant portion of hazard insurance paid for by borrowers of the institution is funneled to an insurance company which is controlled by officers of the lending institution and that the channeled business constitutes the majority of insurance written by the affiliated insurance company.

As a result of these complaints I requested the FBI to conduct a full field investigation. However, in this particular case the institution and its affiliated agency and company refused to permit the FBI to examine their files. When this occurs, the Division has but two alternatives: either to drop the investigation, or to present the matter to a grand jury.

Because of the importance which attached to this matter, I chose the latter alternative.

This grand jury investigation is continuing at the present time. The facts unearthed by the investigation should determine whether the particular institution, its affiliated insurance agency and company and important officers have in fact acted in violation of the Sherman Act.

Third, when one of these investigations indicates that a lender is violating the principle of the I.D.S. case, we will proceed against him. The Supreme Court has said that tying agreements "serve hardly any purpose beyond the suppression of competition." 14/ Because of their inherently anticompetitive nature, insurance tie-in contracts falling within the purview of the Sherman Act are, in the view of the Department of Justice, prima facie unreasonable restraints of trade. That is to say, they are illegal unless they can be shown to be reasonable under the peculiar and particular facts in each individual case. This has been repeatedly called to the attention of the public, and those lenders who persist in unreasonably denying their borrowers access to the competitive insurance market will invite litigation upon themselves.

14/ Standard Oil Co. of Cal. v. U. S., 337 U.S. 293, 305 (1949).

In August 1956 a district court opinion was rendered in the case of United States v. Insurance Board of Cleveland. 15/ The Board, with a membership of 452 insurance agents, accounted for about 85% of all fire insurance coverage in the Cleveland, Ohio area. The complaint alleged that the Board conspired with its members to restrain and monopolize interstate commerce in the business of selling and writing fire insurance in that area through the operation of certain rules which constituted illegal boycotts. According to the complaint, these boycotts were used against non-member agents and companies, against deviating companies or those returning any part of the premium as a dividend or allowance, against mutual companies and against companies selling insurance directly to the public through branch offices. Upon cross motions for summary judgment, the Court said, with respect to the last rule listed above:

> The Direct Writer Rule is a group refusal to deal which relies upon coercion to effectuate its purpose and, under the authorities . . . , it must be held to impose an unreasonable restraint of competition in interstate commerce. 16/

At one point in its discussion, the court stated that it is probable that a substantial proportion of mutual companies are not interested in the Government's attack on the Mutual Rule. Perhaps there are some gentlemen here today who feel differently.

15/ 144 F. Supp. 684 (1956).

16/ Id. at 702.

The Government contended that each of these rules of the Board, including the Mutual Rule, constitutes an agreement to boycott and as such is illegal per se, or in other words, that it falls within that class of practices which have been found by the courts to be so inherently unreasonable and so destructive in their effect upon competition that they are forbidden as a matter of law. Price-fixing is a well known example of such per se illegality. The defendant Board conceded in effect that the rules were concerted refusals to deal, but argued that they must be proven to be unreasonable before they could be held to be illegal. The court agreed with the defendants and held that the "rule of reason" must be applied to test the legality of the Board's rules.

In a further consideration of its reasonableness, the court distinguished three aspects or effects of the Mutual Rule. First that membership in the Board is limited to agents who represent stock insurance companies exclusively; representation of a mutual company disqualifying an agent for membership in the Board. With respect to this exclusion the court said:

> The State of Ohio has granted the Board a corporate charter authorizing it, among other things, to preserve the stock principle in the insurance business and to develop and foster the American agency system . . . . To best subserve its purposes the Board has limited membership in the Association to insurance agents who do business exclusively with stock companies operating under the American agency system. It would poorly serve the objectives of the Board to admit mutual agents as members . . . . In the light of these considerations, the rule . . . does not seem unreasonable. 17/

17 / Id. at 705-706

The second effect of the Mutual Rule is to prohibit the interchange of excess insurance business between members of the Board and mutual companies and agents. In its third and final effect the rule constitutes an agreement among the members not to represent mutual companies. After a general discussion of these two effects of the rule, the court held that there was insufficient evidence in the record to justify the granting of either parties' motion for summary judgment, and said:

> [I]t appears that there are genuine disputes of fact as to the effect of the rule on mutual companies and the public. These are disputes which can be resolved only upon a consideration of all relevant data in a hearing on the merits. Furthermore, the issues here presented are of such importance as to require the presentation and consideration of all available relevant evidence. 18/

A trial date in this case has not yet been set by the court.

Our complaint in United States v. New Orleans Insurance Exchange 19/ was similar to that against the Cleveland Board. The Exchange, a private association of 130 insurance agencies, which controlled approximately three-fourths of the fire, casualty and surety insurance business in the New Orleans area, was charged with violations of Sections 1 and 2 of the Sherman Act. In the words of the Court:

18/ Id. at 707.

19/ 148 F. Supp. 915 (1957)

> The group boycott is effected through a series of by-laws of the Exchange by which members thereof agree to boycott any stock company which plants through any except Exchange agents in the New Orleans area, to boycott any stock company which sells directly to the public, to boycott mutual companies irrespective of how or by whom the insurance is sold, and to boycott non-member agencies so that the facilities of companies planting exclusively through Exchange outlets are denied such agents. 20/

The Exchange stated that one of its reasons for boycotting mutual insurance companies is that the mutuals are socialistic in character whereas its membership is dedicated to the American way of life. The court disposed of this claim by saying:

> That argument sounds high and lofty but the truth is that not only are mutuals boycotted under the requirements of the bylaws, but any company, stock, mutual or otherwise, which does not plant exclusively with Exchange members is likewise discriminated against. Thus the touchstone for acceptance by the Exchange is not belief or disbelief in socialism but willingness to submit to the restraints imposed by the Exchange. 21/

The Exchange also argued that its restrictive bylaws were intended to protect the American agency system. The court, however, said that these assertions of good intent were also subject to considerable question. The evidence showed that mutual companies who are not direct writers also use the American agency system. In fact, all of the Government's witnesses were mutual agents who are a part of the

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20/ Id. at 917.

21/ Id. at 921.

American agency system. Moreover, until 1950 there was an Exchange bylaw which applied the boycott against participating stock companies using the American agency system, irrespective of their willingness to submit to Exchange control. Although the bylaw was repealed in 1950, the evidence showed that the boycott continues. The court said:

> It would seem, therefore, that the reason for the boycott of mutual as well as participating stock companies, as shown by the minutes of the meeting of the Exchange at which the boycott against participating stock companies was adopted, is, not the protection of the American agency system, but the prevention of a possible reduction in agency commissions caused by reduction in cost of insurance to the public. 22/

The Court rendered its decision in February of this year and held that this illegal group boycott must be destroyed. An appeal is now pending.

A situation similar to that in New Orleans exists in another city. When the insurance agents realized that they were being investigated by the FBI in our behalf, they requested us, and we agreed, to withhold the filing of the action until the litigation in the New Orleans case is concluded. Upon its final conclusion, the same judgment ultimately approved in the latter case will be adopted by consent of the parties in this second city.

In closing, I believe it appropriate to quote the court in the

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22/ Ibid.

New Orleans case concerning the necessity of free competition in the insurance field:

> Our economic faith is predicated on free competition uninhibited by group boycotts or other predatory practices. Not only must merchandise stand the cold test of competition, but services performed in connection with the sale thereof must be submitted to the same test, so that in the last analysis the public may have a free choice in spending its money, and businesses, willing and able to compete for that money, may have a free opportunity to do so. 23/

23/ 148 F. Supp. 915, 920 (1957).