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**Regulating Insurance: State Bills Barring Arbitration in Health Care Aren't Preempted
California law currently allows insurers and HMOs to include arbitration clauses in the health insurance policies they sell, but requires that the policies contain certain disclosures concerning arbitration.**

Ins. Code § 10123.19 and Health & Safety Code § 1363.1. In each of the last two terms, the Legislature has considered bills that would repeal these provisions and bar the use of arbitration clauses in health policies outright.

Opponents of this legislation and insurers facing attacks on the arbitration clauses in their policies for failing to comply with the existing disclosure requirements argue that the Federal Arbitration Act ("Federal Arbitration Act"), 9 U.S.C. § 2, preempts any attempt by California to limit the use of arbitration clauses, or even to require special disclosures concerning arbitration. At least one court has reached the same conclusion, holding that the Federal Arbitration Act preempted Health & Safety Code § 1363.1. *Erickson v. Aetna Health Plans of California*, 71 Cal.App.4th 646 (1999).

Unfortunately, the *Erickson* decision and the opponents of legislative restrictions on arbitration clauses in insurance policies fail to reckon with a peculiar federal statute called the McCarran-Ferguson Act, 15 U.S.C. § 1012, which turns normal rules of federal preemption upside down when it comes to state laws that regulate insurance. While the Federal Arbitration Act may restrict state efforts to regulate arbitration clauses generally, the McCarran-Ferguson Act confers on states the power to regulate insurance, and this power includes the power to regulate the use of arbitration clauses in insurance policies.

The Federal Arbitration Act applies only to contracts "evidencing a transaction involving [interstate] commerce." 9 U.S.C. § 2. But this is not a difficult test for a plan to meet. *Erickson* explains that if a plan enters into contracts with out-of-state vendors it can be subject to the Federal Arbitration Act.

The Federal Arbitration Act provides that a written arbitration provision is "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. The U.S. Supreme Court has interpreted this language to mean that the Federal Arbitration Act allows states to regulate contracts, including arbitration clauses, under general contract law, but may not "decide that a contract is fair enough to enforce all its basic terms (price, service, credit), but not fair enough to enforce its arbitration clause." *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265 (1995).

The Supreme Court's decision in *Doctor's Associates, Inc. v. Casarotto*, 517 U.S. 681 (1996) illustrates how little leeway the Federal Arbitration Act leaves states in dealing with arbitration clauses. In that case, the Court invalidated a Montana Statute that required contracts containing an arbitration clause to contain a special notice on the first page of the contract, typed in underlined capital letters. The Court held that the law violated the Federal Arbitration Act because it singled out arbitration clauses for special treatment.

Erickson relied on *Doctor's Associates* to hold that the Federal Arbitration Act preempted Health & Safety Code § 1363.1. Arbitration proponents argue persuasively that if the Federal Arbitration Act bars a state from singling out arbitration clauses for special notice provisions, it must also prevent a state from banning arbitration clauses entirely.

The difficulty with this argument, and with the decision in *Erickson*, is that they fail to consider the effect of the

McCarran-Ferguson Act. The express purpose of that Act is to ensure that the States retain the power to regulate and tax the insurance business. 15 U.S.C. § 1012(a). Section 2(b) of the Act states that, "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 . . . unless such Act specifically relates to the business of insurance. . . ." *Id.*, § 1012(b). This clause also contains a provision exempting the business of insurance from federal antitrust regulation. *Id.*

The McCarran-Ferguson Act establishes a form of "inverse preemption" in the field of insurance regulation, letting state law prevail over general federal rules--those that do not specifically relate to the business of insurance. *Merchants Home Delivery Service, Inc. v. Frank B. Hall & Co., Inc.*, 50 F.3d 1486 (9th Cir. 1995), cert. denied, 516 U.S. 964. Put slightly differently, the Act prescribes the consequences of Congressional silence or specificity. Federal laws that do not conflict with state rules regulating insurance always apply; federal laws that are inconsistent with state rules only apply if Congress says so directly. *Lovilia Coal Co. v. Williams*, 143 F.3d 317 (7th Cir. 1998).

The Supreme Court's decision in *United States Dep't. of the Treasury v. Fabe*, 508 U.S. 491 (1993), established a three-part test to determine whether section 2(b) of the McCarran-Ferguson Act protects state laws from preemption. It does, if (1) the federal statute at issue does not specifically relate to the business of insurance; (2) the state statute at issue was enacted for the purpose of regulating the business of insurance; and (3) the application of the federal statute would invalidate, impair, or supersede the state statute. *Fabe*, 508 U.S. at 500-01.

It is already settled law that the Federal Arbitration Act is a law of general application and does not specifically relate to the business of insurance. See, e.g., *Stephens v. American International Ins. Co.*, 66 F.3d 41 (2d Cir. 1995), and *Quackenbush v. Allstate Ins. Co.*, 121 F.3d 1372 (9th Cir. 1997). Since, absent the operation of the McCarran-Ferguson Act, the Federal Arbitration Act would preempt most of California's attempts to regulate arbitration clauses, the Federal Arbitration Act would therefore "invalidate, impair, or supersede" the state laws in question.

Hence, whether the McCarran-Ferguson Act would protect a law barring the use of arbitration clauses in health policies, or requiring the policies to contain special disclosures when arbitration is used hinges on whether these are state laws "enacted . . . for the purpose of regulating the business of insurance." There are two Supreme Court decisions that examine this statutory phrase, *Fabe*, and *SEC v. National Securities, Inc.*, 393 U.S. 453 (1969).

In *National Securities*, the Court defined laws that regulate the business of insurance in general terms, focusing on the relationship between the insurer and its insured. The Court observed that, "Statutes aimed at protecting or regulating this relationship . . . directly or indirectly, are laws regulating the business of insurance." *National Securities*, 393 U.S. at 460. The Court included within the class of protected laws those that regulate "the type of policy that could be issued, its reliability, interpretation and enforcement." *Id.* *Fabe* re-affirmed this formulation, holding that state laws protected by the Act include laws that operate to ensure that policyholders will ultimately be paid.

The law in this area has not always been as clear as it might be. Recall that the McCarran-Ferguson Act, in addition to protecting state laws that regulate insurance, also creates an immunity from the federal antitrust laws for "the business of insurance." The tendency to import the test formulated for antitrust cases into cases raising the issue of the Act's protection of state insurance laws has made the law murky. This problem has been compounded by the failure to formulate the antitrust immunity test properly. Fortunately, the Supreme Court has taken steps to resolve the confusion.

Cases involving antitrust immunity ask whether a business practice engaged in by an insurance company

constitutes "the business of insurance." If so, then the McCarran-Ferguson Act makes the practice immune from federal antitrust scrutiny. In *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982), the Supreme Court identified three factors relevant to deciding if a particular business practice constitutes the "business of insurance." After *Pireno*, courts tended to apply these factors mechanically, as if they constituted a rigid three-factor test. Last year the Supreme Court expressly disapproved of this practice. *Unum Life Ins. Co. v. Ward*, 526 U.S. 358 (1999). *Ward* held that where the factors are used, they must be applied flexibly.

The more fundamental confusion has surrounded whether and when to apply the *Pireno* factors at all. The antitrust immunity cases required the Court to define "the business of insurance." By contrast, the cases dealing with preemption of state law ask a different question entirely -- whether the state law in question was "enacted . . . for the purpose of regulating the business of insurance."

In *Fabe*, the Court acknowledged that the two types of cases presented different inquiries, and held that the category of state laws enacted to regulate the insurance business is necessarily broader than the business of insurance itself. Therefore, there is no need for a state law that regulates insurance to meet the *Pireno* test, since that test was developed to define the business of insurance.

Under the proper standard, enunciated in *National Securities* and re-affirmed in *Fabe*, there is little question that a law barring or restricting the use of arbitration clauses in health policies would be a law enacted for the purpose of regulating the business of insurance. By preventing health and disability insurers from including mandatory arbitration clauses in the policies they sell, or by restricting the use of these clauses, the state regulates the relationship between insurers and their policyholders, and directs the type of policy that may be issued. In *Mutual Reinsurance Bureau v. Great Plains Mut. Ins. Co., Inc.* 969 F.2d 931 (10th Cir. 1992), the court held that a Kansas law forbidding arbitration clauses in insurance policies regulated insurance and therefore trumped the Federal Arbitration Act.

Under the McCarran-Ferguson Act, the California Legislature has the power to regulate insurance, even if the regulations it enacts conflict with other general federal policies, like the policy favoring arbitration. *Erickson* notwithstanding, insurers who fail to comply with the State's current restrictions on the use of arbitration clauses in health policies do so at their peril, and should the Legislature one day pass a law barring the use of these clauses entirely, it will not be preempted by the Federal Arbitration Act.