

COMMENT

Insurance Anti-Rebate Statutes and *Dade County Consumer Advocates v. Department of Insurance*: Can a 19th Century Idea Protect Modern Consumers?

In 1984, a Florida court of appeals held that the Florida statutes prohibiting insurance agents from rebating part of their commissions to customers violated the due process clause of the Florida Constitution.¹ The court concluded that no rational rela-

1. *Dade County Consumer Advocates Office v. Dep't of Ins.*, 457 So. 2d 495 (Fla. Dist. Ct. App. 1984). At the time this Comment was going to press, the Florida Supreme Court affirmed the district court of appeals decision. *See id.*, *aff'd*, No. 66,178 (June 3, 1986). This Comment generally cites to the court of appeals opinion.

FLA. STAT. ANN. § 626.611(11) (1984) provides:

The department shall deny, suspend, revoke, or refuse to renew or continue the license of any agent, . . . and it shall suspend or revoke the eligibility to hold a license . . . of any such person, if it finds that as to the applicant, licensee, or permittee any one or more of the following applicable grounds exist: . . .

(11) Rebating, or attempt thereat, or unlawfully dividing or offering to divide his commission with another.

FLA. STAT. ANN. § 626.9541(1)(h)1(1984) provides:

(1) The following are defined as unfair methods of competition and unfair or deceptive acts or practices: . . .

(h) Rebates. —

1. Except as otherwise expressly provided by law, or in an applicable filing with the department, knowingly:

a. Permitting, or offering to make, or making, any contract or agreement to such contract other than as plainly expressed in the insurance contract issued thereon;

b. Paying, allowing, or giving, or offering to pay, allow, or give, directly or indirectly, as inducement to such insurance contract, any rebate of premiums on the contract, any special favor or advantage in the dividends or other benefits thereon, or any valuable consideration of inducement whatever not specified in the contract;

c. Giving, selling, or purchasing, or offering to give, sell, or purchase, as inducement to such insurance contract or in connection therewith, any stocks, bonds or other securities of any insurance company or other corporation, association, or other corporation, association, or partnership, or any dividends or profits accrued thereon, or anything of value whatsoever not specified in the

tionship exists between the anti-rebate statutes and the legitimate state purpose of protecting the public.²

The Florida decision is noteworthy because every state prohibits insurance agents and brokers from rebating to their customers a part of the commission earned from the sale of an insurance policy.³ In addition, every state prohibits unfair dis-

insurance contract.

The due process clause of the Florida Constitution provides:

No person shall be deprived of life, liberty or property without due process of law, or be twice put in jeopardy for the same offense, or be compelled in any criminal matter to be a witness against himself.

FLA. CONST. art. I, § 9.

2. Dade County Consumer Advs. v. Dept. of Ins., 457 So. 2d at 497.

3. State insurance code provisions governing unfair methods of competition and unfair and deceptive acts and practices exist in every state, patterned after a model act promulgated by the National Association of Insurance Commissioners. Particular anti-rebate code sections are noted in parentheses:

ALA. CODE §§ 27-12-1 to 24 (1975), (§ 27-12-12); ALASKA STAT. §§ 21.36.010-.350 (1984), (§§ 21.36.100,.120); ARIZ. REV. STAT. ANN. §§ 20-441-.471 (1956), (§§ 20-449,-451); ARK. STAT. ANN. §§ 66-3001 to -3014 (1980), (§ 66-3005(8)); CAL. INS. CODE §§ 790 -]790.]10 (West 1972), (§ 750); COLO. REV. STAT. §§ 10-3-1101 to -1112 (1973), (§ 10-3-1104(g)); CONN. GEN. STAT. ANN. §§ 38-60 to -64 (1958), (§ 38-59); DEL. CODE ANN. tit. 18, §§ 2301 - 2314 (1974), (18 § 2304(14)); GA. CODE ANN. §§ 56-701 - 714 (1982), (§§ 56-704(2), -712; HAWAII REV. STAT. §§ 431-641 to -648 (1984), (§ 431-643(8)); IDAHO CODE §§ 41-1301 to -1331 (1977 & Supp. 1985), (§ 41-1314(1)); ILL. ANN. STAT. Ch. 73, § 1028-1041 (Smith-Hurd 1965); ILL. REV. STAT. § 485.1; IND. CODE §§ 27-4-1-1 to -18 (Burns 1985), (§ 27-4-1-4(8)); IOWA CODE §§ 507B.1 to -.14 (Supp. 1985), (§ 507B.4(8) and (b)); KAN. STAT. ANN. §§ 40-2401 to -2414 (1981), (§ 40-2404(8)(a), 1981 & Supp. (b)); KY. REV. STAT. §§ 304.12-010 to -210 (1981 & Supp. 1984), (§ 304.12-090); LA. REV. STAT. ANN. §§ 22:1211 - :1217 (1968), (§ 22:1214(8)); ME. REV. STAT. ANN. tit. 24-A §§ 2151-2182 (1970), (§ 2160); MD. ANN. CODE art. 48A, §§ 212-234 (1979) (§ 224); MASS. GEN. LAWS ANN. ch. 176D, §§ 1 - 14 (West 1985), (§ 3(8)); MICH. COMP. LAWS ANN. §§ 500.2001 to .2093 (West 1983), (§ 500.2066); MINN. STAT. ANN. §§ 72A.17 - .31 (West Supp. 1985), (§ 72A.20 subd. 10); MISS. CODE ANN. §§ 83-5-29 to -51 (1972), (§ 83-3-121); MO. ANN. STAT. §§ 375.930 - .948 (Vernon Supp. 1986), (§ 375.936(8)); MONT. CODE ANN. §§ 33-18-101 to -1005 (1985), (§ 33-18-210); NEB. REV. STAT. §§ 44-1522 to -1535 (1984), (§ 44-1525(8)); NEV. REV. STAT. §§ 686A.010 - .280 (1985), (§§ 686A.110 - .120, 130); N.H. REV. STAT. ANN. §§ 417:1 - :17 (1983), (§ 417:4IX); N.J. REV. STAT. Ann. §§ 17:29B-1 to -14 (1985), (§ 17:29B-4(8)); N.M. STAT. ANN. §§ 59A-16-1 to -30 (1978), (§ 59-16-15); N.Y. LAW §§ 2401 - 2408 (McKinney 1985), (§§ 2324, 2402); N.C. GEN. STAT. §§ 58-54.1 to .13 (1982 & Supp. 1985), (§ 58-54.4(8)); N.D. CENT. CODE ANN. §§ 26.1-04-01 to -19 (Supp. 1985), (§ 26.1-04-03(8)); OHIO REV. CODE ANN. §§ 3901.19 - .22 (Page 1971 & Supp. 1984), (§ 3901.21(G)); OKLA. STAT. ANN. tit. 36, §§ 1201-1219 (West 1976 & Supp. 1985), (§ 1204(8)); OR. REV. STAT. §§ 746.005 - .270 (1985), (§ 746.045); PA. STAT. ANN. tit. 40, §§ 1171.1-.15 (Purdon Supp. 1985), (§ 1171.5(a)(8)); R.I. GEN. LAWS §§ 27-29-1 to -11 (1979), (§ 27-29-4(8)); S. C. CODE ANN. §§ 38-55-10 to 38-55-410 (Law. Co-op. 1976), (§ 38-55-140); S. D. CODIFIED LAWS ANN. §§ 58-33-1 to 46.1 (1978), (§ 58-33-14); TENN. CODE ANN. §§ 56-8-101 to -118

crimination in pricing insurance policies and prohibits agreements between agents and insureds that are not clearly expressed in the insurance policy.⁴ Collectively, these prohibitions are designed to prevent insurer insolvency and unfair competition.⁵

The Florida case highlights a growing controversy over whether these statutes should prevent individual insurance purchasers from negotiating with the agent the price for the services rendered by the agent—the agent's commission. The controversy involves challenges both to the current marketing system of the insurance industry and to fundamental assumptions about consumer protections enacted nearly a century ago. This Comment reviews the history and application of anti-rebate laws, analyzes the arguments presented in the Florida decision, and suggests a

(Supp. 1985), (§ 56-8-104(7)); TEX. INS. CODE ANN. art. 21.21 and 21.21-2 (1973), (§ 21.21 §4(8)); UTAH CODE ANN. §§ 31-27-1 to 31-27-4 (1974), (§ 31-27-14); VT. STAT. ANN. tit. 8, § 4721 (1984), (§ 4724(8)); VA. CODE §§ 38.1-49 to -57.1 (1981), (§ 38.1-52.8); WASH. REV. CODE §§ 48.30.010 to - .270 (1983 & Supp. 1984), (§ 48.30.140, .170) (1983); W. VA. CODE §§ 33-11-1 to -10 (1982 & Supp. 1985), (§ 33-11-4(8), 33-11-4(8)(c) (Supp. 1985)); WIS. STAT. ANN. §§ 628.31 - .46 (West 1980 & Supp. 1985), (§ 628.34(2)); and WYO. STAT. §§ 26-13-101 to 26-13-123 (1977), (§§ 26-13-110, -112).

4. In addition to an Unfair Practices Act, states may also have particular prohibitions that are used to prevent rebating, *e.g.*, WASH. REV. CODE § 48.18.180, .480, 48.19.020 (1983).

Washington Revised Code § 48.18.180 provides:

Stated premium must include all charges:

(1) The premium stated in the policy shall be inclusive of all fees, charges, premiums, or other consideration charged for the insurance or for the procurement thereof.

(2) No insurer or its officer, employee, agent, solicitor, or other representative shall charge or receive any fee, compensation, or consideration for insurance which is not included in the premium specified in the policy.

(3) Each violation of this section is a gross misdemeanor.

WASH. REV. CODE § 48.18.180 (1983).

Washington Revised Code § 48.18.480 provides:

Discrimination prohibited.

No Insurer shall make or permit any unfair discrimination between insureds or subjects of insurance having substantially like insuring, risk, and exposure factors, and expense elements, in the terms or conditions of any insurance contract, or in the rate or amount of premium charged therefore [sic], or in the benefits payable or in any other rights or privileges accruing thereunder. This provision shall not prohibit fair discrimination by a life insurer as between individuals having unequal expectation of life.

WASH. REV. CODE § 48.18.480 (1985).

5. "All insured persons should be treated the same under like circumstances without having to shop around for agents or companies who will accept less than full premiums." C. CENTER & R. HEINS, *INSURANCE AND GOVERNMENT* 44 (1962).

transitional approach to ending a system of fixed commissions for insurance agents and brokers.

I. HISTORY

Anti-rebate statutes have century-old roots that marked the beginning of the now pervasive state regulation of insurance. The close supervision of insurance companies today is a result of serious abuses in the conduct of the life insurance business in the late 1800s.⁶

The rapid growth and cut-throat competition in life insurance markets in the late 1800s created an environment in which greed, theft, and deceit flourished.⁷ Companies and agents used any means necessary to increase sales and profits.⁸ To attract sales, agents would split their commissions with some of their policyholders.⁹ As the practice escalated, companies paid increasingly larger commissions to retain agents and permit agents to offer larger rebates.¹⁰ Those companies paying the highest commissions attracted the most agents.¹¹ The more agents a company had, the more a company could increase its

6. A. MOWBRAY, R. BLANCHARD, & C. WILLIAMS, *INSURANCE* 518-19 (6th ed. 1969) [hereinafter cited as MOWBRAY].

7. H. GRANT, *INSURANCE REFORM* 8-9 (1979).

8. Practices commonly used by agents and companies to increase sales and profits included "twisting," false policy dividend promises, harsh policy forfeiture provisions, and fraud by "lightening agents" who sold as many policies as possible and quickly left town. *Id.* The MODEL UNFAIR PRACTICES ACT prohibits most of these practices, and all states have statutes governing policy forfeitures, e.g. WASH. REV. CODE § 48.30.040 (1983) (prohibiting false information and advertising), § 48.30.090 (1983) (prohibiting misrepresentation of policies), § 48.30.180 (1983) (prohibiting "twisting," defined as "induc[ing] any insured to lapse, terminate, forfeit, surrender, retain, or convert any insurance policy"), and § 48.76.020 (1983) (requiring certain nonforfeiture and cash surrender provisions in life insurance policies).

9. GRANT, *supra* note 7, at 9. See also S. CLOUGH, *AMERICAN LIFE INSURANCE* 143 (1946) (existing policyholders complained so loudly about inequitable rebates that the company eventually replaced the rebates with an overall reduction in premiums).

10. GRANT, *supra* note 7, at 9. See also M. JAMES, *THE METROPOLITAN LIFE* 31-32 (1947) ("commissions increased from 10 percent on new business and 5 on renewals in 1860 to 33- $\frac{1}{3}$ percent and 16- $\frac{2}{3}$ percent respectively—the average being 25 and 10—in 1866"); M. KELLER, *THE LIFE INSURANCE ENTERPRISE, 1885-1910*, at 74 (1963) (Vice-president of New York Life "reported in 1896 that the Equitable and the Mutual offered discounts of up to 80 percent to secure new business").

11. Insurance companies attempted to thwart agent "stealing" by agreeing that an agent could leave a company to go work for another company only by obtaining the original employer's permission. "Nevertheless, mass raids on agents continued into the early 1900's." KELLER, *supra* note 10, at 74.

market share.¹²

Policyholders who did not receive a rebate realized that if an agent could afford to rebate so much, then the policy was not worth as much as was paid.¹³ Clearly, some policyholders were subsidizing the rebates being paid to other policyholders; thus rebates were condemned as unfairly discriminatory.¹⁴

Policyholders were not the only ones who complained: rebating led to ruinous competition among insurance companies. The practice threatened company solvency and agents' livelihood.¹⁵ The cost of obtaining and keeping policyholders increased as agents used their large commissions to offer rebates to policyholders of rival companies in an effort to convince those policyholders to switch companies.¹⁶ Agents who could not offer as substantial rebates as competing agents lost customers and thus renewal commissions. As expenses to attract and keep business mounted, agents and companies themselves called for reform.¹⁷

Reform came in 1889. New York became the first state to adopt an "anti-discrimination" statute.¹⁸ The statute prohibited rebating by prohibiting discrimination between individuals of the same actuarial class—everyone in the class had to pay the same price for the same policy.¹⁹ Three other states adopted

12. CLOUGH, *supra* note 9, at 92, 158-63.

13. GRANT, *supra* note 7, at 9-10.

14. One early newspaper described the consumer attitude toward rebates:

Nothing has grown faster in the life insurance business than the rebate system. It is admitted to be an error of management. It has been prohibited in some states and may be prohibited in other states on the ground that it causes an unjust discrimination, giving to one man an advantage over another man in the cost of his insurance, thereby destroying that equality of contribution between persons of equal age who receive similar benefits, which is the very essence of a fairly conducted insurance business.

H. JOSEPHSON, DISCRIMINATION - A STUDY OF RECENT DEVELOPMENTS IN AMERICAN LIFE INSURANCE 14 (1960) (quoting *The Chronicle*, January 1889).

15. KELLER, *supra* note 10, at 72-73; GRANT, *supra* note 7, at 11-13.

16. GRANT, *supra* note 7, at 12; *see also* S. KIMBALL, INSURANCE AND PUBLIC POLICY 123 (1960).

17. KELLER, *supra* note 10, at 72-73; GRANT, *supra* note 7, at 11-13.

18. 1889 N.Y. Laws, Ch. 282 §1, now N.Y. INS. LAW §§ 2602, 2606 (McKinney Supp. 1985).

19. Although discrimination is the effect of a rebate, discrimination and rebating are often used synonymously.

The early concept of a rebate was difficult to disassociate from discrimination. . . . [D]iscrimination technically involves the making of a distinction in the amount of premiums to be paid or benefits received between individuals of the same class which are not associated with the risk, while rebating is the

similar measures that same year.²⁰ By 1895, twenty-one states had enacted anti-rebate laws.²¹ Despite the laws, however, rebating continued.²²

In 1895, in response to the ineffectiveness of anti-rebate statutes and under pressure from the National Association of Life Underwriters, thirty insurance companies signed an anti-rebate agreement.²³ The agreement provided that the signatory companies would fire any agent found guilty of rebating, and no company would hire the agent for one year.²⁴ By 1899, the agreement had totally collapsed.²⁵ "At more or less regular intervals everyone swore off; rebating was abolished; and then quite to everyone's surprise, there it was still, a dirty but rugged brat, nobody's in particular, not even conceived in sin and iniquity—just a sort of spontaneous conception of the industry."²⁶ In 1906, publicized accounts of insurance company extravagance and mismanagement caused the New York Legislature to create the Armstrong Committee.²⁷ The committee was charged with

giving or offering to give of any valuable consideration as an inducement to insurance which is not specified in the policy. . . .

. . . [O]nce the terms of the preferential agreement are incorporated into the policy, the question is no longer one of rebating but of discrimination.

J. BROCK, *BAITS AND REBATES* 378, 383 (December 10, 1963) (footnote omitted) (paper presented to the Association of Life Insurance Counsel at the Waldorf Astoria, New York, NY. At the time of presentation, Mr. Brock was General Counsel for National Life Insurance Company, Vermont); see also E. PATTERSON, *THE INSURANCE COMMISSIONER IN THE UNITED STATES: A STUDY IN ADMINISTRATIVE LAW & PRACTICE* 311-21 (1927) (discussing early case law differentiating particular practices as illegal discrimination or illegal rebates).

20. JOSEPHSON, *supra* note 14, at 14 (referring to the Massachusetts, Maine, and Vermont anti-discrimination statutes of 1889-1890).

21. GRANT, *supra* note 7, at 12.

22. *Id.* at 14. The anti-rebate laws did not work because of lapses in enforcement and widespread abuse; thus, if some agents were rebating, other agents had to rebate in order to remain competitive.

23. *Id.* at 12-13.

24. *Id.* at 13.

25. *Id.* at 13-14. KELLER, *supra* note 10, at 74.

26. R. CARLYLE BAILEY, *THE AMERICAN LIFE CONVENTION* 148 (New York 1953).

27. Newspapers and magazines in 1904 and 1905 carried sensationalized accounts of life insurance companies' mismanagement and their abuse of policyholders. While rebating was of concern to the public, press accounts of company spending and investment practices raised a public furor for reform. A fight for control of Equitable Life Insurance company became public and revealed incredible abuses, notably the lavish "French Ball" thrown by the bachelor son of Equitable's founder at a cost of nearly \$100,000. An investigation of Equitable by a special blue ribbon committee appointed by the Equitable Board of Directors concluded "that exorbitant salaries were being paid to officers and favored employees, that excessive commissions were being given to field agents, that

investigating "the business and affairs of life insurance companies doing business in the State of New York" and recommending statutory changes.²⁸ The findings and recommendations from the Armstrong investigation led to comprehensive revision of state laws regulating insurance, including stricter laws governing insurance agent compensation.

The Armstrong Committee recommended, and the legislature adopted, statutes limiting commission earnings, limiting premium collection charges, prohibiting loans to agents unless proper collateral was obtained, and prohibiting all bonuses, prizes and rewards for new business.²⁹ The committee also recommended strengthening anti-rebate laws. The legislature responded by making illegal not only the giving of a rebate, but also its receipt.³⁰

In the years immediately following the Armstrong investigation, other states adopted strict insurance laws mirroring those adopted in New York.³¹ The insurance industry made several attempts to convince the New York Legislature and other legislatures to modify the restrictions on agent commissions but failed.³² For example, in 1908 the New York Legislature passed a bill that liberalized the statute governing agent commissions, but the governor vetoed the changes.³³ Eventually, the strict regulation of agent compensation was supported by the insurance industry because of pressure by agents.³⁴

inadequate accounting procedures for disbursements existed, and that company funds were being used to support prices of Wall Street securities in which Equitable officers were intimately interested." This finding was subsequently confirmed by the New York State Insurance Department. GRANT, *supra* note 7, at 34. For a complete account of these abuses and others, see *generally id.* at 28-54; see also JAMES, *supra* note 10, at 139-66; CLOUGH, *supra* note 10, at 215-35.

28. CLOUGH, *supra* note 10, at 219.

29. *Id.* at 226. See NEW YORK INSURANCE LAW § 4429 (McKinney 1985).

30. CLOUGH, *supra* note 10, at 227 n.34.

31. GRANT, *supra* note 7, at 53. Wisconsin conducted its own "Armstrong" investigation leading to comprehensive reform of insurance laws. See *generally id.* at 55-71. Washington State adopted a law extensively regulating life insurance. 1909 Wash. Laws Ch. 142. Rebating was specifically prohibited. 1909 Wash. Laws Ch. 143 § 19, 21.

32. GRANT, *supra* note 7, at 57.

33. GRANT, *supra* note 7, at 58. In Wisconsin, 24 insurance companies, constituting two-thirds of the companies doing business in the state, stopped doing business in an effort to pressure the Wisconsin legislature into repeal of some of the reform laws. The plan backfired. The public expressed outrage at the tactics of the companies, and the legislature created a state-owned insurance company. The company never did much business, but the state had made its point; several years later, the companies returned. GRANT, *supra* note 7, at 60-63.

34. GRANT, *supra* note 7, at 59.

In 1944, the United States Supreme Court held, in *United States v. South-Eastern Underwriters Association*,³⁵ that the business of insurance was subject to federal antitrust prohibitions. The Court found that insurance was an interstate transaction and thus could be regulated by Congress.³⁶ Shortly after the case was decided, the insurance industry pressed for congressional action to overturn the decision.³⁷ In response, Congress adopted the McCarran-Ferguson Act,³⁸ exempting the business of insurance from federal antitrust laws to the extent that individual states regulated insurance. In an effort to avoid application of the Robinson-Patman Unfair Trade Act,³⁹ the National Association of Insurance Commissioners (NAIC) developed, and the states subsequently adopted, the Model Unfair Trade Practices Act.⁴⁰ The Act generally prohibited rebating and specifically defined certain types of prohibited transactions as rebating.⁴¹

Today, every state has an unfair trade practices act pat-

35. 322 U.S. 533 (1944).

36. *Id.* at 539-53.

37. Ironically, the insurance industry fought state regulation of insurance a couple of decades earlier and attempted to convince Congress to amend the Constitution so that Congress could regulate insurance. GRANT, *supra*, note 7, at 161-62.

38. 15 U.S.C. §§ 1011-15 (1976). "[A]fter June 30, 1948 . . . the Sherman Act . . . the Clayton Act, and . . . the Federal Trade Commission Act . . . shall be applicable to the business of insurance to the extent that such business is not regulated by State law." *Id.* at § 1012(b). See generally Note, *Federal Regulation of Insurance Companies: The Disappearing McCarran Act Exemption*, 1973 DUKE L.J. 1340 (1974); Note, *The Limits of State Regulation under the McCarran-Ferguson Act: Travelers Insurance Co. v. Blue Cross of Western Pennsylvania*, 42 GEO. WASH. L. REV. 427 (1974).

39. 15 U.S.C. § 13 (1976) (prohibiting discrimination in prices and services). See Stelzer, *The Insurance Industry and the Anti-Trust Laws: A Decade of Experience*, 386 INS. L.J. 137, 147-48 (March 1955).

40. The MODEL ACT provides, in part:

Rebates. (a) Except as otherwise expressly provided by law, knowingly permitting or offering to make any contract of life insurance, life annuity or accident and health insurance, or agreement as to such contract other than as plainly expressed in the contract issued thereon, or paying or allowing or giving or offering to pay, allow, or give, directly or indirectly, as inducement to such insurance, or annuity, any rebate of premiums payable on the contract, or any special favor or advantage in the dividends or other benefits thereon, or any valuable consideration or inducement whatever not specified in the contract, or giving, or selling, or purchasing or offering to give, sell, or purchase as inducement to such insurance of annuity of in connection therewith, any stocks, bonds, or other securities of any insurance company or other corporation, association, or partnership, or any dividends or profits accrued thereon, or anything of value whatsoever not specified in the contract.

1947 PROC. NAT'L A. INS. COMMRS., 392, 394.

41. *Id.*

tered after the NAIC Model Act.⁴² Some states have additional statutes prohibiting rebating, for these statutes in many cases predated the Model Act, and some states have expanded the application of the anti-rebate provisions of the Model Act to all types of insurance.⁴³

II. THE FLORIDA DECISION

"We are unable to find any legitimate state interest justifying the continued existence of the anti-rebate statutes."⁴⁴ With this statement, a Florida court of appeals, in *Dade County Consumer Advocates Office v. Department of Insurance*, struck down Florida's anti-rebate statutes, which had been adopted in 1915.⁴⁵ The court held that the statutes violated the Florida Constitution's due process clause by constituting "an unjustified exercise of the police power."⁴⁶

The decision in *Dade County* ended a seven-year legal effort to overcome the anti-rebate laws. In 1977, a licensed Florida insurance agent, Joseph Blumenthal, had sued the Florida Department of Insurance, arguing that the anti-rebate laws prevented him from competing for insurance sales.⁴⁷ The lower court held that the laws were constitutional, and Mr. Blumenthal appealed to the state supreme court.⁴⁸ While his appeal was pending, Mr. Blumenthal died, and his case was dismissed as moot.⁴⁹

In May of 1983, Walter Dartland, Director of the Dade County Consumer Advocates Office, sued the Florida Depart-

42. See *supra* note 3.

43. E.g., 1909 Wash. Laws Ch. 142 §§ 19, 21 predates Washington's Unfair Trade Practices Act, WASH. REV. CODE Ch. 48.30. See also WASH. REV. CODE § 48.30.140 (prohibiting rebates for all lines of insurance except marine insurance). The Texas State Constitution prohibits rebates: "That all drawbacks and *rebatement of insurance*, freight, transportation . . . are forever prohibited, and it shall be the duty of the Legislature to pass effective laws punishing all persons in this State who pay, receive or contract for, or respecting the same." TEX. CONST. art. 16, § 25 (emphasis added).

44. *Dade County Consumer Advocates Office v. Department of Ins.* 457 So. 2d 495, 497 (Fla. Dist. Ct. App. 1984).

45. *Id.*; see 1915 Fla. Laws § 1 ch. 6849.

46. 457 So. 2d at 499. The standard of review is "whether the challenged anti-rebate statutes reasonably and substantially promote the public health, safety or welfare." *Id.* at 497 (citing *Liquor Store, Inc. v. Continental Distilling Corp.*, 40 So. 2d 371 (Fla. 1949) and 10 FLA. JUR. 2d *Constitutional Law* §§ 211, 214 (1979 and Supp. 1983)).

47. Brief of Plaintiffs-Appellants at 5, *Blumenthal v. Department of Insurance*, No. 77-355 (Leon County Cir. Ct.).

48. *Id.*

49. *Id.* (citing *Blumenthal v. Department of Insurance*, No. 53,933 (July 25, 1979)).

ment of Insurance, challenging the state anti-rebate statutes.⁵⁰ Dartland argued that the anti-rebate statutes violated the Florida Constitution "because they unreasonably promote the interests of a limited group of individuals, insurance agents, to the detriment of Mr. Dartland and other Dade County consumers."⁵¹ The trial judge, finding no genuine issues of material fact, granted summary judgment to the Department of Insurance.⁵² The judge ruled that the statutes were a valid exercise of state police power and state regulatory authority in protecting the public.⁵³ On appeal, the First District Court of Appeals reversed.⁵⁴

The Florida Insurance Department argued that the "insurance industry is so affected with the public interest as to be subject to state regulation under its police power[,] from the licensing of agents to the rates for policies."⁵⁵ The Department argued that anti-rebate statutes are a "legitimate and constitutional exercise of [a] state's police power,"⁵⁶ for they prevent ruinous competition by insurers. Thus, by preventing discrimination among similarly situated policyholders, the statutes foster insurer solvency.⁵⁷ The court found, however, that the strongest argument for the Department, presented by amici curiae, was

50. *Id.* at 6.

51. *Id.* at 1.

52. *Id.* at 7. See also Answer Brief of Appellees at 2.

53. Answer Brief of Appellees at 2. Appellees argued that if the appellate court found that the granting of summary judgment was erroneous, appellees should be permitted to submit evidence and argument controverting appellants' arguments. Answer Brief at 3. Apparently, the Insurance Department filed a motion to dismiss based upon procedural arguments, and Dade County filed a motion for summary judgment that had been pending for three months prior to the trial court's decision. Brief of Plaintiffs-appellants at 7, Reply Brief of Plaintiffs-Appellants at 5. Although the Insurance Department had not requested summary judgment, the judge granted summary judgment in the Department's favor and, according to the Department, summary judgment was granted without reliance on the affidavits filed by the parties. Brief of Plaintiffs-Appellants at 7, Answer Brief of Appellees at 2.

The issue of summary judgment and the request for remand in the event of an appellate decision adverse to the Insurance Department was critical to the department, since apparently the Department did not attempt to controvert Dade County's evidence at trial. Reply Brief of Plaintiffs-Appellants at 5, Answer Brief of Appellees at 2. Ultimately, the appellate court relied upon the evidence presented by Plaintiffs-Appellants at trial and did not permit remand. See *Dade County*, 457 So. 2d at 497 nn. 3 & 4; Reply Brief of Plaintiffs-Appellants at 4-6.

54. *Dade County*, 457 So. 2d at 498.

55. Answer Brief of Appellees at 7.

56. *Id.* at 18.

57. *Id.* at 18, 20.

that the statute promoted agent professionalism.⁵⁸

The Dade County Consumer Advocates Office argued that the public is better served by allowing insureds and agents to negotiate commission rates.⁵⁹ Appellants supported this argument by drawing analogies to other professional services,⁶⁰ by citing other statutes that promote the same goals as the anti-rebate statute,⁶¹ and by countering the positive goals of the statute with examples of its negative effects.⁶² Appellants character-

58. 457 So. 2d at 497 n.2. The Florida Association of Life Underwriters, the Florida Association of Insurance Agents, and the American Council of Life Insurance, Inc., filed briefs on behalf of the Department. According to plaintiffs-appellants, amici arguments support setting a fixed price for any service or commodity rather than explain what considerations justify a set commission, by arguing that competition may increase costs, that less sophisticated policyholders would lose out, and that the stability of the insurance contract would be undermined. Reply Brief of Plaintiffs-Appellants at 2, 3.

59. Brief of Plaintiffs-Appellants at 10-13.

60. *Id.* Plaintiffs-Appellants noted that doctors, lawyers, and stockbrokers can negotiate their fees. As appellants stated, "every other profession operates without laws requiring price fixing." *Id.* at 11. Appellants concluded, "[i]f people can be trusted to choose between a qualified attorney and a legal secretary for advice about important legal matters, they certainly can be trusted to choose between two or more licensed insurance agents depending on price and other services offered." *Id.* at 13. Appellants relied heavily upon *The Pricing and Marketing of Insurance*, A Report of the U.S. Department of Justice to the Task Group on Antitrust Immunities. (January 1977) [hereinafter cited as Justice Department Report]. The report focused upon federal anti-trust immunities for pricing and marketing insurance. The report, in recommending deregulation of insurance rates, reviewed current insurance pricing mechanisms and, in studying fixed insurance rates, noted the problems and inequities of anti-rebate statutes. See Justice Department Report § VI.

61. Brief of Plaintiffs-Appellants at 3, 4. Appellants generally noted the comprehensive regulation of insurance to prevent fraud and mismanagement and to promote insurer solvency. The regulation of insurance is quite extensive in all states: e.g., Washington State authorizes the State Insurance Commissioner to examine insurance companies, rating bureaus, agents, brokers, solicitors, adjusters and any person who holds a controlling interest in an insurer. WASH. REV. CODE §§ 48.03.010, .020 (1984). The insurance code sets capital and surplus requirements for insurers, WASH. REV. CODE § 48.05.340 (1984)); governs assets, liabilities and investments of insurers, WASH. REV. CODE chs. 48.12, 48.13 (1984); requires licensure and regulation of agents, brokers and solicitors, WASH. REV. CODE ch. 48.17 (1984); sets standards for insurance contracts and rates, WASH. REV. CODE chs. 48.18, 48.18A, 48.19(1984). There are few, if any, aspects of insurance that are not regulated.

62. Appellants argued that the anti-rebate statute creates an inherent conflict of interest for agents and brokers to the extent that agents and brokers sell policies paying the highest commission rate without regard to consumer need. Appellants noted that the Public Employees Services Company (PESCO) was asked by Dartland to institute a program adopted by Michigan insurers whereby the insurance company provides the policyholder with a child safety seat in order to reduce accident losses. PESCO refused, arguing that such a program would violate state anti-rebate laws by giving policyholders something of value not provided for in the policy. Finally, appellants argued that fixed commissions promote excessive prices by eliminating agent competition. Brief of Plaintiffs-appellants at 10-15.

ized the anti-rebate statute as an "anti-discount" law.⁶³

In arguing that states have constitutional authority to regulate insurance and that anti-rebate laws generally promote constitutionally legitimate regulatory goals, the Insurance Department failed to go beyond traditional rationales supporting anti-rebate laws. The Department cited various state cases decided more than a half century ago to support the constitutionality of the Florida statute.⁶⁴ As the court noted, however, "[t]he precedential value and persuasiveness of these cases are severely limited by the impact of the revolution in consumer's [sic] rights which has occurred since the turn of the century."⁶⁵ Specifically, the court accepted appellants' argument that recent cases have rejected consumer protection rationales to support fixed pricing.⁶⁶ "The paternalistic approach to a consumer's ability to make reasonable decisions without government intervention as exemplified by these rulings has been rejected by modern courts."⁶⁷ Thus, arguments supporting an anti-rebate law in 1915 do not necessarily support an anti-rebate law in 1986. If the anti-rebate laws are necessary to protect the public, that

63. Brief of Plaintiffs-Appellants at 16. Appellants compared the anti-rebate law to the old Fair Trade Act, which required retailers to charge consumers the price set by the wholesaler. Appellant argued that since anti-rebate laws force agents to earn or charge the insurer's set commission, anti-rebate laws resemble the Fair Trade Act and are actually "anti-discount" laws. See *infra* note 109.

64. Answer Brief of Appellees at 9-15, citing *State ex rel. Vars V. Knott*, 135 Fla. 206, 184 So. 725 (1938); *Rideout v. Mars*, 99 Miss. 199, 54 So. 801 (1911); *Commonwealth v. Morningstar*, 144 Pa. 102, 22 A. 867 (1891); *People v. Formosa*, 20 N.E. 492 (N.Y. Crim. 1892); *Metropolitan Life Ins. Co. v. People*, 209 Ill. 42, 70 N.E. 643 (Ill. 1904); *People v. Hartford Life Ins. Co.*, 252 Ill. 398, 96 N.E. 1049 (1911); *Leonard v. American Life and Annuity Co.*, 139 Ga. 274, 772 S.E. 41 (1913); *Calvin Phillips & Co. v. Fishback*, 84 Wash. 124, 146 P. 181 (1915); *Shortridge v. Hipolito Co.*, 114 Cal. 682, 300 P. 467 (Cal. 2nd Dist. Ct. App. 1931); *German Alliance Ins. Co. v. Lewis*, 233 U.S. 389 (1914); and *Utah Ass'n. of Life Underwriters v. Mountain S.L. Ins. Co.*, 58 Utah 579, 200 P. 674 (1921).

65. *Dade County*, 457 So. 2d at 498 (Fla. Dist. Ct. App. 1984). Appellants noted that

appellees have cited ten cases from other states, giving the impression that these decisions uphold the constitutionality of laws similar to the Florida statutes challenged in this action. However, eight of these cases are wholly irrelevant to the constitutional issues raised in this case. Five of them do not even concern a constitutional question, and three concern statutes outlawing rebating by a life insurance company and not by an agent, a prohibition which plaintiffs specifically have not challenged in this action.

Reply Brief of Plaintiffs-Appellants at 7. In addition, appellants noted that two cases held simply that the state may regulate rates, which appellant did not challenge. *Id.*

66. 457 So. 2d at 498 (citing *Virginia Board of Pharmacy v. Virginia Citizens Consumer Council*, 425 U.S. 748 (1976)).

67. 457 So. 2d at 498.

necessity must be proved on other grounds; old arguments must be refined to pinpoint those abuses that could attend the repeal of the laws.

While traditional arguments supporting anti-rebate laws may need refinement, both supporters and critics of these statutes often have failed to distinguish the anti-competitive or price-fixing aspects⁶⁸ of an anti-rebate statute from the statute's literal and technical application.⁶⁹ Anti-rebate laws cast a wide net prohibiting a variety of practices,⁷⁰ some of which may unnecessarily complicate insurance transactions, may be used to mislead and defraud the public, or may be too difficult to regulate adequately.⁷¹ Strict reliance upon historic arguments to support these laws ignores the evolution in insurance regulation and consumer protection, but strict reliance upon price competition arguments ignores the complexity and potential benefit of anti-rebate laws. In short, the problem with the anti-rebate laws are not that they do not promote consumer protection but rather that the laws as written are overly broad, thereby both promoting and thwarting consumer interests.

Traditional arguments that anti-rebate laws promote insurer solvency, prevent discrimination, and ensure agent pro-

68. The heart of appellants' argument was that anti-rebate laws, "more properly called 'anti-discount' laws, . . . injure consumers by requiring them to pay the full commission for insurance policies, whereas otherwise they could bargain for a lower price." Brief of Plaintiffs-Appellants at 1. "The plain purpose and effect of [anti-rebate] statutes is to prohibit price competition or discounting by insurance agents who might otherwise return a portion of their commissions to their customers." *Id.* at 4-5.

69. See generally J. BROCK, *BAITS AND REBATES*, *supra* note 19, discussing what constitutes a rebate and how the anti-rebate statute operates. See also Kimball and Jackson, *The Regulation of Insurance Marketing*, 61 COLUM. L. REV.; PATTERSON, *supra* note 19, at 307-21.

70. Anti-rebate statutes prohibit more than just offering a cash discount. For example, an agent cannot offer stocks, bonds, or other securities as an inducement to sale of a policy. See *supra* note 40.

These two things [stock and insurance] should not be confused in the public mind. If both are sold at once, the merits of the insurance will not be properly considered by the insured. It does not follow, of course, that the only way to prevent these evils is to forbid altogether the sale of stock in connection with insurance[, for] . . . proper regulation of these sales would minimize harmful tendencies.

PATTERSON, *supra* note 19, at 330.

71. These statutes indicate the type of activity which could be used to defraud the public. However, the Justice Department Report, *supra* note 60 at 295-96, discusses rebating as a method of negotiating agent commissions, but does not distinguish rebating as a discount from the statutory definition of a rebate and the anti-rebate statute's prohibitions.

professionalism are undercut by the existence of statutes specifically designed to achieve these goals.⁷² Moreover, traditional arguments ignore the present reality that insurers can and do permit reduced commission rates or "discounts" to certain classes of insurance purchasers, thus contradicting the concept that anti-rebate laws ensure uniform pricing.⁷³ While rebating may be a potentially abusive marketing practice,⁷⁴ the prohibition on rebating does not directly address solvency, anti-discrimination, or agent professionalism. If the anti-rebate statute promotes these particular goals, the statute does so tangentially and, in so doing, causes other problems.⁷⁵

III. TRADITIONAL ARGUMENTS

A. *Insurer Solvency*

The argument that "the anti-rebate statutes are designed, in part, to preclude ruinous competition and to promote insurer solvency"⁷⁶ is tenuous at best; other existing statutes are designed specifically to prevent insolvency and ruinous competition.⁷⁷ Historically, rebates led to insolvency because company

72. See *supra* note 61; Fogarty, *The Case Against Rebating, and Schultz, Rebating: A Free Market Concept*, Best's Review Life/Health Insurance Edition, August, 1985, at 32, 40.

73. See *infra* notes 101-02 and accompanying text.

74. See *supra* notes 8-17 and accompanying text.

75. See *infra* note 144 and accompanying text..

76. Answer Brief of Appellees at 22.

77. The anti-rebate laws may have an indirect effect on promoting insurer solvency, but other statutes would ensure solvency in the absence of an anti-rebate law. "Company insolvency is no longer a significant problem due to the states' enactment of 'legal reserve' balance requirements and rate-setting safeguards." Frankel, *Insurance Agent Commission Deregulation: Antirebate Laws and an Alternative to Repeal*, 2:2 J. INS. REG. 258 (December 1983). Mr. Frankel also notes that statutory limits on commission rates as, for example, in New York, control company expenses in obtaining new business. *Id.* at 259. "Rate wars" are prohibited by the Unfair Practices Acts, e.g., WASH. REV. CODE § 48.30.240 (1983): "Any insurer which precipitates, or aids in precipitating or conducting a rate war and by so doing writes or issues a policy of insurance at a less rate than permitted under its schedules filed with the Commissioner, or below the rate deemed by [the commissioner] to be proper and adequate to cover the class of risk insured, shall have its certificate of authority to do business in [Washington] suspended until such time as the commissioner is satisfied that it is charging a proper rate of premiums." *But see State ex. rel Northwest Nat'l. Ins. Co. v. Sullivan*, 178 Wash. 436, 35 P.2d 24 (1934), narrowly construing Rem. Rev. Stat. § 7157 (WASH. REV. CODE § 48.30.240) as applying only when a rate war actually exists. In addition to this statute, Washington has a "prior approval" statute for property-casualty insurance, see WASH. REV. CODE § 48.18.110 (2) (1983), which provides: "In addition to the grounds for disapproval of any such form as provided in subsection (1) of this section, the commissioner may disapprove

finances were not scrutinized and because reserve and capitalization requirements were nonexistent or lenient.⁷⁸ With the adoption of statutes strictly regulating loss reserves, for example, many of the solvency problems associated with rebating have disappeared.⁷⁹

As long ago as 1927, the presumption that rebating leads to insurer insolvency was questioned.⁸⁰ Rebating had been viewed as threatening insurer solvency because the insurer might not collect adequate premiums to cover the insured risk if too much of the premium were allocated to agent commission.⁸¹ However, if the insurer maintains adequate reserves based upon the benefits promised rather than upon the actual premium received by the insurer after rebate, then the insurer will have sufficient funds to pay claims.⁸²

Another fear for insurer solvency expressed in connection with rebates is that life insurance policies "issued at rebated initial premiums will show a larger proportion of lapses after the first year (when the rebate will no longer be given); thus, a life insurance company's financial strength will be weakened by the practice of rebating."⁸³ Life insurance policy premiums collected during the first year are used primarily to pay agent commis-

any form of disability insurance policy if the benefits provided therein are unreasonable in relation to the premium charged." WASH. ADMIN. CODE ch. 284-34 regulates rates for credit life and credit accident and health insurance. In particular, WASH. ADMIN. CODE R. 284-34-040(3) provides: "Commissions or other payments or allowances to creditors, agents or general agents shall never be considered a justification, or any part of a justification, for a higher rate as being reasonable in relation to benefits."

78. See *supra* note 27.

79. See *infra* note 82.

80. PATTERSON, *supra* note 19, at 308 (an insurer's "practice of rebating does not necessarily mean insolvency").

81. *Id.* Most rebating is done by agents and not companies. Insurance companies pay agent commissions whether or not agents keep the full commissions. "It is the amount received by the insurance company which determines the financial soundness of the company." *Id.*

82. Any problem with inadequate reserves is resolved by regulation requiring additional reserves. *Id.* Every state has a "standard valuation" law used to determine life and annuity contract reserves. These reserve statutes are developed by the NAIC. See WASH. REV. CODE ch. 48.12 (1983). *E.g.* WASH. REV. CODE § 48.12.080(2) (1983) provides: "(2) If the loss experience of an insurer shows that its loss reserves, however estimated, are inadequate, the commissioner shall require the insurer to maintain loss reserves in such increased amount as is needed to make them adequate."

83. PATTERSON, *supra* note 19, at 308 n.4. In an interesting footnote, Patterson comments on at least two of the cases used by the Florida Insurance Department to support the Florida anti-rebate statute, suggesting that past courts have sustained the constitutionality of the statute without reviewing the validity of the argument of insurer solvency.

sions.⁸⁴ In subsequent years, the percentage of premiums devoted to agent commission decreases.⁸⁵ Thus, during the first year, an agent has more money with which to rebate. The argument assumes that if agents were permitted to rebate, a policyholder would be induced to cancel an existing policy and replace the policy continually in order to receive the large rebate that can only come in the first year of the policy.⁸⁶

The first problem with this argument is that it only applies to life insurance products, since most property and casualty insurance policies are written annually.⁸⁷ Moreover, not all life insurance products have a commission structure that heavily loads first-year premiums with commission expenses.⁸⁸ Despite this difference, the anti-rebate laws generally apply to all lines of insurance.

The second problem with this argument is that it implicitly assumes that most policyholders would see only a benefit in replacing a policy;⁸⁹ consumers would not be bothered by other aspects of annual policy turnover, such as new applications, contestability periods, and benefit losses. The argument thus assumes that price is the consumer's sole criterion. Moreover, the argument ignores the possibility that insurance companies might simply choose to restructure policy pricing to avoid the problem.⁹⁰ The incentive to replace a policy lies more with the

84. MOWBRAY, *supra* note 6, at 398.

85. *Id.*

86. *Insurance Agent Commission Deregulation, 1981: Hearing Before the Subcommittee on General Oversight of the Comm. on Small Business, 97th Cong., 1st Sess. 9 (1981)* [hereinafter cited as *1981 Hearing*].

87. Kimball and Jackson, *supra* note 69, at 147. "Outside of life insurance, rebates are most often a constant percentage of each year's commission, the continuing rebate being necessary to secure the business against attacks of rebating competitors. In life insurance, however, renewal commissions are small so that continuing rebates are not practical, and the rebate seems generally limited to all or a part of the first year commission."

88. Life insurance products, from term insurance to universal life insurance, offer a wide array of compensation options for agents. Lincoln Benefit Life Insurance Company, for example, recently advertised an annually renewable term insurance policy that allows the agent to determine how commissions would be paid—high first-year commissions or steady level commissions for a number of years. 86 *BEST'S REVIEW LIFE/HEALTH INSURANCE EDITION 1* (May 1985). The California Association of Life Underwriters proposed a level commission plan eliminating high first-year commissions. Haggerty, *Cal. Agents Chief Proposes Level Commission Plan*, *The National Underwriter*, Oct. 23, 1982, at 2.

89. *1981 Hearing*, *supra* note 86, at 9-11.

90. A level commission schedule, ending high first-year commissions, would reduce the incentive to rebate, and a company reduction in the agent's commission earnings would not permit the agent to rebate without causing the agent significant income losses.

agent than with the policyholder.⁹¹ Inducing policy replacement is a problem of misrepresentation and false advertising, for under certain circumstances, a policyholder is actually benefited by replacing a policy.⁹² Inducing policy replacement not for the policyholder's benefit but to enhance commission earnings is commonly known as "twisting."⁹³ Twisting, however, exists in spite of anti-rebate laws and, in some instances, may be encouraged by insurance company practices of offering large commissions to increase sales of a new product.⁹⁴ In an effort to combat the problem of twisting, some states have adopted regulations strictly governing the replacement of life insurance policies.⁹⁵ Twisting thus is another problem that could be addressed

Moreover, greater reliance on group sales, mass marketing, and direct writing by insurers could reduce insurer expenses in obtaining new business and avoid some of the costs associated with commissions. See generally S. HUEBNER & K. BLACK, *LIFE INSURANCE* 598-602 (10th ed. 1982).

91. See Testimony of John Regan: "Many companies have two term or two whole life . . . products in their rate books where the only significant difference is in the commissions . . ." 1981 *Hearings, supra* note 86, at 41. Thus, depending upon which policy is sold, an agent can increase or decrease commissions. "The most persistent abuse in life insurance sales is replacement of existing policies with new policies. Since commissions are based solely on first year premiums, many sales people spend much of their careers persuading policyholders to forfeit their old policies and purchase new insurance." Frankel, *supra* note 77, at 260.

92. Kimball & Jackson, *supra* note 69, at 193-96.

93. See *supra* note 8 for a statutory definition of "twisting."

94. Insurance trade journals often contain advertisements from insurers offering agents high commissions to sell particular products. Insureds ultimately pay higher premiums to cover these commissions. Examples of these advertisements directed to agents abound: "Your disability commissions increase every year . . . all by themselves?" 86 *BEST'S REVIEW, LIFE/HEALTH INSURANCE EDITION* 133 (May 1985) (advertisement by Provident companies); "Upon receipt of the first month's premium, Crown Life will send you three months commission in advance." *Id.* at 79 (advertisement by Crown Life); "Our Universal Life has better commissions than some others." *Id.* at 116 (advertisement by Western Reserve Life); "Commission 15% for business effective during April and May 1985. This is a special only for this two month period, starting June 1985 - 12% commission," *Insurance Advocate*, May 4, 1985 at 12 (advertisement by Eagle Insurance Company); "Lucrative Commissions, High first year schedule," *Insurance Advocate*, April 13, 1985, at 25 (advertisement by John Adams Life Insurance Company); and "Arrowhead is offering 20% Commission!" *Insuranceweek*, March 22, 1985, at 4 (advertisement by Arrowhead General Insurance Agency).

95. See, e.g., WASH. ADMIN. CODE R. §§ 284-23-300 to -470 (1983) (setting forth the duties of agents, replacing insurers, existing insurers, and direct-response sales). The regulations also set forth notices which must be given by the agent or insurer to the policyholder. These notices detail the relative advantages and disadvantages in replacing existing insurance and must be signed by the policyholder acknowledging receipt and reading of the notice. WASH. ADMIN. CODE R. § 284-23-500 to -503. Among other provisions, the regulations require the insurer providing the replacement policy to notify the existing insurer, thus giving the existing insurer a chance to retain its insured. WASH.

more effectively by direct regulation than by statutes governing rebating.

B. Discrimination

The second traditional argument advanced in support of anti-rebate laws is that the laws prevent discrimination.⁹⁶ The argument is based upon two principles. The first is the " 'one-price' idea, firmly rooted in the retail marketing traditions of the American people."⁹⁷ The public is best served by the convenience of uniform pricing. A product for sale should cost the same no matter where it is purchased. The second principle is that of social equality—similarly situated persons should pay the same price for the same product.⁹⁸ A rebate of part of the purchase price undercuts these principles, since not everyone receives a rebate or the same amount of rebate.⁹⁹

In theory, the anti-rebate and anti-discrimination statutes would appear to ensure that the principles of uniform pricing and social equality are met. In actuality, the statutes merely ensure that the insurer controls the ultimate price paid.¹⁰⁰ All persons do not pay the same price for the same policy, since commercial insurance purchasers routinely negotiate agent and broker commissions,¹⁰¹ and certain marketing techniques such as direct writing, mass merchandising, and group insurance may result in lower premiums to persons in a position to benefit from

ADMIN. CODE R. §§ 284-23-450(d), 460(b).

96. See *supra* note 19 and accompanying text.

97. PATTERSON *supra* 19, at 309.

98. *Id.*

99. See *supra* note 14 and accompanying text.

100. Insurance companies set the premium for a policy or agree to set a premium in accordance with the agent's or broker's recommendations when selling a commercial policy. In either case, unless the insurer permits a reduced or increased commission in setting the premium, no commission negotiation can occur. For a brief discussion of commission rates and flexibility in agent and broker commission earnings for the sale of group policies, see B. BEAM, *GROUP INSURANCE: BASIC CONCEPTS AND ALTERNATIVES* 305-09 (1982).

101. Schedule rating permits the agent or broker to tailor the premium rate to the individual insured's actual loss potential and permits the agent or broker to reduce commissions. S. HUEBNER, K. BLACK & R. CLINE, *PROPERTY AND LIABILITY INSURANCE* 583-84 (3rd ed., 1982). In a later section on the regulation of agents and brokers, the authors note the prohibition on rebating and in a footnote state: "This point is made mute (sic) in those large premium cases where the agent arranges an insurance premium from the insurer that is on a 'net cost' basis. The addition of the agent's commission or service fee is a matter of negotiation." *Id.* at 602, n.12.

these forms of marketing.¹⁰²

Ironically, insurance companies do not violate anti-rebate laws when a commercial buyer pays a discounted commission. Nor do insurance companies violate anti-rebate laws when certain marketing techniques result in different premiums for the same type and amount of insurance. The premium for the policy reflects the negotiated commission; thus, there is no variance in the stated premium of a policy.¹⁰³ For example, the insurer may quote a rate to a broker that is net of commission, and the broker will set a commission and quote a final premium to the buyer. Moreover, the anti-discrimination statute permits insurers to use acquisition costs as a factor in rate setting.¹⁰⁴ Therefore, if a sale to a particular person or group of persons can be shown to result in a lower cost to the insurer, then the premium can be lowered to reflect the cost savings.¹⁰⁵ Thus, the principles of uniform pricing and social equality are undercut in actual practice.

No one would suggest that insurers should be allowed or encouraged to deviate from sound underwriting practices by

102. Certain marketing techniques result in lower premiums because the cost of obtaining the business is lower. Group property-casualty insurance has been opposed by some consumers, agents, and regulators because nongroup members cannot receive the same cost savings for the same policy. See MOWBRAY, *supra* note 6, at 407-08. Aetna Casualty and Surety Company of America has met opposition in marketing group auto insurance for consumers. The group plan saves money on commissions and other expenses. A. TOBIAS, *THE INVISIBLE BANKERS* 241 (Washington Square Press pocket ed. 1982).

103. The anti-rebate statutes prohibit variance in the stated premium of a policy. Coupled with the anti-discrimination statutes, which prohibit the charging of a different premium rate for the same risk, all similarly situated persons are theoretically charged the same price for the same policy. The Tennessee Attorney General has concluded that the state's anti-rebate law would be unconstitutional if read as a total ban on rebates and other inducements. He has concluded, however, that only discriminatory rebates are prohibited. 86-16 Op. Att'y Gen. (1986).

104. See WASH. REV. CODE § 48.18.480, *supra* note 4 (permitting "expense elements" to be considered when determining whether discrimination has occurred).

105. See *Independent Ins. Agents & Brokers v. Herrmann*, 79 Wash. 2d 462, 486 P.2d 1068 (1971). In *Herrmann*, the court found that "mass marketing" which results in lower expense for acquisition, including agent commissions, does not violate WASH. REV. CODE § 48.18.480 (the anti-discrimination statute) since "the expression 'expense elements' includes an insurer's expenses incurred in the acquisition and maintenance of policies or in the collection of premiums . . . Discrimination based upon substantially different expense elements is authorized by RCW 48.18.470." *Id.* at 465-66. (See *supra* note 5 for language of WASH. REV. CODE § 48.18.480.) Could it be argued that an individual agent's reduction in service to the policyholder is a difference in expense allowing a reduction in premium?

charging someone less for a risk merely to increase sales.¹⁰⁶ Sound underwriting requires that enough funds be collected to meet losses. Discrimination in this respect would not only be unfair to the person charged more for the same risk but also would be financially dangerous.¹⁰⁷ However, discrimination in pricing for agent and broker services does not cause the same financial danger to the insurer.¹⁰⁸ As to the unfairness in similarly situated persons paying agents different commissions, society not only tolerates this practice but encourages it.¹⁰⁹ The advent of discount securities brokerage firms,¹¹⁰ discount retailers of consumer goods, and franchising and discounting of legal, medical, or other professional services severely challenges the

106. Despite the basic concept of collecting enough premium to cover a risk, insurance companies abandoned strict underwriting standards in the past few years in an effort to increase sales and obtain premium income for investment purposes, hoping to offset underwriting losses with investment gains (cash-flow underwriting). Now that interest and investment earnings have decreased, insurers are facing huge losses and consumers are facing dramatic increases in premiums, "anywhere from 50 percent to 400 percent on risks without any corresponding increase in [loss] exposure." National Underwriter, May 10, 1985 at 1. The result is a scramble by insurers to reduce expenses by cancelling agency contracts, policies, and whole lines of business, *id.*; see also Insurance Week, March 1, 1985, at 1; March 22, 1985, at 1; May 17, 1985, at 1; and May 31, 1985 at 1.

107. See generally MOWBRAY, *supra* note 6, at 459-72. The Washington Commissioner recently adopted rules establishing standards for schedule rating plans used by commercial property and casualty insurers to tailor premiums to individual risks, thus taking into account a greater or lesser chance of a loss by the insured. WASH. ADMIN. CODE R. 284-24-100; Wash. Admin. Reg. 85-23 (1985). In the first paragraph of the rules the Commissioner finds "[t]hat existing schedule rating plans permit excessive credits or debits, commonly resulting in discrimination against insureds or inadequate premiums. . ." WASH. ADMIN. CODE R. 284-24700. The Commissioner limited these debits or credits to 25%. WASH. ADMIN. CODE R. 284-24-100 (2). The rules are an excellent example of statutes, other than the rebate statutes, fulfilling the functions assigned to the rebate statutes; the Commissioner based his authority to adopt the rules on the rate regulation statute—WASH. REV. CODE § 48.19.

108. See *supra* note 81 and accompanying text. If the insurer receives a constant fixed amount for the insurance risk net of agent commission, the fact that the agent receives much or little for his services will affect the agent, not the insurer. However, the insurer could be indirectly affected if there are insufficient numbers of agents selling its products, but this problem arises most often when an insurer sets a commission rate which agents find unacceptable.

109. The Consumer Goods Pricing Act of 1975, 15 U.S.C. § 2, repealed provisions permitting wholesale-retail price agreements. The analogy of repeal of Fair Trade laws and repeal of anti-rebate laws has consistently been made by proponents of deregulation of agent and broker commissions. See, e.g., Formisano, *Property and Liability Insurance Markets in a Net Pricing Framework*, CPCU Journal, March 1981, at 40.

110. Securities Acts Amendments of 1975, 15 U.S.C. § 78f(e)(1): "On or after [the effective date of this act], no national securities exchange may impose any schedule or fix rates of commissions, allowances, discounts, or other fees to be charged by its members."

notion that everyone should pay the same price for services rendered in connection with the sale of an insurance product.¹¹¹

In short, a distinction must be drawn between discrimination in the price paid for the pure insurance risk and discrimination in the price paid for the services of agents and brokers. The harms caused by discrimination in pricing the pure insurance risk are not the same as the harms sought to be avoided in preventing rebates of commissions.

When the equality and "one-price" principles are stripped away from the discrimination argument, what is left is a straightforward consumer protection argument. Rebating, as it was practiced at the turn of the century, simply was unfair to some consumers. Rebates were viewed as discriminatory because the ability to obtain one was fortuitous, and agents awarded rebates unequally. Thus, two people could see the same agent on the same day to purchase the same policy yet only one receive a rebate. Similar charges of unfair discrimination would be made by consumers if a retailer arbitrarily permitted some persons in the store to receive a lower price than others. However, the possibility that agents or brokers will negotiate rebates unfairly is not sufficient to justify a complete prohibition on negotiation. Unfair negotiation could be addressed by a statute directly prohibiting unfair discrimination in pricing agent and broker services.¹¹²

C. Agent Professionalism

The final argument traditionally used to support anti-rebate statutes is that such statutes promote agent professionalism. Presumably, preventing agents from negotiating commission rates ensures that agents will focus more on quality service than on price.¹¹³ The irony in arguing that anti-rebate laws ensure

111. Courts have consistently held that agreements prohibiting deviations from set fees by members of a professional association are illegal. *See, e.g., Arizona v. Maricopa County Medical Soc'y*, 457 U.S. 332 (1982) (striking down maximum fee schedule for health care services). Similarly, attorney fees have been "deregulated." *Goldfarb v. Virginia State Bar*, 421 U.S. 773 (1975) (minimum fee schedule constitutes illegal price fixing).

112. The court in *Dade County* addressed the argument that repeal of the anti-rebate law would result in discriminatory pricing of agent services by noting that if inducements to purchase insurance were not available to all individuals of the same class and risk, such practice "would be considered an unfair method of competition or deceptive act or practice" under the Florida Insurance Code. 457 So. 2d at 499.

113. Justice Department Report, *supra* note 60, at 298. Whether a system of fixed

professionalism is that the argument suggests that, given the chance to rebate, a great number of agents and brokers would abandon their high standards of professionalism. The argument also ignores the extensive regulation of agents and brokers.

Statutes governing agent and broker licensing, qualifications, and business practices promote professionalism to a much greater degree than anti-rebate laws.¹¹⁴ Continuing education requirements,¹¹⁵ disclosure requirements,¹¹⁶ prohibitions on "twisting" and misrepresentation,¹¹⁷ and prohibitions on false advertising and defamation of insurers by agents,¹¹⁸ all exist to ensure agent professionalism. Moreover, the insurance commissioner can revoke or suspend the license of any agent or broker found by the commissioner to be "incompetent, or untrustworthy, or a source of injury and loss to the public."¹¹⁹ With these types of statutes regulating agents and brokers, the question becomes: Why would agents and brokers support a law that prohibits them from negotiating their commissions or earnings?

At least one commentator has explained agent support for anti-rebate statutes by noting the competition that existed prior to enactment of the statutes and the desire of agents for market protection. "Historically the agent has sought an artificial support for the existing market structure. He wanted assurance that commission levels could not be undermined by sharp competitive practices, and he viewed rebating as a danger to the proper level of agency compensation."¹²⁰ Professionalism was partly ensured by establishing stability and predictability in the marketplace.

More recent views supporting the agent professionalism argument tend to rely on the earlier position that anti-rebate

commissions promotes quality service has been the subject of debate in life insurance. One author has recommended that to earn renewal commissions the agent must submit evidence of service rendered to the policyholder. See Dorfman, *Reformation in Life Insurance Agents' Compensation*, 43 *RISK AND INS.* 447-61 (Sept. 1976).

114. *E.g.*, WASH. REV. CODE ch. 48.17 (1983) (regulating agents and brokers).

115. *E.g.*, WASH. REV. CODE § 48.17.150 (authorizing the commissioner to adopt rules setting the education requirements for continued licensing of an agent); WASH. ADMIN. CODE R. 284-17-200 to 284-17-320 (1983) (implementing statutory education requirements).

116. WASH. ADMIN. CODE, *supra* note 95.

117. WASH. REV. CODE §§ 48.30.180, .090 (1983).

118. WASH. REV. CODE §§ 48.30.040, .080 (1983).

119. WASH. REV. CODE § 48.17.530(1)(h) (1983).

120. Kimball & Jackson, *supra* note 69, at 191.

laws protect markets.¹²¹ Proponents of anti-rebate laws suggest that rebating attracts the unscrupulous, forces smaller agencies out of business, and results in lower services to reduce price.¹²² However, these arguments could be made in any industry to support fixed prices. To the extent that consumers are willing to pay for services, services will be provided. Poor service or inadequate service are more properly resolved by the statutes and regulations governing agents' and brokers' qualifications and licensing. As noted earlier, this argument focuses upon the effects of competitive pricing of commissions, not upon the anti-rebate law's prohibitions and original purposes.

IV. ARGUMENTS AGAINST ANTI-REBATE LAWS

In the last twenty years, the state anti-rebate laws have come under increasing scrutiny. Two commentators reflect this reevaluation in their stance: "While we are not prepared to assert categorically that anti-rebate laws should be repealed, we do challenge the traditional assumption that such laws are obviously desirable."¹²³

In 1977, a Justice Department task group recommended that "the process for determining the level of commissions [for insurance agents and brokers] . . . must evolve from the interplay of market forces, subject only to federal and state disclosure requirements."¹²⁴ Four years after the Department's report, the Insurance Commissioner of Wisconsin proposed legislation to repeal the state's anti-rebate law.¹²⁵ That same year, Representative LaFalce, Chairman of the United States House Small Business General Oversight Subcommittee, introduced legisla-

121. Fenske, *Proposal to Repeal Antirebate Law Stirs Emotional Outcry in Wisconsin*, Best's Insurance Management Reports, March 16, 1981, release No. 3. Mr. Steinback, executive secretary of the Professional Insurance Agents of Wisconsin, stated in reference to the Wisconsin Insurance Commissioner's proposal to repeal the anti-rebate law: "It would nurture graft . . . [the Wisconsin Insurance Commissioner is] hoping that agents will get into an unholy price war and write policies at next to nothing Unregulated competition will destroy [insurance] and ruin an established economic mechanism which has benefited the Wisconsin economy as a whole." *Id.* at 2. See also Formisano, *supra* note 109, at 33.

122. *Id.* Agent fear of competition from other agents practicing rebating may be misdirected since insurers are cancelling agency contracts, lowering commission earnings, and otherwise forcing smaller, cost prohibitive agencies out of business. Insurance Week, May 31, 1985, at 15.

123. Kimball and Jackson, *supra* note 69, at 192.

124. Justice Department Report, *supra* note 69, at 302-03; see *supra* note 68.

125. Best's Insurance Management Reports, *supra* note 121.

tion proposing a federal override of every state's anti-rebate law.¹²⁶ While these legislative approaches to permitting agent commission negotiation have failed, the Florida court, by its decision in *Dade County*, ultimately may force a change. The recent lawsuit brought by Consumers Union against the California Commissioner¹²⁷ challenging the constitutionality of the anti-rebate law suggests that in the absence of legislative action, the courts will be asked to resolve the issue. The heart of the debate over the anti-rebate law is whether negotiation of agents' and brokers' compensation should be permitted and whether the anti-rebate law, adopted nearly a century ago, is necessary or desirable to protect insurance consumers. As one commentator suggested in 1981, "It's time to dust off the anti-rebate laws . . . and see if they really serve the purpose they were intended to serve when they were put on the books in a totally different age."¹²⁸

Critics of the anti-rebate law argue that the law thwarts competition, hurting both agents and policyholders, and that any problems associated with repeal of the law are capable of resolution under existing or additional regulations.¹²⁹ Critics further argue that rebating still continues today in one form or another and that rebating is difficult to regulate, thus leading to inconsistent enforcement and unintended results.¹³⁰

A. *Difficulty in Regulation*

Rebating is difficult to regulate because of problems in defining and detecting a rebate and because rebating is viewed as a legitimate marketing technique by the public and the business community.¹³¹ Several examples illustrate the variety of questions that arise and reveal the inconsistency in enforcement. An agent who engaged in the business of lending, real estate, and insurance did not violate the anti-rebate law when the agent, in taking loan applications, also obtained an agreement

126. See 1981 Hearing, *supra* note 86.

127. Consumer Union of United States v. Bunner, No. 84-3144 (Super. Ct. S.F. filed July 17, 1985). See also "Consumer group sues to allow insurance discounts," Los Angeles Herald Examiner, July 17, 1985, at D-1, D-4.

128. Jaffe, *Points & Viewpoints*, National Underwriter, Property & Casualty Ed., Oct. 2, 1981, at 52.

129. See 1981 Hearing, *supra* note 86, at 4-20 (testimony of Susan Mitchell, Wisconsin Insurance Commissioner).

130. *Id.*

131. Kimball and Jackson, *supra* note 69, at 186-92.

by the borrower to buy insurance from the agent for the term of the loan.¹³² However, if the agent had offered the loan as an inducement to the purchase of insurance, the anti-rebate statute would have been violated.¹³³

An insurance company wishing to provide goggles to employees of the insured manufacturer to reduce work-related injuries could not provide the goggles without violating the anti-rebate statutes.¹³⁴ Similarly, a Florida insurer was asked to institute a program adopted by Michigan insurers of providing infant car seats to automobile policyholders; the insurer refused, citing the Florida anti-rebate statute.¹³⁵

Under the anti-rebate laws, agents are strictly limited in what they can give to policyholders. For example, Washington prohibits the offering of any "goods, wares, or merchandise of an aggregate value in excess of five dollars."¹³⁶ A business lunch might violate this provision if the agent picks up the lunch tab for a prospective client who has too hearty an appetite.¹³⁷ The enforcement of this provision can be time-consuming, difficult, and sometimes wasteful of regulatory resources.¹³⁸ For example, a Michigan court deliberated the issue of whether an agent's purchase of drinks for a prospective insured violated the anti-rebate law "where the parties solicited are sober and mentally normal."¹³⁹ In 1985, the Washington Insurance Commissioner advised a group of Eastern Washington insurance agents that a promotional program offering anyone a chance to win a free trip to Seattle to attend a Seattle Seahawks's football game was a violation of the insurance code.¹⁴⁰ Said the Commissioner's office: "The law may be out-of-date . . . but that is a problem

132. *Calvin Phillips & Co. v. Fishback*, 84 Wash. 124, 146 P. 181 (1915).

133. *Key v. National Life Ins. Co.*, 107 Iowa 446, 78 N.W. 68 (1899).

134. *PATTERSON*, *supra* note 69, at 319 (citing W.U.R. Mass. 10 (1923)).

135. Brief of Plaintiffs-Appellants, *supra* note 47, at 14 n. 3.

136. WASH. REV. CODE § 48.30.140(4) (1983).

137. 1981 *Hearing*, *supra* note 86, at 7 (testimony of Susan Mitchell, Wisconsin Insurance Commissioner, noting similar examples as technical violations of the anti-rebate law. Among Ms. Mitchell's examples: "The agent takes the client on a golf outing and pays the fees; . . . the agent gives the client a calculator or calendar.").

138. *Kimball and Jackson*, *supra* note 69, at 186.

139. *Northern Assurance Company v. Meyer*, 194 Mich. 371, 378, 160 N.W. 617, 619 (1916).

140. Letter from Deputy Commissioner Robert E. Johnson to Rion S. Groves and Jerry F. Rochelle (October 24, 1985) (an "Advertising program to obtain leads for sale of insurance with a prize in excess of \$5 violates RCW 48.30.150, the illegal inducement statute.")

for the legislature, not us. We simply apply the laws given to us. . . . It is too late to effectively stop [the offer, but]. . . [you] have been put on notice that a program such as this is not to be repeated. If it is, severe penalties will follow."¹⁴¹ The anti-rebate law also affects routine business transactions that are indirectly related to insurance business. For example, the California Insurance Commissioner recently found that a percentage-of-sales lease agreement between a commercial bank and an insurance company for purposes of operating an agency probably violated the anti-rebate law.¹⁴² In contrast, the Tennessee Attorney General advised the Tennessee Commissioner that a similar percentage-of-sales lease agreement between a bank and an insurance agency did not violate the state anti-rebate law.¹⁴³

That some aspects of the anti-rebate law unnecessarily prohibit legitimate business activity is evidenced by the actions of some states in modifying anti-rebate laws to permit an agent or broker to offset a consulting fee with commissions.¹⁴⁴ Prior to the statutory change, an agent specializing in pension and profit-sharing program designs for employers was not permitted to reduce the consulting fee if the agent subsequently sold insurance for the program and earned a commission in addition to

141. Letter, *supra*, at 1.

142. Insurance Week, November 9, 1984, at 1, 4. The California Commissioner's decision was a private letter ruling which was not and will not be made public. The proposed lease agreement was between American National Bank and John Hancock Mutual Life.

143. Opinion letter from Kate Eycler, Assistant Attorney General for Tennessee, to Commerce and Insurance Commissioner John C. Neff (August 13, 1984). The proposed lease agreement was between First Tennessee Bank and Craddock Insurance Agency. The issue of agent/bank lease agreements and their possible violation of anti-rebate laws is secondary to the primary political issue of whether and to what extent the business of banking and insurance should be mixed. The issue became even more controversial with the Comptroller of the Currency Staff Interpretative Letter No. 274 (December 2, 1983). Brian Smith, Chief Counsel, in responding to the American Bankers Insurance Group in Florida, concluded that "state insurance laws, such as laws barring the payment to or the splitting of commissions with unlicensed parties, cannot bar a national bank and an insurance agent from entering into a percentage lease." *Comptroller Staff Interpretive Letters*, Federal Banking Law Reports, at 77,587 (85.438) (January 6, 1984 update).

The Washington State Supervisor of Banking has adopted a rule that would permit state-chartered banks to enter percentage-of-sales lease agreements with insurance agencies. The rule provides, in part: "(2) No bank or trust company may receive commissions or other revenues from the lessee other than periodic rental payments received under terms that are usual and customary in leasing space used for similar commercial purposes as determined by the supervisor . . ." WASH. ADMIN. CODE R. 50-12-100.

144. *E.g.*, WASH. REV. CODE § 48.30.157.

the fee.¹⁴⁵ In effect, the law had enforced double billing for the same service. Some states, however, still prohibit offsetting consulting fees with commission earnings.¹⁴⁶

Difficulties in enforcement stem in part from public perceptions of anti-rebate laws. An informal survey conducted in the early 1960s revealed that generally "people unconnected with the insurance business failed to see anything objectionable in rebating."¹⁴⁷ The survey concluded that "policyholders by and large see no objection to rebating. While insurance men do oppose the practice, their attitude is partly a result of professional conditioning and partly self-interest."¹⁴⁸ Moreover, the public is accustomed to receiving rebates for a variety of products and services. Public support for anti-rebate laws is further diminished since the laws punish both the offering and the receipt of a rebate.¹⁴⁹ Because both activities are impermissible, neither party will reveal the rebate. Since the transaction can be easily disguised if there is a threat of detection (for example, a loan that has been repaid), the regulator may find that proof and prosecution are impossible. These difficulties in regulating rebates, placed in the context of greater regulatory concerns such as company solvency, make effective enforcement of the anti-rebate laws unlikely.¹⁵⁰

B. Competitive Disadvantages

In addition to presenting regulatory problems, the anti-rebate law thwarts competition, hurting both the agent and the policyholder. "[W]ith the emphasis on competition as the best means to assure consumers of the lowest prices[,] . . . anti-rebate laws are an anachronism."¹⁵¹

The anti-rebate law, by prohibiting agents from negotiating commission earnings, creates disincentives to compete, since an

145. See *Charging of Fees by Licensees*, 81 WASH. INS. COMM'R BULL. No. 2 (March 10, 1981).

146. Florida agents recently asked whether a fee could be offset with commission earnings and were advised that such a practice would be prohibited. 96 INS. ADVOCATE 10 (1985) (reporting Florida Insurance Department General Counsel opinion).

147. Kimball and Jackson, *supra* note 69, at 190.

148. *Id.*

149. *E.g.*, WASH. REV. CODE § 48.30.170 (rebate acceptance prohibited).

150. Kimball and Jackson, *supra* note 69, at 199.

151. Jaffe, *supra* note 128, at 52. See also *Monitoring Competition: A Means of Regulating the Property and Liability Insurance Business*, NAT. A. INS. COMM'R, at 515-23.

agent will earn the same amount from the sale of a particular policy as another similarly situated agent. Competition, therefore, must come from the insurance companies, as manufacturers, rather than from agents, as retailers of policies and services. However, since the agent's compensation is set by the insurer, the agent's value is determined not by the purchaser or policyholder but by the insurer.¹⁵² "Companies compete for agents, not buyers of their products, on the basis of the size of commissions they offer."¹⁵³ As noted earlier, if the insurer markets policies that permit the agent to negotiate a commission by selling a policy with a lower commission rate, then the agent has an incentive to reduce operating expenses so that lower commissions are profitable. The agent who can make a profit with a lower commission can gain a greater market share. Nevertheless, one study found that independent agents, in choosing among different companies' policies, frequently chose to sell the policy paying the highest commission.¹⁵⁴ Another report noted, "[One] Company has testified in several state hearings that it writes very little credit life insurance because other underwriters' offerings are structured to be far more lucrative to the seller. [The Company] stated that they were not competitive; their rates were too low to provide enough commissions to attract lender and car dealer interest."¹⁵⁵

Concern over compensation of insurance agents and brokers and the effect of compensation systems upon insurance markets has received international attention. In 1977, the Australian Law Reform Commission published a discussion paper that, *inter alia*, reviewed the need for statutory changes governing the marketing of insurance.¹⁵⁶ After examining many different countries' systems of insurance brokerage, the commission concluded that brokers and agents who represent more than one insurer have an

152. Kimball and Jackson, *supra* note 69, at 191 n.164. "It was not the market value of the agent to the policyholder that decided commission rates, but his value to a company whose main objective, at least in life insurance, tended to be rapid expansion."

153. 1981 *Hearing*, *supra* note 86, at 6.

154. Formisano, *supra* note 109 at 39 (citing J. David Cummins & Steven N. Weisbart, *The Impact of Consumer Services on Independent Insurance Performance* (Glenmost, NY, IMA Education and Research Foundation (1977))).

155. John W. Wilson & J. Robert Hunter, *Investment Income and Profitability in Property/Casualty Insurance Ratemaking* 50 n.1, Report by J. W. Wilson & Associates, Inc. to the National Association of Insurance Commissioners (1983).

156. Baxt, *Commercial Law Note*, 53 A. L.J. 153 (1979) (citing *Insurance Contracts*, Discussion Paper No. 7, Australian Law Reform Commission (Cth), 1977).

“institutionalized conflict between interest and duty.”¹⁵⁷ After extensive public hearings and comment by other government agencies and private groups, the commission issued its final report,¹⁵⁸ concluding that “placement of insurance is sometimes made on the basis of a broker’s interest rather than that of his client” and that attempts have been made by brokers to have insurers increase commissions under threat of withdrawal of the client’s business.¹⁵⁹ The commission noted other countries’ concerns with commission payments to life insurance agents and the incentive for brokers to sell policies paying the highest commissions.¹⁶⁰ While conflicts of interest may arise with the payment of commissions, the problem is worsened by the consumer’s inability to negotiate a fairer commission. The anti-rebate law ensures that even if the consumer discovers an overly generous commission, the consumer’s only choice is to reject the insurance. The critical difference between Australia’s concern and the United States Justice Department’s concern is that Australia and other commonwealth countries do not prohibit rebating.¹⁶¹

In addition to being denied the advantages of price competition, consumers may not want or need the agent services that are paid for with the premium. Moreover, the consumer is forced to pay for these services whether or not the agent actually performs them or performs them well. The essence of negotiated commissions is the ability of the consumer to purchase the qual-

157. Baxt, *supra* note 156, at 154.

158. Australian Law Reform Commission, Report No. 16, Insurance Agents and Brokers, (1980) [hereinafter cited as Commission Report No. 16].

159. *Id.* at 46. The commission acknowledged the professional brokers group’s position that most brokers would not look to their own interest since the broker would not survive in a competitive market and thus the broker attempts to obtain the least expensive coverage. Other government agencies found the commission’s concern to be more theoretical than practical; however, the commission adopted another agency’s statements as its own: “The public expects that an insurance broker, as a professional advisor, will always act in his client’s best interest. It seems, therefore, that a remuneration system which does not ensure impartiality is inconsistent with the role of an insurance broker.” *Id.* at 47.

160. *Id.* at 94-96; U.S. Subcommittee on Oversight and Investigation of the Committee on Interstate and Foreign Commerce, Report on Life Insurance Marketing and Cost Disclosure, 12 (1978) (Commission Report No. 16 at 94 n.2); CLAYTON, BRITISH INSURANCE 359-60 (1971) (Commission Report No. 16 at 41 n.39); Colenutt, *The Regulation of Insurance Intermediaries in the United Kingdom*, 46 J. RISK & INS. 77, 82 (1979) (Commission Report No. 16 at 41 n.42); Carruthers, Report 3 on Insurance Study, Ontario, Canada (1975) (Commission Report No. 16 at 42 N. 43); Carruthers, Report 4 on Insurance Study, Ontario, Canada (1975) (Commission Report No. 16 at 42 n.43).

161. Colenutt, *supra* note 160, at 77-86.

ity and level of services desired.¹⁶²

Under a system of fixed commissions, a consumer can only purchase a particular service by paying for a full range of service of which the particular, needed services is but one component.¹⁶³ Whether a consumer actually uses an agent's services does not affect the price the consumer will pay for the policy. "The payment of commissions out of gross premium gives the consumer of insurance no opportunity to make a rational decision about whether to [use] an [insurance] intermediary. Even if no intermediary is [used] the majority of consumers must pay the same gross premium charged."¹⁶⁴ Moreover, some policies may not have a sliding commission rate; thus, theoretically, a consumer buys more service when purchasing greater insurance limits. Critics have analogized the combination of policy and services with the single price abuses of other "bundled" products in other industries. "It is the overwhelming consensus of economists that unbundling in such areas as computers, securities, and via deregulation of airlines and truckers has significantly increased economic welfare by permitting supply of a wider variety of services and combinations of services at lower prices."¹⁶⁵

While commissions set by insurers may result in noncompetitive prices to policyholders, agents also can be hurt by insurer pricing practices. This problem has become so acute recently that the President of the National Association of Professional Insurance Agents (PIA) has issued a plea to insurers nationwide to maintain current commission levels.¹⁶⁶ Faced with losses caused in part by cash flow underwriting,¹⁶⁷ insurers are reducing commission levels and cancelling agency contracts in an effort to reduce expenses.¹⁶⁸ As a result, many agents are being forced out of business. As President Bailey of the PIA

162. 1981 *Hearings*, *supra* note 86, at 31-37 (testimony of Mr. Burstein, economist).

163. *Id.* at 36.

164. Colenutt, *supra* note 160, at 82.

165. 1981 *Hearings*, *supra* note 86, at 33. Despite this argument of "unbundling" products and services, it is important to note that some services provided by agents may be imposed by law and may not be waived through negotiation. *See, e.g.*, WASH. ADMIN. CODE R. § 284-023-450 (policy replacement, agent duties). A question arises as to whether negotiation of commission earnings would pressure some agents to take short-cuts in company or statutorily mandated services. In either case, however, the agent is violating a standard that can be violated with or without the rebate law and that can be enforced with or without the rebate law.

166. *Insurance Week*, June 14, 1985, at 3.

167. *Id.* *See also supra* note 106 and accompanying text.

168. *Id.*

stated, "Growth in production and marketshare cannot be stimulated by reducing commissions in the name of competition."¹⁶⁹ That single statement exemplifies the problem that is caused by commissions fixed by insurers and that is enforced by the anti-rebate law: agents are hurt because they may not be earning enough to cover expenses and make a profit. Moreover, the statement reinforces criticisms that consumers may be unable to purchase a policy if no agent is willing to sell it because of low commissions. "The ultimate consequence of anti-rebating laws, which had as one purpose preservation of the agency system by keeping up the compensation level, may be to undermine that system" ¹⁷⁰

In addition to the problem of inadequate compensation for agents, efficient, better qualified agents may be paid the same amount for their services as inefficient agents. If agents were free to negotiate income, "more industrious or more able agents would tend to command what economists call rents of ability. The superiority of their services would command a premium in the market."¹⁷¹ Thus agents, as well as insurance purchasers, are potentially harmed by the inability to bargain for needed services.

V. ALTERNATIVES TO AN ANTI-REBATE LAW

Because the decision in *Dade County* has been upheld by the Florida Supreme Court,¹⁷² the insurance industry and the Florida Insurance Commissioner must decide how insurance will be marketed in Florida without an anti-rebate law. Serious problems could arise as a result of a repeal of the anti-rebate law unless the effects of repeal are understood and alternatives to complete repeal are considered.

Before any alternative to the anti-rebate law is considered, two issues must be examined. First, the anti-rebate law is a broad law prohibiting a wide range of activities or practices; some of these activities or practices should continue to be prohibited. Second, an understanding of current insurance marketing systems and methods is necessary to avoid unnecessary mar-

169. *Id.*

170. Kimball and Jackson, *supra* note 69, at 192.

171. 1981 *Hearings*, *supra* note 86, at 35.

172. See *Department of Ins. v. Dade County Consumer Advocates*, No. 66,178 (June 3, 1986).

ket disruptions by alternatives to the anti-rebate law.

The first issue is the most critical. The fundamental error to be avoided in considering the anti-rebate law is the mistaken belief that "rebating," as prohibited by the law, is just the return of money to a policyholder or reduction in price that consumers sometimes enjoy in purchasing other goods and services.¹⁷³ Under the broad language of the anti-rebate statute, "any other valuable consideration or inducement whatsoever which is not expressly provided for in the policy"¹⁷⁴ constitutes a rebate. Thus, the statute prohibits: acceptance of real or personal property or securities in lieu of premiums where the property's value is considerably below the value of the policy; waiver of a debt owed to an agent such as a premium finance note; rendering of services without charge prior to the sale of a policy, where those services would normally require compensation; granting of loans on favorable terms which induce the purchase of a policy; selling of stocks, bonds, or other securities as an inducement to purchase insurance; and giving of any gift or prize beyond a minimal value specified by statute.¹⁷⁵ These are not the only examples of "rebates"; but clearly the factors used to determine whether a rebate has occurred extend beyond the mere discounting of an insurance policy or return of a portion of commission earnings.

An understanding of current market practices is important to the selection of an alternative to anti-rebate law because not all marketing systems are amenable to the practice of rebating, and some systems may be damaged by permitting any form of rebating. Thus, marketing systems should be reviewed to determine the impact of an alternative to an anti-rebate law upon the relationships between consumer and agent or broker; between the company and the agent or broker; and between agents, brokers, or companies and other types of insurance and financial service providers. For example, insurance may be marketed through independent agents, salaried salespersons, direct mail or advertising, brokers, group plans, financial institutions, or general agents. Each of these marketing systems may involve contracts between the companies and the sales force, may affect other statutes (such as illegal tie-in sales by financial institu-

173. See MODEL ACT, *supra* note 40.

174. WASH. REV. CODE § 48.30.140(1) (1983).

175. See generally BROCK, *supra* note 19, at 383-410.

tions), and may offer differing degrees of potential competition in the event of a modification or repeal of the anti-rebate law. For example, could an insurance company refuse to do business with an agent who negotiates commissions? Could an insurance company contractually prohibit negotiating commissions? Could the effect of a decision to repeal the anti-rebate law and otherwise deregulate commissions invite federal regulation, in the absence of alternative state regulation showing the state's intent to regulate agent and broker compensation?¹⁷⁶ Could agents or brokers refuse to negotiate with some purchasers and demand a full commission while granting a discount to other, similarly situated purchasers?

After reviewing the two basic issues of the scope of prohibited activities under the anti-rebate law and the variety of insurance marketing systems, reformers must consider the fundamental effects of negotiable commissions and, in particular, the effect of competition at the retail level. This competition could take one of two forms: rebating as a cash discount of commission costs or net pricing of insurance so that the agent or broker determines the commission independent of the costs for insuring the risk.

In reviewing these two alternatives to fixed commissions, the United States Justice Department found that rebating has the advantage of an insurer-imposed ceiling on commission income but the disadvantage of maintaining insurer control over agent and broker income. Rebating also has the disadvantage of being difficult to control and regulate.¹⁷⁷ With respect to net pricing, the Department identified the advantage as unrestricted price competition, enabling the marketplace to exert maximum pressure in determining agent and broker compensation. But the Department identified four potential disadvantages to unrestricted competition through net pricing: "Unrestricted price competition between agents would: (1) force the small agencies out of business; (2) overemphasize price vis-a-vis service; (3) result in gouging of some consumers; and (4) produce insignificant savings to the consumer."¹⁷⁸ However, the Depart-

176. See generally Kintner, Bauer, and Allen, *Application of the Antitrust Laws to the Activities of Insurance Companies: Heavier Risks, Expanded Coverage, and Greater Liability*, 63 N.C. L. Rev. 431-91 (1985) [hereinafter cited as Kintner].

177. See *infra* notes 131-50 and accompanying text.

178. Justice Department Report, *supra* note 60, at 297. See also 1981 Hearings, *supra* note 86, at 75-81 (testimony of William Abus, associate general counsel, National

ment argued that the problem of a reduction in the number of agents or elimination of some smaller agents is not unique to the insurance market, and deregulation of other markets has shown that concentration of services has not occurred.¹⁷⁹

The problem of the overemphasis of price rather than service should be left to the marketplace. If agents provide services consumers want, services will be provided although the value of these services is determined in a competitive market. Moreover, the Department noted that independent agents should fare better than direct writers of insurance because a stronger fiduciary relationship could be established between the agent and the policyholder.¹⁸⁰ In responding to the problem of excessive commission rates, the Department noted that proper disclosure and advertising of agent services and fees would allow consumers to make informed choices.¹⁸¹

Finally, in responding to the problem of insignificant savings, the Department noted that while not every type of insurance will result in substantial savings, some lines of insurance may. Moreover, in property and casualty insurance, where some policyholders pay a disproportionate share of commissions, deregulation would distribute costs more equitably.¹⁸²

The Justice Department's reliance upon competition, subject to disclosure, assumes the application of federal antitrust and pricing laws, since the report by the Department concerned congressional action overriding state anti-rebate laws.¹⁸³ However, if a state modifies its anti-rebate law instead of repeals it, the McCarran-Ferguson exemption would continue to preclude application of federal antitrust and pricing laws.¹⁸⁴

Association of Life Underwriters).

179. Justice Department Report, *supra* note 60, at 297. See also Formisano, *supra* note 109, at 41: "In sum, the experience of securities dealers and fair trade product retailers indicates that although market changes occur, the 'destructive competition' and 'demise of the small merchant' arguments do not hold. Indeed, the consumer appears to benefit from broadened use of different marketing and pricing strategies."

180. Department of Justice Report, *supra* note 60, at 298-301.

181. *Id.* at 301-02.

182. *Id.* at 302-03. Personal automobile insurance premiums are usually higher in urban than in suburban areas for the same coverage because generally the risks are higher in urban areas. However, the agent provides the same service to both insureds but receives a greater commission on the sale to the urban insured since commission is a percentage of the premium payment. If the agent provides the same service to both insureds, should not each insured pay the same commission?

183. *Id.*

184. See Kintner, *supra* note 176, at 479.

Competition with disclosure was the solution proposed and adopted in Australia. The Australian Law Reform Commission (LRC) reviewed three methods of resolving problems with remuneration of brokers: imposition of a client fee system, limits on commissions, and disclosure of fees and commissions by the broker.¹⁸⁵ Some brokers already may charge a fee in addition to commissions. The LRC's proposal prohibited commissions and required all of the broker's income to be paid for by the broker's client.¹⁸⁶

Several concerns were raised, however, with an exclusive fee-for-service system. First, in the life insurance market, brokers might be at a competitive disadvantage with life agents if brokers attempted to collect the full charge equivalent to the high first-year commission paid to agents by insurers; thus, the client might have substantially larger first-year costs with the broker as compared with the agent.¹⁸⁷ Second, an exclusive fee-for-service system could eliminate the marketing function of insurance brokering and evolve a new form of insurance specialty that would cause a rise in insurance costs, a reduction in the rate of remuneration for brokers, and reduced service and competition.¹⁸⁸ Third, the Insurance Council of Australia (ICA) argued that the fee system ignored the tradition of commissions and the degree of entrenchment of the commission system.¹⁸⁹ Finally, the ICA pointed out that such a fee system ignored the fact that certain functions performed by brokers and paid for by insurers would cease, leaving insurers with costs and tasks once performed by brokers, such as policy preparation and co-insurance.¹⁹⁰

With respect to maximum commission rates, the LRC noted New York's system, which was designed to restrict commissions and expenses, and found the limits anti-competitive.¹⁹¹ The limits would discourage diversification of services by brokers and might tend to result in costly regulatory enforcement.¹⁹²

Two main arguments were raised in opposition to disclos-

185. Commission Report No. 16, *supra* note 156, at 48-54.

186. *Id.* at 48. See also Dizard, *Fees vs. Commissions*, Institutional Investor, Aug. 1979, 125-26 (discussion of fee for service in the United States).

187. Commission Report No. 16, *supra* note 155, at 44.

188. *Id.* at 49.

189. *Id.*

190. *Id.*

191. *Id.* at 50.

192. *Id.*

ure. First, critics argued that insureds are simply not entitled to know how much a broker earns since consumers are not entitled to such information from other salespersons.¹⁹³ Second, critics argued that such disclosure would be disruptive, leading consumers to purchase directly from the insurer, thereby decreasing competition.¹⁹⁴ In response, the LRC pointed out the difference between a salesperson working for a manufacturer or retailer and a broker working for the insured.¹⁹⁵ The LRC compared brokers to other professionals, from lawyers and surveyors to stock brokers and real estate agents, and concluded that other professionals must disclose their fees and "if insurance brokers cannot justify to their own clients the level of their remuneration, revision of the form and level of remuneration may well be in the public interest."¹⁹⁶

The LRC responded to these arguments in a way which reveals the distinction between the United States, using an anti-rebate law, and some commonwealth countries such as Australia, which do not prohibit rebates.¹⁹⁷ The LRC suggested that disclosure would lead insureds, in some cases, to "[a]pproach the insurer for direct purchase at a reduced cost; seek a rebate from the broker of a part of his commission; seek a total rebate of the commission and either employ the broker on a fee-for-service basis or . . . employ a different broker or an insurance consultant."¹⁹⁸ Thus, disclosure works because consumers use the information to negotiate the type and level of compensation.

The final recommendation of the LRC was implemented by the Australian Parliament: adoption of the Insurance Agents and Brokers Act. The Act provides that brokers must disclose, as soon as is possible, all fees charged for services; brokers additionally must, upon request, disclose any commission or other benefit received by the broker from the insurer.¹⁹⁹

While the Australian Act and Commission recommendations offer some possible solutions, other options are available. Rather than enact a blanket repeal of the anti-rebate law, a

193. *Id.* at 51.

194. *Id.* at 52.

195. *Id.* at 51.

196. *Id.* at 52.

197. PATTERSON, *supra* note 19, at 309.

198. Commission Report No. 16, *supra* note 155, at 51-52.

199. Insurance (Agents and Brokers) Act 1984, AUSTL. ACTS P. Part IV Section 32. See also 58 LAW INST. J. 1210-11 (Oct. 1984).

state could specifically address particular problems with the law and could adopt a transitional approach to bringing an end to fixed commissions. For example, the anti-rebate law could be modified to increase the statutory amount that an agent could spend on entertaining clients and instituting promotional contests.²⁰⁰ The law also could be modified to permit regulatory approval of safety programs that technically violate anti-rebate prohibitions, such as authorizing companies to give child-safety seats to policyholders.²⁰¹ Finally, the law could be modified by removing penalties for receipt of a rebate, thereby removing some obstacles to proving that a rebate has occurred.²⁰²

In addition to resolving particular problems with the anti-rebate law, a state could subject negotiated commissions to regulatory review and approval, thus permitting a gradual implementation of competition in the sale of insurance. A system could be designed that would authorize the insurance commissioner to review specific proposals by agents or brokers for instituting a fee-based compensation program in lieu of commission earnings where such a program would result in adequate disclosure to the insurance buyer and minimal potential for consumer abuse. For example, because commercial insurance purchasers already negotiate agent and broker compensation through insurance company policy design, the commissioner could authorize straightforward negotiations without the need for insurer involvement.²⁰³ Furthermore, a statute could authorize a system

200. Substitute House Bill No. 2018, passed by the Washington State House Committee on Financial Institutions and Insurance, would increase the Washington limit on expenditures by agents and brokers from \$5 to \$25 (S.H.B. 2018 § 1 sub§ 4 and § 2, sub§ 3).

201. S.H.B. 2018 provides that "the Commissioner may approve programs sponsored by insurers, agents, or brokers that are primarily designed to promote the public health and safety." S.H.B. 2018 § 1, sub§ 5(b). When the Illinois state legislature adopted a law requiring restraint of children in motor vehicles, an amendment was made to the state anti-rebate law to exempt companies providing child-safety seats to policyholders. The amendment provides,

Nothing in this section shall prevent a company from offering a child passenger restraint system or a discount from the purchase price of a child passenger restraint system to policyholders, when the purpose of such restraint system is the safety of a child and compliance with the "Child Passenger Protection Act, approved June 27, 1983, as amended." ILL. ANN. STAT. ch. 73 ¶ 763 § 151 (Smith-Hurd 1986 Supp.).

202. Kimball and Jackson, *supra* note 69, at 189-92.

203. S.H.B. 2018 provides in part, "Notwithstanding the provisions of [the anti-rebate law]: (a) An insurer, general agent, agent, or broker may waive all or part of the commission to be earned from the sale of an insurance policy to a charitable, civic, or

of net-pricing for the agent or broker who acts as a financial planner, thereby permitting the agent or broker to charge a single fee for all services provided. Such a system could avoid the conflict of interest arising when the agent, acting as financial planner, develops a plan requiring the purchase of insurance that will result in commission earnings to the agent.

Regardless of the modification of the anti-rebate law chosen, certain practices now prohibited by the law should be permitted while others that are injurious to consumers should be banned.²⁰⁴ As one critic stated twenty-five years ago, "Rebating . . . should perhaps be confined to a narrower compass by a closer examination of the evil to be prevented. There may even be an argument for repealing this prohibition altogether."²⁰⁵

CONCLUSION

For over half a century, agents and brokers have been prohibited from deviating from the commission rates established by insurers for the sale of insurance policies. The competitive abuses caused by agents who rebated commissions occurred at a time when the insurance industry was minimally regulated. Moreover, consumer protection attitudes of fifty years ago have changed dramatically. Today's comprehensive regulation of insurance and the changed view of consumer protection have challenged the fundamental assumptions underlying anti-rebate laws.

The recent Florida decision striking down the state anti-rebate statute follows closely on the heels of the congressional move to override state anti-rebate laws and Wisconsin's proposal to repeal its own anti-rebate law. The *Dade County* opinion and the hearings in Congress suggest that the time for review of the anti-rebate statutes has arrived. State legislatures should review these laws before Congress or the courts act to void or otherwise override them.²⁰⁶

commercial enterprise or organization . . ." § 1, sub§ (5)(a) (1986).

204. See *supra* note 70 and accompanying text.

205. Kimball and Jackson, *supra* note 69, at 200.

206. The Washington State Legislature has been reviewing agent and broker compensation and the state's anti-rebate law. During the fall of 1985, the House Financial Institutions and Insurance Committee conducted hearings on proposals to deregulate commissions. In 1986, the committee adopted legislation exempting commercial insurer transactions from the anti-rebate law and granting authority to the insurance commissioner to exempt practices that technically violate the law but which promote public health or safety. Ultimately, the legislation died in the House Rules Committee. (S.H.B.

Traditional arguments supporting anti-rebate laws are insufficient to sustain these laws. That competition through negotiation of insurance agent and broker commissions may lead to unfair practices is insufficient to justify a blanket prohibition on such negotiation. Competition in agent and broker commissions may save the consumer money, may result in a higher quality of service, and may permit agents and brokers greater freedom to determine income. The anti-rebate laws should be modified to the extent that they prohibit sound business practices and competition and thereby deprive consumers of the ability to make informed choices for the type and level of service needed.

If competition is introduced into agent and broker commissions, specific legislation addressing potentially abusive marketing practices could lessen or prevent the incidence of unfair practices that could arise in a competitive market. Absent a complete reversion to negotiated commissions, the anti-rebate law could be modified to permit insurers to institute innovative safety programs, to permit agents to spend more to entertain clients and establish promotional programs, and to permit negotiation of commissions in those types and markets of insurance that are least prone to abuse. Proper regulation governing unfair pricing of agent and broker services, proper disclosure, and a gradual introduction of commission negotiation into insurance markets would benefit both agents and consumers.

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