Insurance Market Integration

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European Community and United States of America

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PROEFSCHRIFT

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Contents (abridged)

Dedication

Although I alone am responsible for this research, it could not be what it is but for the involvement of several people.
I would like to thank my promoters, Sacha Prechal and Ernst Hirsch Ballin for their guidance, support and patience through the years. I would also like to thank Jim Chen of the University of Minnesota Law School who helped me with my initial research into United States law and who introduced me to Michelle Boardman who so generously agreed to be a member of the PhD Committee.
Thanks to my former colleagues and friends at the department of international and public law at Tilburg University. Particularly Anna, Conny, Guido and Antoine deserve my thanks for long coffee-breaks and discussions over dinner. Life as an "AIO" was pretty good!
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Many people close to me have had to suffer my stories about institutional structures, grants of authority, legal developments in insurance market integration and state insurance market interests. To them I offer apologies and thanks! My parents and sister have given me steadfast support and encouragement, my dear friends (all of you) and my 2+1 "paranimfen" have all helped me through to the conclusion of this journey. Most of all I thank Paul, my husband for his unconventional motivation methods, support and friendship.
Finishing this work now, somewhat later than I intended means that I can dedicate it to two little boys, Lucas and Benjamin who mark the beginning of an even greater story.

Astrid Spierings

Chapter 1

Introduction

States regulate their markets with the objective to assure their proper functioning and to protect the interests on their markets from disturbances within and outside the states' borders. Although the objective of states' rules and regulation is alike, the variety of rules and regulations is large and can form obstacles and barriers among the states' markets. The obstacles and barriers, in particular their paralyzing economic effect, were one of the reasons for six European States in the 20th century, as they were in the 18th century for the former British colonies in what is now the United States of America, to cooperate in order to accomplish the economic integration of their markets.

The European states created a European Community with an institutional structure that limits the sovereign powers of the member states, and grants authority to the Community to limit both the authority of the states to regulate and the liberty of the market participants to act in the market, in order to eliminate the intentional barriers and minimize the obstacles to free and fair interstate trade. The former British colonies had taken an even bolder step. Rather than drafting a Treaty among sovereign states, they formed a federation of states, based on a Constitution, with an institutional structure that limits their sovereignty, and a grant of authority for the federation to realize economic integration.

Although the objective of the cooperation in the European Community and the United States of America was similar, the economic integration of the states' markets by eliminating the intentional barriers and minimizing the obstacles to free and fair interstate trade, the means, the institutional structure and the grants of authority to accomplish this objective differ, as does the resulting legal development of market integration in the European Community and in the United States.

1 Institutional Structure and Grants of Authority

The member states of both the European Community and the United States of America have drafted and signed an institutional document in which they limit their sovereignty, and in which they create institutions that are granted the authority to bind the (member) states and the market participants.

The institutional structure and the grants of authority in the institutional documents of the European Community and the United States federation differ. The member states of the European Community have limited their sovereignty for the Community to accomplish the objectives set forth in the Treaty establishing the European (Economic) Community[1] – as well as the EURATOM Treaty and the Treaty establishing the European Coal and Steel Community.[2] – Based on a limited

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1 The Treaty establishing the European Economic Community (EEC Treaty) was signed on 25 March 1957 in Rome and entered into force on 1 January 1958. The name of the EEC Treaty was changed in the Treaty establishing the European Union to "Treaty establishing the European Community" (EC Treaty) on 1 November 1993.

2 The Treaty establishing the European Atomic Energy Community (EURATOM) was signed

and selective attribution of powers "the Treaties set up a system for distributing powers among the different Community institutions, assigning to each institution its own role in the institutional structure of the Community and the accomplishment of the tasks entrusted to the Community in this Treaty."[3] Through executing these tasks the objectives of the European Community are realized.[4]

In the United States of America, the states surrendered their international sovereignty and limited their interstate sovereignty with the signing of the United States Constitution.[5] The articles of the United States Constitution however contain general statements of principles and general grants of authority to the Federation and its institutions and not tasks or objectives to accomplish.

Despite these differences in details of the limits for the states, and the differences in attribution of tasks and powers to the institutions in the Treaty establishing the European Community (EC Treaty) and the United States Constitution, the role of the European institutions are very similar to the role of the United States institutions: the application and interpretation of the institutional documents to determine limits to the states' authority to regulate and market participants liberty to act in the market.[6] The articles of both the EC Treaty and the United States Constitution are constantly applied to new situations that are not described in the institutional documents. This means that the institutions need to apply and interpret the articles of the institutional document to fit every new situation that the institutional document has not specifically provided for.

The role of the Council of the European Community and the federal Congress are comparable. Both have been granted the authority to regulate. Where in the EC Treaty the Council has been given tasks and objectives to accomplish, the United States Constitution leaves Congress the choice to use the authority granted.

The European Court of Justice (ECJ) and the United States Supreme Court have the authority to interpret the institutional documents, to determine their meaning, and to invalidate legislation or executive actions which conflict with their interpretation of the institutional documents.[7] Although their interpretation

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on 25 March 1957 in Rome and entered into force on 1 January 1958. The Treaty establishing the European Coal and Steel Community (ECSC) was signed on 18 April 1951 in Paris and entered into force on 23 July 1952 for a period of fifty years.

3 *European Parliament v Council of the European Communities.* Case C-70/88, ECR [1990] Page I-02041, paragraph 21.

4 R. Barents, L.J. Brinkhorst, *Grondlijnen van Europees recht*, Deventer: Kluwer, 11e, geheel herziene druk – 2003, 121.

5 "The United States federation can bind states in matters of war, peace, and treaties, that of levying money and regulating commerce with foreign nations and the Indian tribes, and are limited by the Constitution with regard to fiscal matters, monetary matters, and matters of interstate commerce." From the letter of the President of the Constitutional Convention submitting the proposed Constitution to the President of Congress.

6 Where in the European Community the Treaty places direct limits on the states and the market participants (see chapter 2) in the United States of America only the states can be limited by the Constitution while federal acts based on the Constitution can limit both market participants and states (see chapter 6).

7 Although both are granted the authority to interpret, the procedures and jurisdiction differ. "It is the responsibility of the Court of Justice to ensure that the law is observed in the interpretation and application of the Treaties establishing the European Communities and of the provisions laid down by the competent Community institutions. To enable it to carry out that task, the Court has wide jurisdiction to hear various types of action. The Court has

authority is similar, the use of this authority by the ECJ and the US Supreme Court has had very different results. With a detailed, limited and selective attribution of powers in the EC Treaty and the objectives of the states' cooperation included in the institutional document, the application and interpretation of the EC Treaty has been one of direction and speed. The institutions have concretized the Community rules and powers with respect to the common market, developing and refining it by systematically placing it in the context of integration and in relation to the objectives of Community law.[8]

In the United States, the general statements of principles and the general grants of authority to the federal institutions first and foremost have the function of determining the division of power between the federation and the states. Without the inclusion of objectives in the Constitution and in the general grants of authority, the application and interpretation of the Constitution and federal regulation has primarily clarified the authority of the federation versus the authority of the states, rather than that it has developed and refined the Constitution's rules and grants of authority in a set direction or accomplished an objective.

The institutional structure and grants of authority were to facilitate economic market integration and have determined its legal development. One of the markets affected by the institutional structure and grants of authority is the insurance market. Because insurance is "one of the triggers of progress"[9] and an "indispensable production tool"[10] it has become a major component of modern economies.[11]

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competence, inter alia, to rule on applications for annulment or actions for failure to act brought by a member state or an institution, actions against member states for failure to fulfil obligations, references for a preliminary ruling and appeals against decisions of the Court of First Instance."
http://curia.eu.int/en/instit/presentationfr/index_cje.htm
"The Constitution limits the Court to dealing with 'Cases' and 'Controversies'. John Jay, the first Chief Justice, clarified this restraint early in the Court's history by declining to advise President George Washington on the constitutional implications of a proposed foreign policy decision. The Court does not give advisory opinions; rather, its function is limited only to deciding specific cases. The Justices must exercise considerable discretion in deciding which cases to hear, since more than 7,000 civil and criminal cases are filed in the Supreme Court each year from the various state and federal courts. The Supreme Court also has original jurisdiction in a very small number of cases arising out of disputes between states or between a state and the federal Government. When the Supreme Court rules on a constitutional issue, that judgment is virtually final; its decisions can be altered only by the rarely used procedure of constitutional amendment or by a new ruling of the Court. However, when the Court interprets a statute, new legislative action can be taken. The Supreme Court has original jurisdiction in only very few situations." article III(2) Constitution
http://www.supremecourtus.gov/

8 Kapteyn, VerLoren van Themaat; hoofdred.: P.J.G. Kapteyn ... [et al.], *Het recht van de Europese Unie en van de Europese Gemeenschappen*, 6e, geheel herziene druk / bewerkt door R. Barents ... [et al.]. Deventer Kluwer - 2003, 359.

9 Fabio Padoa, the Geneva Association – Twenty Years on, in *The Geneva Papers on Risk and Insurance*, 18 no 68 July 1993, 228.

10 Reimer Schmidt, *Reflections on the Twentieth Anniversary of the Geneva Association, in The Geneva Papers on Risk and Insurance*, 18 no 68 July 1993, 251.

11 Padoa (1993), 224-228.
Schmidt (1993) 233-36.
1973-1993: Twenty Years of Activity of the Geneva Association, in The Geneva Papers on Risk and Insurance, 18 no 68 July 1993, 237-291.

States acknowledge the importance of the insurance market for their economies[12] by regulating it for the adequate safeguarding of the interests in the insurance market and a proper functioning of the market.

With the many different and sometimes conflicting interests on the insurance market, state insurance regulation is abound. Whether it regulates the proper functioning of the market, insurer solvency, the exchange of statistical data between insurance providers or the legal position of consumers, it affects every aspect of the insurance market. While the interests on the various state insurance markets are comparable, the appreciation of the interests and the choice and level of protection can vary substantially from state to state and form obstacles and barriers to interstate trade in insurance. The Treaty establishing the European (Economic) Community and the United States Constitution were drafted to create an institutional structure and grants of authority to eliminate intentional barriers and minimize obstacles to interstate trade in general, including, as will be seen in subsequent chapters, those on their insurance markets.

2 Insurance Market Integration

The European Community established a single insurance market in 1994 with the completion of the third of three generations of insurance directives.[13] The first and second generations of insurance directives facilitated the freedom of establishment

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12 The total gross premium (total insurance premium written) in life and non-life insurance in the EU in 2003 amounted to 1173100 million US dollars and in the USA 1366732 million US dollars. From the Insurance Statistics Yearbook, Organisation for Economic Co-operation and Development 2005.

13 Directives were also enacted on: Tourist assistance "Directive 84/641/EEC "; Credit insurance and suretyship insurance "Directive 87/343/EEC"; Legal expenses insurance "Directive 87/344/EEC"; Motor vehicle liability insurance "Directive 90/618/EEC"; Accounting "Directive 91/674/EEC", "Directive 78/660/EEC", "Directive 83/349/EEC"; e-Commerce "Directive 2000/31/EC"; Insurance groups "Directive 98/78/EC";, Financial conglomerates "Directive 2002/87/EC"; Insurance mediation "Directive 77/92/EEC – no longer in force, repealed by 2002/92/EC –"; Insurance agents and brokers, "Recommendation 92/48/EEC", "Directive 2002/92/EC"; Motor insurance "Directive 72/166/EEC", "Directive 72/430/EEC", "Recommendation 73/185/EEC", "Recommendation 74/165/EEC", "Decision 74/166/EEC – no longer in force –", "Decision 74/167/EEC – no longer in force –", " Recommendation 81/76/EEC", " Directive 84/5/EEC", "Directive 90/232/EEC", " Decision 91/323/EEC – no longer in force, repealed by 2003/564/EC –", "Decision 93/43/EEC – no longer in force, repealed by 2003/564/EC –", "Decision 97/828/EC – no longer in force, repealed by 2003/564/EC –", "Decision 1999/103/EC – no longer in force, repealed by 2003/564/EC –", "Directive 2000/26/EC", "Decision 2001/160/EC – no longer in force, repealed by 2003/564/EC –", "Decision 2003/20/EC", "Decision 2003/564/EC"; Reinsurance "Directive 64/225/EEC"; Solvency "Directive 2002/12/EC – no longer in force, repealed by 2002/83/EC – ", "Directive 2002/13/EC"; Winding-up "Directive 2001/17/EC"; Insurance Committee "Directive 91/675/EEC", "Decision 2004/6/EC establishing CEIOPS – Committee of European Insurance and Occupational Pensions Supervisors –", "Decision 2004/9/EC – not yet in force with the aim to establish EIOPC – European Insurance and Occupational Pensions Committee –"; and International agreements "Regulation (EEC) No 2155/91", " Decision 91/370/EEC", " Directive 91/371/EEC Implementation of the Agreement between the EEC and the Swiss Confederation 2001/776/EC", "EC-Switzerland Joint Committee Decision No 1/2001 amending annexes and protocols."
For an up to date list see http://europa.eu.int/

and the freedom to provide services, prohibiting discriminatory state regulation and laying down minimum rules for the authorization and supervision of insurance providers. The third generation of insurance directives provides for a single license for European insurance providers. Once an insurer is authorized to operate in a member state, it can establish a branch or provide cross-border insurance services throughout the European Community without the need to obtain a new license from the host member state. This combined with home country control, a supervisory structure where the supervisor of the insurer's home member state supervises the insurer, has simplified cross border access for insurers. The limits to the regulatory authority of the states in the three generations of insurance directives is but a part of the removal[14] of obstacles and barriers to free and fair interstate trade and market access. The authority of the states to regulate is also directly limited by the EC Treaty articles, as is the liberty of the market participants to act in the market.

In the United States, the legal development of insurance market integration has been different. Unlike the EC Treaty, the Constitutional Commerce Clause, the general grant to Congress to "regulate commerce among the states", does not contain any direct limits to the states' regulatory authority. It was not until 1945 that Congress used its Constitutional authority to regulate insurance. When it did, it chose to maintain the status quo of the states regulating the business of insurance. It enacted the federal McCarran-Ferguson Act "regulating the continued legislation of the business of insurance by the states." This Act grants the states an almost unlimited freedom to regulate and tax the business of insurance, and almost completely excludes federal regulation to apply to the business of insurance, including federal anti-trust regulation that could limit the liberty of market participants to act in the market.[15] The choice of the federal Congress was influenced, among other things, by the fact that the states for 75 years had had the authority to regulate and tax the business of insurance and the continuation thereof was found to be "in the public interest."[16]

3 State Insurance Law

State insurance law comprises the rules and regulations that govern the access to, the organization of, and the interaction on the insurance market. These state rules protect the proper functioning of the market by protecting the various interests on it. These interests include, among other things, the interests of parties in a fair insurance contract, the interests of insurance providers in easy and affordable market access and the public interest of the state in a financially sound and reliable insurance industry. Despite the fact that the interests on the different insurance markets are comparable, the choice of form and content of the regulation can differ greatly. This can result in obstacles and barriers to free and fair interstate trade in

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14 The elimination of intentional barriers and the minimization of obstacles to free and fair interstate trade.

15 Where only states can be limited by the Constitution, states and market participants can be limited by federal acts based on the Constitution.

16 Section 1011 McCarran-Ferguson Act, Declaration of Policy, U.S.C. Title 15 Commerce and Trade, Chapter 20 Regulation of Insurance.

insurance, hindering market access for insurers as well as consumers, and making cross-border insurance activity cost-inefficient and complicated.

Although state insurance regulation and economic integration ultimately pursue the same objective, the proper functioning of the markets, the manner in which it is accomplished can be incompatible. As said earlier, where state insurance market regulation protects intrastate interests against disturbances from within and outside the market's borders, the objective of economic integration is to eliminate intentional barriers and minimize obstacles when these hinder free and fair interstate trade. The elimination or minimization of state regulation that form interstate obstacles and barriers but that protect the interests on the state insurance markets can disrupt the state regulatory system of protection and the proper functioning of the state's market.

To accomplish insurance market integration and the proper functioning of the markets interstate and intrastate, both objectives need to be achieved. This allows interstate barriers to be eliminated and obstacles minimized without the risk of surrendering the protection of interests on the insurance markets. An institutional structure and grants of authority that provides the means to accomplish this helps to avoid the disintegration of the states' regulatory systems and maintain a system for safe and sound insurance markets, while free and fair interstate trade is facilitated.

4 The Research Question

In this study, I seek an answer to the following question:

> "What institutional structure and grants of authority facilitate legal developments which result in insurance market integration that accommodates state insurance market interests?"

The purpose of the study is to determine what elements of the institutional structure and grants of authority facilitate law making, either regulations or case law, which results in insurance market integration that takes the interests on the insurance markets into consideration. It does not include developments outside the legal possibilities that the institutional structure and grants of authority in the institutional documents of the European Community and United States of America offer.[17]

The choice for this particular sector of the economy, insurance, as case study, came from its importance for the economies of every state, making it a heavily regulated sector. With comparable interests in the insurance markets, but great

[17] For example, in the United States of America the National Association of Insurance Commissioners (NAIC), which is a voluntary organization of insurance regulators from the 50 states, the District of Columbia and the four U.S. territories, was created in 1871 by the state insurance regulators to address the need to coordinate regulation of multi state insurers. It has not only influenced the development of insurance market integration in the United States with its proposal to grant the states the power to regulate the business of insurance and to partially exempt the insurance industry from federal anti-trust regulation after the *South-Eastern Underwriters* Case (see chapter 6 section 2), it has taken many initiatives to facilitate interstate trade in insurance services.
See http://www.naic.org

variance in appreciation and protection of these interests, regulation between the states can differ greatly and cause obstacles and barriers to free and fair interstate trade.

The choice in this study for a comparison of the European Community and the United States of America is based on the differences in outcome in the legal development of European insurance market integration and United States insurance market integration despite their common objective to eliminate intentional barriers and minimize obstacles to free and fair interstate trade.

The different choices in institutional structure and grants of authority to achieve the economic integration of the markets in the European Community and the United States of America, combined with the multitude of state regulations that safeguard the many interests of the states' markets, inspired to ask, not only whether the legal development of insurance market integration has accommodated insurance market interests, but what institutional structure and grants of authority facilitate these legal developments.

This study is confined to a comparison of the institutional structure and grants of authority of the European Community and the United States of America, and their respective impact on the legal development of insurance market integration. Where in this study the European Community and the United States federation and their insurance markets are used as examples, the same question and the answers are of interest for any transboundary market within a federal context or a transnational authority context.

Before an answer can be formulated as to the elements of the institutional structure and grants of authority that facilitate legal developments which results in market integration that accommodates state market interests, this study answers two preliminary questions. The first question is whether the institutional structure and the grants of authority have contributed to legal developments that results in accomplishing the objective of economic integration of the insurance markets, i.e., the removal of obstacles and barriers to free and fair interstate trade on the insurance markets. The second question is whether the institutional structure and the grants of authority have contributed to legal developments that result in accomplishing the objective of state insurance regulation, i.e., the protection of the interests on the state insurance markets. This is done by reviewing legal documents, regulation and case law of market integration in general and the insurance market integration in particular.

The elements of the institutional structure and grants of authority that have contributed to accomplishing insurance market integration that accommodates state insurance market interests are determined by reviewing the institutional structure and grants of authority responsible for the legal developments in the European Community and the United States of America.

5 What this Book is not about

This study provides an answer as to the effect of the choice and design of the institutional structure and grants of authority on the legal developments of states' market integration and in particular on insurance market integration that accommodates state insurance interests. It focuses on life insurance and non-life insurance alone, leaving out all other insurance, – for example insurance forming part of a statutory system of social security. Using the insurance markets as the case

study the research has focused on the institutional documents, Community respectively federal regulation, and interpretative and law speaking activities of the European, respectively federal institutions that determine the legal developments of insurance market integration.

This book is not a complete description of life and non-life insurance regulation and case law in the European Community and the United States of America. It does not pretend nor attempt to be exhaustive. The focus with regard to the European Community is on the EC Treaty and the relevant articles for insurance market integration, Community competition regulation, insurance specific secondary legislation and in particular on the three generations of insurance directives that created the "single insurance market", on ECJ case law and on Commission decisions, regulations and interpretations. It mentions other Community (insurance) regulation only in the context of the three generations of insurance directives.

With regard to the United States of America, this study focused on the United States Constitution, in particular the Commerce Clause, the federal McCarran-Ferguson Act and Supreme Court case law. Other Constitutional and federal law will be mentioned only in the context of the McCarran-Ferguson Act and its relevance for insurance market integration.

6 Structure of the Study

The subsequent five chapters describe the objective of economic integration and state insurance market law (chapters 2 and 3), the legal development of insurance market integration in the European Community (chapters 4 and 5) and the United States of America (chapter 6) and in the final chapter (7) the elements of the institutional structure and grants of authority that have been responsible for legal developments which result in insurance market integration that accommodates state insurance market interests are determined.

Chapter 2 begins with the objective and means of economic integration in Europe and the United States of America, respectively. It describes the objective of economic integration; the removal of obstacles and barriers to free and fair interstate trade and market access by limiting the authority of the states to regulate and the liberty of market participants to act in the market, and the means to accomplish it: the institutional structure and the grants of authority. It describes the institutional structure and grants of authority in a historical context, both in general as well as with regard to the economic integration of the insurance markets.

Chapter 3 deals with the objective of state insurance law. It explains, from a historic point of view, the existence of rules and regulations that govern state insurance markets, the organization of the state insurance market and the behavior of state market participants, and provides examples of different rules and regulations that protect states insurance market interests.

Chapter 4 describes the legal developments of the limits to the authority of the states to regulate and the limits to the liberty of the market participants to act in the market for the purpose of economic integration in the EC Treaty and case law and the exceptions to these limits. Chapter 5 describes the legal developments of the limits to the authority of the states to regulate and the liberty of the market participants to act in secondary Community regulation and case law and the exceptions to these limits.

Chapter 6 describes the legal developments of the limits to the authority of the states to regulate and the limits to the liberty of the market participants to act in the market for the purpose of economic integration in the United States Constitution, federal regulation and case law.

Chapter 7 first summarizes the findings of chapters 4, 5 and 6 on the legal development of insurance market integration in the European Community and the United States, and concludes with an evaluation and analyses of the elements of the institutional structure and grants of authority that have facilitated legal developments which result in insurance market integration that accommodates the state insurance market interests.

Chapter 2

Cooperation among States

Economic Integration – Objective and Means

1 Introduction

When the former English colonies in North America federated in 1787, their objective was to create an institutional structure and grant it the authority to economically integrate their markets, eliminating intentional barriers and minimizing obstacles to interstate trade for the proper functioning of their common market. Nearly two centuries later, in 1958, six European States formed an Economic Community with an institutional structure and the authority to accomplish the same objective. Where the objective is the same between the two cooperation forms, the choice of institutional structure and grant of authority are different and have affected the legal developments of market integration in general and the insurance market in particular.

This chapter in section 2 describes the objective of state cooperation in the European Community and the United States of America and in section 3 the institutional structure and grants of authority chosen to accomplish it.

2 Objective of State Cooperation

After the end of the Second World War and the Liberation from German occupation, the last thing on the political agendas of the European States was the creation of a supranational government[18] to govern their recovery and limit their regained freedom. Similar sentiments were felt some 169 years earlier in the American colonies after their successful war of independence[19] against the British. The economic consequences of war and the fear of economic and possibly military warfare among themselves however resulted in cooperation between the American States in the 18th century as well as the European States in the 20th century. After an experiment as a confederation[20], the American States formed a constitution based federation in 1787. In Europe, six years after the end of the Second World War, in 1951, six states, including a rehabilitated Germany, formed the first of a series of treaty-based economic communities.

The objectives of the cooperation among the member states of both the European Community and the United States of America were similar. Both envisaged that market interdependence would encourage economic growth and

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18 The French Schuman plan however did propose the creation of a European Community with supranational powers and an independent high authority. See section 3.1.1.

19 Declaration of Independence, adopted 4 July, 1776 by representatives of the thirteen colonies in North America.

20 Articles of Confederation, 15 November 1777.

diminish the risk of deteriorating economic and political relations and possibly war. Cooperation between states was to result in economic integration, the elimination of trade restrictions and unfair trade practices, and free and fair trade among the States.

Although the European states and the states in North America envisaged the economic integration of their markets through the elimination of interstate obstacles and barriers by limiting states' authority to regulate as well as the freedom of the market participants to act, the means they chose to accomplish this objective differed. Whereas the North American states federated, approved a Constitution, and authorized the federal Congress "to regulate commerce among the States", the European states formed a treaty-based Community that granted specific, detailed powers to Community institutions that limited both member states and market participants.

2.1 Europe

Cooperation among European nations was a consequence of two World Wars. The First World War resulted in a strategy of retribution and containment of Germany. Although after the Second World War the initial approach was similar, the international political and economic developments soon lead to cooperation with Germany.[21]

As an alternative to the pre-World War II policy of retribution and containment of Germany, Belgium, the Netherlands, Luxembourg[22], France, Italy and Germany established the European Coal and Steel Community (ECSC)[23] in 1952.[24] This Community served two purposes: it entailed immediate supervision of the rearmament of Germany, and permitted the German economy to grow alongside other western European economies.[25]

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[21] Kapteyn 2003, 4.
P.J.G. Kapteyn & P. VerLoren van Themaat ed. and further rev. by Laurence W. Gormley; in cooperation with the ed. of the fifth Dutch edition: P.J.G. Kapteyn ... [et al.]. *Introduction to the law of the European Communities: from Maastricht to Amsterdam*, 3rd ed. Londen; The Hague [etc.] Kluwer Law International - 1998, 5: "Especially after the final breach between the four great powers about the course of action to be taken with regard to Germany, this restrictive French policy appeared less and less feasible in an atmosphere of growing tension between East and West." "In Anglo-American circles a thriving Germany closely allied to the West was regarded more and more as an essential condition of the recovery of Europe and as an indispensable bulwark against the dreaded Russian expansion."
Paul Craig and Gráinne de Búrca, *E.C. Law: Text, cases, and materials*, Oxford University Press Inc., 1998, 7: "The severe economic problems of the European states, the split of Germany into east and west, and the Cold War."

[22] Belgium, the Netherlands and Luxembourg had signed the Benelux Treaty in 1944 to create a customs union.

[23] This Community ended on July 23 2002.

[24] Signed on 18 April 1951, entered into force on 23 July 1952.

[25] Kapteyn 2003, 5.
Kapteyn/Gormley 1998, 5-6: "The Schuman Plan constituted a brilliant attempt to break through this impasse. The policy aim remained the same: effective guarantees against a revival of a German menace to French security. But the means for achieving this aim were altered drastically. The former negative policy directed at a continued allied tutelage of Germany was replaced by a tendency toward a far-reaching partnership on a basis of parity of the two

The preamble to the treaty that established the European Community for Steel and Coal says that it aims "to substitute for age-old rivalries the merging of the essential interests" of the member states "by establishing an economic community." ECSC members agreed not only to cooperate with Germany, but also to yield sovereignty for economic integration of the steel and coal markets. Other forms of cooperation between European states had thus far only been intergovernmental.[26] The ECSC however was the first of three European communities with an institution that (within the limits of the treaty) was authorized to bind members and limit their power to regulate.[27]

In 1955 the ECSC member states decided[28] to move in the direction of a general economic integration of the European markets rather than continuing to integrate per sector of the economy.[29] In 1958 the Treaty establishing the European Atomic Energy Community (EURATOM)[30] and the Treaty establishing the European Economic Community (EEC) went into effect. Whereas EURATOM and the ECSC were granted powers to regulate one specific economic sector, to facilitate the development of nuclear energy and to integrate the steel and coal markets respectively, the EEC was granted powers to create a common market among the European member states.[31]

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countries within a European setting."
Derek W. Urwin, *The Community of Europe: a History of European Integration since 1945*, Longman Group UK Limited, 1995, 45.

26 The European states gathered in the intergovernmental Organization for European Economic Cooperation in 1948 (superceded in September 1961 by the Organisation for Economic Co-operation and Development (OECD)) and in the North Atlantic Treaty Organization, a military cooperation between the United States of America and the European states to defend Europe against attacks from the east, in 1949. The call for more economic and political cooperation among the European states resulted in the intergovernmental Council of Europe. The statute of the Council of Europe was signed on May 5, 1949. The Council of Europe was an important forum for discussion between the European states about the terms, as well as the form of future cooperation.

27 For institutional structure and grants of authority see section 3.

28 At the Messina conference 1-2 June 1955.

29 A Committee, chaired by Paul Henri Spaak, published a report on economic integration in 1956. The report concluded that the existing economic organization of the European states could impossibly maintain the expansion pace and level of progress it had been experiencing immediately after the war. Europe needed a common basis for its development and a progressive integration of its markets. It followed the Beyen plan, breaking with the functionalist idea of an integration by economic sector, and embracing the idea of establishing one European Common Market.
Craig de Búrca, 1998, 10-11.
Kapteyn - 2003, 9, 11-13.
Kapteyn/Gormley 1998, 11, 14-16.

30 Because of the fear that the French Assembly would not ratify the creation for a common market, the proposal for the common market and the peaceful use of atomic energy was regulated in two separate treaties so that even if France would not ratify the common market, the creation of a common market for atomic energy would not be endangered.
Kapteyn - 2003, 15.
Kapteyn/Gormley 1998, 17.

31 The Treaty of Rome did specify the common agricultural policy and the transport policy as central to the integration process.
Vickerman, *The single European market, prospects for economic integration*, Harvester

The preamble of the (original) "Treaty establishing the European Economic Community" (EEC Treaty) stated that it lays "the foundation of an ever closer union among the peoples of Europe" with the economic integration of the states' markets into one common market. The objective to create the EEC was not just to liberalize trade between the European markets[32], but also to cooperate in economic policy making. To create a common market with a common economic policy would not just "promote a harmonious development of economic activities, a continuous and balanced expansion, an increase in stability, an accelerated standard of living and closer relations between the states belonging to it"[33], but it would also make the member states mutually dependent thereby preventing destructive economic or military warfare.

Although the "common market" was not defined in the 1957 EEC Treaty or in any subsequent amendment, the requirements to establish a common market were specified in the preamble to the EEC Treaty and in its articles. In order to eliminate interstate barriers and obstacles that prevented economic integration, all customs duties, quantitative restrictions on the import and export of goods and all other measures having equivalent effect had to be removed, as well as all obstacles to the freedom of movement for persons, services and capital.[34] Furthermore the EEC Treaty required a common customs tariff and the institution of a system that ensures that competition in the common market is not distorted.[35]

2.2 United States of America

After their independence from the British, the former English colonies on the North-American continent formed a confederation which constituted the definite cession from the allegiance to England.[36] With the independence from the British the military and economic position of the former colonies changed. In addition to providing a legal basis for cooperation among the former colonies, the Articles of Confederation provided "the necessary security for all states against all force offered to, or attacks made upon them, or any of them, on account of religion, sovereignty, trade, or any other pretense whatever". Although this offered the confederated states military protection, it did not protect their economic interests.

Wheatsheaf, New York, 1992, 3.
Urwin 1995, 71-75.

32 As it was for the coal and steel markets in the ECSC.

33 Article 2 EEC Treaty.

34 "The establishment of the common market embraces three aspects in particular: first, the establishment of 'an internal market characterized by the abolition, as between member states of obstacles to the free movement of goods, persons, services and capital; secondly, 'system ensuring that competition in the internal market is not distorted', and thirdly, a common commercial policy."
Kapteyn 2003, 104-105.
Kapteyn/Gormley 1998, 122-123.

35 The preamble stated that common action is required to eliminate the barriers which divide Europe, to ensure economic and social progress, as well as concerted action for the removal of existing obstacles in order to guarantee steady expansion.

36 Bernard Schwartz, *A Commentary on the Constitution of the United States, part I: The Powers of Government*, 1963, The Macmillan Co., 4-6.

The war not only brought independence, it also caused fierce competition with the former motherland as well as between themselves. To protect their domestic markets, interstate barriers were erected that imposed regulatory obstacles to trade and discriminatory taxes on commerce.[37] Independence had brought political freedom as well as economic vulnerability to the former colonies.

To stop the development towards protectionism and economic warfare and to secure their freedom and the peace of their newly won independence, the confederate states had to restore their economic interdependence to guarantee freedom of commerce. The Articles of Confederation did not inhibit economic protectionism between states. Neither did it grant the Confederation authority to bind member states in matters of commerce, or grant its only institution, Congress, the authority to limit the powers of the states to regulate and the liberty of the market participants to act.

A convention was held to discuss the economic problems among the confederate states.[38] As a result a proposal for a new Constitution was sent to Congress on September 17, 1787. The objective and task of the federation was to halt protectionism and economic warfare among the states and to secure freedom of commerce and fair competition nationwide.[39] To effectuate the economic integration of the states, a free market with "unrestrained intercourse between the states themselves" needed to be created. Economic integration was not just to "advance the trade of each by an interchange of their respective productions, not only for the supply of reciprocal wants at home, but for exportation to foreign markets." It aimed to "replenish the veins of commerce in every part, and acquire additional motion and vigor from a free circulation of the commodities of every part."[40]

The new Constitution changed the institutional structure that determined the legal relationship between the states, the new Federation and its institutions, and granted authority to federal institutions. One article authorized the Federation and

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37 Andre Kaspi, *De geschiedenis van de Verenigde Staten van Amerika, deel 1: de Periode van 1607 tot 1945*, 1986, Editions du Soleil, p. 97.
Schwartz 1963, 7-8.

38 John E. Nowak, Ronald D. Rotunda, *Constitutional Law*, 5 ed. West Publishing Co. 1995, Hornbook Series, 118.
Nowak, Rotunda, 1995, 1335 footnote 1."Prior to the calling of the convention the legislature of Virginia had passed a resolution to appoint commissioners that would meet with commissioners from the other Union states "to take into consideration the trade of the United States; to consider how far a uniform system in their commercial regulations may be necessary to their common interest and their permanent harmony; and to report to the several states such an act, relative to this great object, as, when ratified by them, will enable the United States in Congress effectually to provide for the same."
The report of the meeting of Commissioners served during the convention as the proposal for a Constitution of the United States."

39 Nowak Rotunda 1995, 139.
"Two general concerns for the drafting of the Constitution in general and the Commerce Clause in particular; 1) the power must have been meant to put an end, either in itself or through federal legislation, to the trade barriers and tariffs which had led to the economic problems during the preceding period; and, 2) the national power must have been intended to be broad enough to deal with the type of economic problems of the nation as a unit."

40 Alexander Hamilton, Federalist No. 11, *The Utility of the Union in Respect to Commercial Relations and a Navy.*

specifically granted the federal Congress the authority to bind the states in matters of commerce among the states.[41] This "Commerce Clause"[42] was especially included to enhance[43] economic integration. It granted Congress the authority to regulate commerce among the states and therewith the power to minimize the obstacles and eliminate intentional barriers that limited free and fair interstate trade.

3 Institutional Structure and Grants of Authority

The institutional structure and grants of authority of the European Community and the United States Federation determine the legal development of their market integration. In the subsequent section I describe the institutional structure and the authority granted to the European Community and the United States Federation to accomplish the objective of economic integration. In section 3.1 I begin with the institutional structure and the authority granted to institutions of the European Community: the competence delimitation between the European Community and the member states, the limits to the states' sovereignty as a result of the institutional structure, and the authority granted to eliminate intentional barriers and minimize obstacles to free and fair interstate trade in general, and the insurance markets in particular. In section 3.2 I describe the institutional structure and the authority granted to institutions of the United States of America: the competence delimitation between the Federation and the states, the limits to the states' sovereignty as a result of the institutional structure, and the authority granted to eliminate intentional barriers and minimize obstacles to free and fair interstate trade in general, and the insurance market in particular.

3.1 European Community

What began in 1951 with the European Community for Steal and Coal with six member states, is today a European Union with 25 member states.[44] Although the institutional structure has changed and the objective of the cooperation among the member states has expanded over the years, cooperation among European states continues to pursue economic integration and continues to be based on treaties.

Despite the fact that the European Community is based on an international treaty among sovereign states, it is not a traditional international organization. The member states have limited their sovereignty, are committed to unconditional and irrevocable obligations and created a new legal order. The treaties not only directly limit the authority of the member states to regulate, they limit the ability of the market participants to act and authorize the institutions of the Community to bind the states and market participants in order to accomplish common objectives.

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41 Schwartz 1963, 7-10.

42 Article 1 sub 8 subsection 3 United States Constitution.

43 Together with clause 6 in section 9 and clause 2 in section 10 of article 1 of the Constitution.

44 Belgium, the Netherlands, Luxembourg, France Italy and Germany were joined by Denmark, Ireland and the United Kingdom in 1972, Greece in 1981, Spain and Portugal in 1986, Finland, Austria and Sweden in 1995, and Hungary, Poland, Latvia, Estonia, Lithuania, Slovakia, Slovenia, the Czech Republic, Malta, and Cyprus in 2004.

3.1.1 Institutional Structure

As seen in section 2, the "Treaty establishing the European Community for Steel and Coal" (ECSC)[45], signed in Paris on April 18, 1951 [46], created a Community that pooled and administered coal and steel resources in western Europe. The 1950 Schuman Plan, which laid the ground work for the European Community for Steel and Coal, considers the ECSC to be "the first concrete foundation of a European federation indispensable to the preservation of peace." This foundation, according to the preamble of the ECSC Treaty, was laid "by establishing an economic community."

Although the French Schuman Plan had proposed a European Community with supranational powers and an independent high authority, the ECSC was, and the two (remaining) subsequent Communities are a "mixed form between the supranational organization proposed by Schuman and an international organization of the OEEC type."[47] The proposal in the Schuman Plan to create an independent high authority with supranational powers, together with a Court of Justice to see to the legitimacy of the High Authority's actions, was complemented with a parliamentary organ to which the high authority had to answer, as well as an intergovernmental layer, i.e., the Council of Ministers. The intergovernmental layer was deemed necessary to coordinate ECSC policy with the states' economic policy in order to avoid national economic policies undoing measures taken by the High authority.[48]

The novelty of joining sovereign states in an intergovernmental – Treaty based – organization and granting it supranational powers, and the combined supranational intergovernmental institutional structure continued in two subsequent communities.[49] The proposals for the EURATOM and EEC Treaties not only included the intergovernmental Council of Ministers in the institutional structure, but granted it the exclusive authority to make binding decisions.[50] The EEC Treaty also specified a permanent place for the European Parliament (previously the general Assembly),

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45 April 18, 1951.

46 Entered into force on 23 July 1952 for 50 years and was dissolved on July 23, 2002.

47 Frans A.M. Alting von Geusau, *Beyond the European Community*, A.W. Sijthoff, Leyden, 1969, 53.

48 Frans A.M. Alting von Geusau 1969, 50-53.
Kapteyn - 2003, 6-7.
Kapteyn/Gormley 1998, 7-9.

49 With the establishment of the EEC and EURATOM it was agreed that there would be one parliamentary organ for all three communities, the European Parliament, one Court of Justice for all three communities, and one Economic and Social Committee for the EEC and EURATOM. The merger Treaty of 8 April 1965, in force on 1 July 1967, merged the executing institutions, the Council and the Commission (high authority) of all three communities.
Kapteyn 2003, 51-52.
Kapteyn/Gormley 1998, 73-74.

50 Although the EEC Treaty proposal, contrary to the ECSC, provided for the coordination of the policy of economic integration of the Community with the economic policies of the member states, making an intergovernmental layer for that purpose unnecessary, the intergovernmental Council of Ministers did find a permanent place in the institutional structure of the European Communities as the sole institution to take binding decisions.
Frans A.M. Alting von Geusau 1969, 53.

the European Commission (previously the High Authority), the European Court of Justice[51], and later, through treaty amendments, the European Council[52], the Court of First Instance, and the Court of Auditors.

The Single European Act[53] (SEA) amended the Treaty of Rome[54] and altered the institutional structure of the Community. It introduced the cooperation procedure for the European Parliament expanding its influence on decision making and it introduced the Court of First instance into the institutional structure. It codified European Political Cooperation[55] between the member states, including the European Council into the institutional structure of the Community. The cooperation of the member states in the European Council concerned matters of foreign and security policy with regard to the Community.[56]

The need for a monetary union to supplement the internal market[57], and the developments in eastern and central Europe, resulting in Germany's Unification[58], initiated the draft for a new European Treaty. The ambitions for closer cooperation among the member states were focused on the establishment of a European Monetary Union by 2000 and increased political cooperation between the member states.[59] The new, ambitious Treaty on the European Union, was signed in Maastricht in 1992 and came into force on 1 November 1993. It introduced the idea of closer cooperation between the member states at a different pace.[60] It changed, among others, the name of the European Economic Community into European

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51 Which was given the main task to ensure that in the interpretation and application of this Treaty the law is observed, article 177 Treaty establishing the European Economic Community, article 220 EC Treaty.

52 Not to be mistaken with the Council of Ministers.

53 Signed in February 1986 and entered into force on July 1, 1987.

54 The SEA implemented the legislative program of the 1985 White Paper on "Completing the Internal Market" (COM (85) 310) facilitating law making and economic integration, in the European Community.

55 European Political cooperation had started in 1970 where the member states laid the basis with meetings between the ministers of foreign affairs four times a year to discuss common foreign policy. This cooperation was purely intergovernmental. At the Paris summit of 9-10 December 1974 the European Council was set up. It was decided that heads of government would meet at least three times a year, accompanied by their foreign ministers as the Council of the Communities and in the context of political cooperation. In 1987, in the Single European Act this wa s codified in the Treaty.
Kapteyn - 2003, 22-.
Kapteyn/Gormley 1998, 27-.

56 The European Political Cooperation was (at that time), contrary to the economic integration cooperation in the Communities, of a purely intergovernmental nature.

57 "In the diminishing effectiveness of autonomous national economic and monetary policies and the increasing mutual dependence in an ever increasing number of policy areas lay the justification for, in turn: a common agricultural, transport and (external) commercial policy in the old EEC Treaty; the introduction of the European monetary system in 1978; the gradual introduction of an economic and monetary union and the facilitation of a stronger community social policy through the changes brought about by the Treaty on the European Union."
Kapteyn/Gormley 1998, 129.
Kapteyn - 2003, 110.

58 1990.

59 Kapteyn/Gormley 1998, 36.
Kapteyn - 2003, 28.

60 Articles 11 and 11a EC Treaty.

Community, expressing that the objectives of the Community go further than just economic integration.[61] The Treaty on the European Union introduced a tripartite structure, three pillars, of which one is communautaire, consisting of the original Treaties[62] and the two intergovernmental pillars. The institutions of the three original communities are the institutions of the European Union and are granted (limited) competence in the second and third pillars.

The subjects of the second and third pillar are not entirely new to the European integration effort. Foreign and security policy for example has since the Single European Act been part of the integration effort, albeit always intergovernmental. That has not changed with the introduction of the new pillar structure.

The Amsterdam Treaty[63] amended and supplemented the Treaty on the European Union. It extended the qualified majority voting powers of the Council, it extended the Parliaments right of co-decision, and asylum and immigration was moved from the third intergovernmental union pillar to the first, communautaire, pillar. Amsterdam established the process for the creation of a European Monetary Union: three phases resulted in the establishment of the common European monetary union in 1999.

The most recent intergovernmental conference on the structure of the union was the ICG of Nice in 2000. In Nice the remaining issues with regard to the institutional structure (among others) were negotiated between the member states. The Treaty of Nice, 26 February 2001, changed the institutional structure of the EU to prepare for the enlargement of the Union with eastern and central European states on 1 May 2004.

3.1.2 Limits to Sovereignty

By signing the EC Treaty member states not only joined an international organization, but they also limited their sovereignty, and committed themselves to obligations that were unconditional and irrevocable[64] for the benefit of the Community. The ECJ formulated the effect of membership to the European Community on the sovereignty of the States in several cases.

In 1962, in the case of *NV Algemene Transport- en Expeditie Onderneming van Gend & Loos v Netherlands Inland Revenue Administration*[65] the ECJ was asked to interpret whether nationals of a state could claim individual rights on article 12 EEC Treaty[66] which national courts are obliged to protect. In order to determine whether the

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61 Kapteyn/Gormley 1998, 39.
Kapteyn - 2003, 30.

62 ECSC (dissolved on July 23, 2002) EC and EURATOM.

63 Signed on 2 October 1997, entered into force on 1 May 1999.

64 *Amministrazione delle Finance dello Stato v. Simmenthal SpA.* Case 106/77, ECR [1978] Page 0629.

65 *NV Algemene Transport- en Expeditie Onderneming van Gend & Loos v Netherlands Inland Revenue Administration.* Case 26-62, ECR English special ed. [1963] 0001.

66 Article 25 EC Treaty.
Ex. Article 12 of the original EEC Treaty: "member states shall refrain from introducing between themselves any new custom duties on imports or exports or any charges having equivalent effect, and from increasing those which they already apply in their trade with each other."

provisions of an international treaty can be directly relied on before national courts the ECJ considered the spirit, the general scheme and the wording of the provisions. It concluded that:

> "the European Economic Community constitutes a new legal order of international law for the benefit of which the states have limited their sovereign rights, albeit within limited fields, and the subjects of which comprise not only the member states but also their nationals."

In 1964, in the case of *Costa E.N.E.L.*[67] the Giudice Conciliatore of Milan asked the ECJ for a preliminary ruling[68] with regard to the validity of an Italian national law. The Italian government argued that this request was inadmissible. Where article 177 only provides the ECJ with the authority to interpret the Treaty and not the authority to apply the Treaty to a specific case or determine whether a national law is invalid, the ECJ found that it has the power to extract from the question those questions that regard the interpretation of the Treaty. As regard to its authority to interpret the Treaty and its effect on the member states' legal system it has become an integral part of the legal system of the member state and courts are bound to apply it:

> "By contrast with ordinary international treaties, the EEC treaty has created its own legal system which, on the entry into force of the Treaty, became an integral part of the legal systems of the member states and which their courts are bound to apply. By creating a Community of unlimited duration, having its own institutions, its own personality, its own legal capacity and capacity of representation on the international plane and, more particularly, real powers stemming from a limitation of sovereignty or a transfer of powers from the states to the Community, the member states have limited their sovereign rights and have thus created a body of law which binds both their nationals and themselves."
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> ...
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> "The transfer by the states from their domestic legal system to the Community legal system of the rights and obligations arising under the Treaty carries with it a permanent limitation of their sovereign rights."[69]

3.1.3 Direct Effect of Community Law

One consequence of having created this new legal order is the direct effect of Community law. Community law not only imposes obligations on states, but also on individuals as well as grants them rights without the need of transpositioning Community law into member states' legislation first.[70]

In the case of *van Gend & Loos* the ECJ found that:

> "independently of the legislation of member states, Community law not only imposes obligations on individuals but is also intended to confer upon them rights which become part of their legal heritage. These rights arise not only where they are expressly granted by the Treaty but also by reason of obligations which the Treaty imposes in a clearly defined way upon individuals as well as upon the

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67 *Flaminio Costa v E.N.E.L.* Case 6/64, ECR English special ed. [1964] 0614.
68 Article 234 EC Treaty ex. article 177 EEC Treaty.
69 *Flaminio Costa v E.N.E.L.* Case 6/64, ECR English special ed. [1964] 0614.
70 Irrelevant of the member states' constitutional law.

member states and upon the institutions of the Community."[71]

And in *Costa E.N.E.L.*:

> a member state's obligation under the EEC Treaty, which is neither subject to any conditions nor, as regards its execution or effect, to the adoption of any measure either by the states or by the Commission, is legally complete and consequently capable of producing direct effects on the relations between member states and individuals. Such an obligation becomes an integral part of the legal system of the member states, and thus forms part of their own law, and directly concerns their nationals in whose favor it has created individual rights which national courts must protect."[72]

For individuals to be able to rely on Treaty articles against other individuals before their national courts, horizontal direct effect, the ECJ has made a distinction between Treaty articles that impose obligations on individuals and states alike, and articles that impose obligations on states alone. In the first situation, a Treaty article that imposes obligations on individuals, can be enforced against another individual before a national court.[73] In the second situation, a Treaty article that imposes obligations on states, can be enforced by an individual against another individual before a national court when it prohibits a state to act or fail to act in a clearly defined manner.[74]

3.1.4 Precedence of Community Law

Another consequence of having created a new legal order is that Community law has supremacy over member state's laws, both existing and future laws. In *Costa E.N.E.L.* the Court formulated it as:

> "The integration into the laws of each member state of provisions which derive form the Community and more generally the terms and the spirit of the Treaty, make it impossible for the states, as a corollary, to accord precedence to a unilateral and subsequent measure over a legal system accepted by them on a basis of reciprocity. Such a measure cannot therefore be inconsistent with that

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[71] *NV Algemene Transport- en Expeditie Onderneming van Gend & Loos v Netherlands Inland Revenue Administration.* Case 26-62, ECR English special ed. [1963] 0001.

[72] *Flaminio Costa v E.N.E.L.* Case 6/64, ECR English special ed. [1964] 0614.

[73] "It is beyond doubt that provisions of the Treaties or of regulations can impose obligations on individuals if they are clear from their very nature and scope, as, for example, is the case for undertakings in the field of competition." Kapteyn/Gormley 1998, 547.

[74] As early as 1974 the ECJ found that discrimination on the basis of nationality or place of establishment not only has vertical direct effect, *Reyners* (2/74) and *van Binsbergen* (33/74), but also horizontal direct effect, *Walrave Koch*, 36/74: 18 "the abolition as between member sates of obstacles to freedom of movement for persons and to freedom to provide services, which are fundamental objectives of the Community contained in article 3 (c) of the Treaty, would be compromised if the abolition of barriers of national origin could be neutralized by obstacles resulting from the exercise of their legal autonomy by associations or organizations which do not come under public law." and 20: "although the third paragraph of article 60, and articles 62 and 64, specifically relate, as regards the provision of services, to the abolition of measures by the state, this fact does not defeat the general nature of the terms of article 59, which makes no distinction between the source of the restrictions to be abolished."
Kapteyn 2003, 438-439.
Kapteyn/Gormley 1998, 546.

legal system. The law stemming from the Treaty, an independent source of law, could not, because of its special and original nature, be overridden by domestic legal provisions, however framed, without being deprived of its character as Community law and without the legal basis of the Community itself being called into question".

In 1978, in the case of *Amministrazione delle Finanze dello Stato v Simmenthal SpA.*[75], the ECJ confirmed the supremacy of Community law over existing member states' laws. The adoption of new national legislative measures was prevented because they were not compatible with Community provisions.[76] The Court emphasized that, by having signed the Treaty, the obligations of the member states were unconditional and irrevocable, and formed "the very foundation of the Community."[77]

3.1.5 Grant of authority to the Community and its Institutions to Economically Integrate the States' markets

The authority granted to Community institutions to integrate the markets economically, is based on a limited and selective attribution of powers in the Treaty.[78] The Community and its institutions can only act within the limits of the powers granted to it by the Treaty and only within the objectives assigned to it in the Treaty.[79] The Community does not possess 'kompetenz-kompetenz', and is unable to create new powers without an amendment of the Treaty.[80] The member states are competent unless the European Community is competent. Every Community action requires a specific power included in the Treaty that determines the institution[81], the tool[82] and the purpose[83] for which the power is granted.

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[75] *Amministrazione delle Finanze dello Stato v Simmenthal SpA.* Case 106/77, ECR [1978], 0629.

[76] *Amministrazione delle Finanze dello Stato v Simmenthal SpA.* Case 106/77, ECR [1978], 0629, paragraph 17.

[77] *Amministrazione delle Finanze dello Stato v Simmenthal SpA.* Case 106/77, ECR [1978], 0629, paragraph 18.

[78] Barents Brinkhorst 2003, 122.

[79] Articles 5 (The Community shall act within the limits of the powers conferred upon it by this Treaty and of the objectives assigned to it therein.) and 7.1 (The tasks entrusted to the Community shall be carried out by the following institutions: – a European Parliament, – a Council, – a Commission, – a Court of Justice, – a Court of Auditors. Each institution shall act within the limits of the powers conferred upon it by this Treaty.) EC Treaty.

[80] Limited possibilities are offered in article 308.
Kapteyn/Gormley 1998, 138.
Kapteyn - 2003, 115.

[81] Article 7.1 EC Treaty.

[82] Article 249 EC Treaty: "In order to carry out their task and in accordance with the provisions of this Treaty, the European Parliament acting jointly with the Council, the Council and the Commission shall make regulations and issue directives, take decisions, make recommendations or deliver opinions.
A regulation shall have general application. It shall be binding in its entirety and directly applicable in all member states. A directive shall be binding as to the result to be achieved, upon each member state to which it is addressed, but shall leave to the national authorities the choice of form and methods. A decision shall be binding in its entirety upon those to who it is addressed. Recommendations and opinions shall have no binding force."

[83] Articles 2 EC Treaty: "The Community shall have as its task, by establishing a common market and an economic and monetary union and by implementing common policies or activities

The principle of attribution of power was supplemented with the principle of subsidiarity and proportionality in the Treaty of Maastricht in 1997 to limit the effect of extensive interpretation and use of Community powers on the member states' freedom to regulate and act. Where attribution allows the Community and its institutions to use the powers granted to it in the Treaty, subsidiarity requires that the powers only be used if the member states themselves are unable to accomplish the set objective, and only to the extent necessary to achieve the objectives of the Treaty.[84]

The limited authority given to the Community was first laid down in the EEC Treaty and later confirmed in the Single European Act[85], the Treaty on the European Union[86] and in the amended EC Treaty.[87]

Article 3 of the original, 1957 EEC Treaty required a common market be established for the economic integration of the markets of the member states.[88] The common market was to be established within 12 years, in three stages of four years each, during which a customs union had to be created, all obstacles and barriers to the freedom of movement for goods, persons, services and capital had to be eliminated, a system that ensured fair competition had to be established, and a common trade policy had to be implemented. The customs union was accomplished within the set time frame.[89] It simply required the elimination of all custom duties among the states. The elimination of remaining obstacles and barriers that limit the free movement of goods, persons, services and capital was, and still is, more complicated.

The EC Treaty contains besides grants of authority to create a common market also express prohibitions for the member states[90] and the market participants.[91]

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referred to in Articles 3 and 4, to promote throughout the Community a harmonious, balanced and sustainable development of economic activities, a high level of employment and of social protection, equality between men and women, sustainable and non-inflationary growth, a high degree of competitiveness and convergence of economic performance, a high level of protection and improvement of the quality of the environment, the raising of the standard of living and quality of life, and economic and social cohesion and solidarity among member states."

84 Article 5 EC Treaty: "The Community shall act within the limits of the powers conferred upon it by this Treaty and of the objectives assigned to it therein." and "In areas which do not fall within its exclusive competence, the Community shall take action, in accordance with the principle of subsidiarity only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the member states and can therefore, by reason of the scale or effects of the proposed action be better achieved by the Community. Any action by the Community shall not go beyond what is necessary to achieve the objectives of this Treaty."

85 Article 3 Single European Act.

86 Article E, Treaty on the European Union.

87 Article 5 EC Treaty.

88 Kapteyn 2003, 104.
Kapteyn/Gormley 1998, 122-123.

89 Before the end of the 12-year transitional period.

90 See for example articles 3, 12, 23, 25, 28, 29, 43, 56 and 76 EC Treaty. Prohibition of custom duties and quantitative restriction and of all charges having equivalent effect on the import and export of goods between member states, prohibition of discrimination on grounds of nationality, prohibition of restrictions on the freedom of establishment, the provision of services and the movement of capital.

91 See for example article 81 and 82 of the EC Treaty: prohibition of all agreements between

These prohibitions do not have a positive implication on Community powers, i.e., the Community does not automatically assume authority over the subject matters that have been prohibited to the member states and market participants.[92]

Although the EC Treaty both contains prohibitions and specifically authorizes the Community to establish the free movement of goods, persons, services and capital, through the removal of obstacles and barriers among the states, it left the interpretation and the subsequent elimination of obstacles and barriers to Community institutions.

Because decision making in the Council initially required unanimity[93], the limits of the states' (regulatory) authority did not exceed beyond what the states themselves, represented in the Council, unanimously agreed. Although the European Court of Justice can, and does, interpret the limits to the states' regulatory authority and the limits to market participants liberty to act, it is, unlike the Council, limited to the cases brought before it.

The 1957 EEC Treaty prescribed the replacement[94] of unanimous voting in the Council by (qualified) majority voting during the transitional period.[95] However, unanimity was only effectively replaced with the Single European Act of 1987.[96] In 1965, the 12th year of the transitional period, France opposed the planned (partial) abandonment of unanimity voting in the Council. After seven months of boycotting votes in the Council, the "empty seat policy", a compromise was reached. In the 1966 Luxembourg Compromise the member states agreed to reach consensus when major interests of a member state were at stake, which for all practical reasons meant that unanimity was maintained. The result of the Luxembourg Compromise was that the Council not only searched for consensus when major interests were at stake, but avoided voting for most matters and instead looked for consensus. No member state would be limited in its freedom through Council decisions, unless they agreed to be limited. However, the (few) direct limits to the freedom of the states and the market participants to regulate and act in the Treaty could, and were interpreted by the ECJ to bind the member states and market participants alike.[97] The ECJ executed its authority to interpret the EC Treaty and found increasingly

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undertakings, decisions by associations of undertakings and concerted practices which may affect trade between member states and which have as their object or effect the prevention, restriction or distortion of competition within the common market, and the prohibition of any abuse by one or more undertakings of dominant position within the common market or in a substantial part of it.

92 K. Lenaerts, Two hundred years of U.S. Constitution and thirty years of E.E.C. Treaty: Outlook for a comparison in *Two hundred years of U.S. Constitution and thirty years of E.E.C. Treaty: outlook for a comparison* / K. Lenaerts (editor) ... [et al.]: Deventer, Netherlands: Kluwer Law and Taxation, 1988, 16: "Whereas, in the United States, a 'negative implication' on state power was derived by the Supreme Court from the express grant of power to Congress in the Commerce Clause, it appeared impossible for the Court of Justice to simply infer a similar power in favor of the Community as a 'positive implication' on Community power flowing from the express prohibition laid upon the member states."

93 See for example articles 51, 54, 56, 57, 59, 63 EEC Treaty.

94 See for example articles 56, 57, 63 EEC Treaty.

95 12 years.

96 Signed in February 1986 and ratified on July 1, 1987.

97 See chapter 4.
Kapteyn 98, 249-250.

more limits to the states' regulatory authority in the Treaty text, thereby removing obstacles and barriers to the four freedoms.[98]

In addition to replacing unanimous voting in the Council, the 1987 Single European Act implemented the legislative program of the 1985 White Paper on "Completing the Internal Market". It changed the approach to removing obstacles and barriers in the Treaty from detailed harmonization of national rules to minimum harmonization of essential rules only, in combination with the mutual recognition of member states' laws and home country control. The principle of mutual recognition was introduced in 1978 by the ECJ in the case of *Cassis de Dijon*.[99] In this case a German provision laid down fruit liqueurs could only be marketed if they complied with the minimum alcohol content of 25%. Cassis de Dijon, with an alcohol content of between 15 and 20% was freely marketed in France where it was produced. The ECJ found that a member state should allow goods (and services) from another member state to enter its market if these goods have been produced and introduced on the market according to the rules of the home member state.[100]

These grants of authority facilitated not only the legal development of market integration in general but the legal development of insurance market integration as well.[101]

3.1.6 Grant of Authority to Integrate the Insurance Markets

While all four freedoms are required for the economic integration of the European market, the second freedom, the free movement of persons, and the third freedom, the free movement of services, are the most relevant for creating a common insurance market. Although these freedoms do not mention insurance as such, they imply the inclusion of European insurance providers and insurance services in their wording.[102] The free movement of persons includes the freedom of establishment, including "the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms ..."[103] Article 43 EC Treaty (ex 52) specifically requires that restrictions limiting the freedom of

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98 Chapter 4.

99 *Rewe-Zentral AG v Bundesmonopolverwaltung für Branntwein. (Cassis de Dijon)*. Case 120/78. ECR [1979] Page 00649.

100 Unless there is a valid reason why they should not be introduced into another member state. Paragraph 14, *Rewe-Zentral AG v Bundesmonopolverwaltung für Branntwein. (Cassis de Dijon)*. Case 120/78. ECR [1979] Page 00649.

101 See chapters 4 and 5.

102 Article 48 (ex article 58): " 'companies or firms' means companies or firms constituted under civil or commercial law, including cooperative societies, and other legal persons governed by public or private law save for those which are non-profit-making."
Article 50 (ex article 60): "Services shall be considered to be 'services' within the meaning of this Treaty where they are normally provided for remuneration, in so far as they are not governed by the provisions relating to freedom of movement for goods, capital and persons.
'Services' shall in particular include:
(a) activities of an industrial character;
(b) activities of a commercial character;
(c) activities of craftsmen;
(d) activities of the professions."

103 Article 39-48 EC Treaty (ex. article 52-58).

establishment for residents and companies be removed. In article 83 (ex 87) the EC Treaty grants the Council the authority "to give effect to the principles set out in Articles 81 and 82" regarding the rules on competition by means of regulations or directives.

The Council confirmed the authority of the Community to integrate the insurance market in its General Programs.[104] Articles 54 and 63 of the EEC[105] Treaty, ordered the Council to formulate these two general programs, one to abolish restrictions on the freedom of establishment and another to abolish restrictions on the freedom to provide services. Both had to be formulated before the end of the first stage, in 1963.[106] In 1958 the Commission installed a working group that included functionaries from the member states to study the various topics for inclusion in the General Programs. The working group created nine specialized working groups, including one to study the insurance industry.[107]

Based on the final conclusions of the working group the European Commission presented the General Programs to the Council in March and July 1960.[108] After hearing the advice of the Economic and Social Committee and the European Parliament, the Council formulated the General Programs. These included the removal of restrictions on establishment for insurance providers and the provision of insurance services, and confirmed the authority of the Community and its institutions to integrate the insurance markets of the member states.[109]

While the Council confirmed the Community's authority to integrate the insurance markets in the General Programs of 1962, it was only in 1987 that the European Court of Justice confirmed the Community's authority to limit the insurance market participants in their freedom to act, and to create fair competition in the insurance market. Where as early as 1973 the Commission stated in its Second Report on Competition Policy that competition rules applied the insurance companies[110] it was only in 1987 the ECJ found in the case of the *Verband der Sachversicherer eV v European Commission*[111] that "the Community competition

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104 General Programme for the abolition of restrictions on freedom to provide services, Official Journal of the European Communities 36/62.
General Programme for the abolition of restriction on freedom of establishment, Official Journal of the European Communities 32/62.

105 Amended.

106 Article 54 of the original Treaty establishing the European Economic Community. Tweede algemeen verslag over de werkzaamheden van de Gemeenschap (18 September 1958 - 20 maart 1959) page 75.

107 Working group 5b, Tweede algemeen verslag over de werkzaamheden van de Gemeenschap (18 September 1958 - 20 maart 1959) page 76.

108 Tweede algemeen verslag over de werkzaamheden van de Gemeenschap (18 September 1958 - 20 maart 1959) page 77.

109 *Jean Reyners v. Begian State*, 2/74, ECR [1974], page 0631, paragraph 21: "It appears from the above that in the system of the chapter on the right of establishment the 'general programme' and the directives provided for by the Treaty are intended to accomplish two functions, the first being to eliminate obstacles in the way of attaining freedom of establishment during the transitional period, the second being to introduce into the law of member states a set of provisions intended to facilitate the effective exercise of this freedom for the purpose of assisting economic and social interpenetration within the Community in the sphere of activities as self-employed persons."

110 Merkin and Rodger, 1997, 167.

111 *Verband der Sachversicherer e.V. v Commission of the European Communities* Case 45/85, ECR

system, as set out in particular in articles 85 and 86[112] of the EEC Treaty and in the provisions of regulation no 17[113], applies without restriction to the insurance industry."[114]

The Verband der Sachversicherer eV (property insurers' association) brought a legal action before the ECJ to have the Commission's decision of 5 December 1984 overturned.[115] In the contested decision the Commission stated that a recommendation by the defendant to its members to increase premiums for industrial fire and consequential loss – nominally, in order to re-establish stable and viable conditions in the insurance sector –, constituted an infringement of article 85 (1) of the EEC Treaty (81.1 EC Treaty). The Verband der Sachversicherer submitted that article 85(1) was not yet applicable to the insurance industry in full and without qualification because "until the adoption by the council under article 87(2)(c)[116] of the EEC Treaty of special provisions relating to insurance, the prohibition contained in article 85 b(1)[117] of that treaty does not apply to the insurance industry and ... the Commission cannot, by applying that prohibition, contribute to the creation of a position which article 87 (2) (c)[118] intended to avoid."[119]

The ECJ rejected the Verband der Sachversicherer's arguments and referred to a previous judgment, *Ministere Public v Asjes*[120], in which Treaty limits to the insurance industry applied. There it had already stated that where the Treaty intended to remove certain activities from the applicability of the competition rules it made an express derogation to that effect. No such provision for insurance was made in the Treaty.[121] Also, "where regulation no. 17 of the Council of 6 February 1962[122] lays down detailed rules for the implementation of articles 85 and 86 of the EEC treaty[123] for all the branches of the economy to which the provisions apply with the sole exception of those covered by special rules laid down on the basis of article 87 of the EEC treaty[124] ... no exception of that type, however, exists in the case of the insurance industry."[125] The ECJ concluded that the Community competitive system applied without restriction to the insurance industry, establishing authority. It added however that the conclusion "in no way implies that Community competition law

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[1987] Page 00405.

112 Articles 81 and 82 EC Treaty.

113 Regulation No 17 of the Council of 6 February 1962. (Official Journal, English special edition 1959 - 62, 87.)

114 *Verband der Sachversicherer e.V. v Commission of the European Communities.* Case 45/85, ECR [1987] Page 00405, paragraph 14.

115 See also chapters 4 and 5.

116 Article 83 EC Treaty.

117 Article 81 EC Treaty.

118 Article 83 EC Treaty.

119 *Verband der Sachversicherer e.V. v Commission of the European Communities.* Case 45/85, ECR [1987] Page 00405, paragraph 10.

120 *Criminal proceedings against Lucas Asjes and others, Andrew Gray and others, Jacques Maillot and others and Léo Ludwig and others.* Joined cases 209 to 213/84, ECR [1986] Page 01425.

121 *Verband der Sachversicherer e.V. v Commission of the European Communities.* Case 45/85, ECR [1987] Page 00405, paragraph 12.

122 Official Journal, English special edition 1959 - 62, 87.

123 Articles 81 and 82 EC Treaty.

124 Article 83 EC Treaty.

125 *Verband der Sachversicherer e.V. v Commission of the European Communities.* Case 45/85, ECR [1987] Page 00405, paragraph 13.

does not permit the special characteristics of certain branches of the economy to be taken into account"[126] referring to the exemption possibility in article 81(3) (ex 85.3) of the EC Treaty.

3.2 United States of America

3.2.1 Institutional Structure

The choice for a league of friendship among the former colonies of the North American continent was a result of the war of independence from the British. Although the newly formed states realized that they needed each other for common defense, they did not choose to surrender their newly won independence and sovereignty. To cooperate in a confederation provided the necessary security against all force against, or attacks made upon them, or any of them, on account of religion, sovereignty, trade, or any other pretense. It also allowed the states to retain their sovereignty, freedom and independence, and every power, jurisdiction, and right, not explicitly delegated to the United States Congress.[127]

The national Congress, the only Confederate institution established under the Articles of Confederation had limited powers. As described earlier in this chapter, the Confederation was confronted with this restriction when interstate trade barriers were imposed and the national Congress lacked authorization to stop this development. The Virginia legislature called for a convention to consider the trade of the United States.[128] This convention, that convened to solve the problems of protectionism between the states, was the first step toward the current Constitution of the United States of America.

The decision to cooperate in a federation resulted from the need to overcome the problems that a league of independent nations had been unable to solve. According to the Federalist Papers, the problem with the Confederation was that the Articles of Confederation held legislation for states or governments in their corporate or collective capacities, as in a traditional international organization, and did not directly involve the individuals of which these states consist. In practice this meant that the actions of the Confederation were nothing more than recommendations that states could optionally observe or disregard.[129] To overcome the problems, the choice was made to extend the authority of the Union to include the citizens, to form a government that would not only make but also enforce laws, and to base it all on a constitution with enforceable rights for the citizens of the federation.

The Federation's institutional structure, laid down in the United States Constitution, has remained the same since 1786. Rather than a league of nations in which states are parties, a federal government was created by the citizens of the United States, consisting of citizens of the United States and existing for the citizens of the United States. The United States of America, like the European states two centuries later, created a "legal entity comprised of states for the purpose of

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126 *Verband der Sachversicherer e.V. v Commission of the European Communities.* Case 45/85, ECR [1987] Page 00405, paragraph 15.

127 Articles of Confederation.

128 Nowak Rotunda 1995, Appendix A 1335.

129 Alexander Hamilton, Federalist No. 15, *The Insufficiency of the Present Confederation to Preserve the Union.*

pursuing certain common ends and which has been given, to this effect, the power to exercise limited but direct jurisdiction over their citizens[130], but where for all other fields of public action the individual states maintain their full autonomy."[131]

3.2.2 Limits to Sovereignty

The federal structure is specified in the Constitution through a division of powers between state and federal government. The states gave up their external sovereignty when they joined the Federation, their intra-state powers and authority however, are limited only by the Constitution and the federal institutions, and then only within parameters stipulated in the Constitution.[132]

Contrary to the confederation, the institutions of the new Federation consist of more than just the legislative body, the Congress.[133] It includes an executive branch, the president, and a judicial branch, the federal court system, which includes the United States Supreme Court. Also, the states did not just limit their sovereignty in matters of international relations of the Union. The limits to their sovereignty are reflected in the Federation's exclusive power to declare war, to make peace, negotiate treaties, to levy money and to regulate commerce as well as the transfer of the correspondent legislative, executive and judicial authorities to the general government of the Union.[134]

3.2.3 Supreme Law of the Land

The authority of the federal government is specified in the Constitution. When it executes these powers, federal law can[135] preempt concurrent state legislation.[136] The states are ultimately subordinate to federal authority. The heart of this subordination is article VI section 2 of the Constitution, the Supremacy Clause: "the Constitution of the United States and the laws of the United States which shall be made in pursuance thereof; and all treaties made, or which shall be made, under the

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130 Read also residents. In the United States Americans are citizens of their states but think of themselves as residents of the states in which they live, and citizens of the United States.

131 Ingolf Pernice (ed.) *Harmonization of legislation in federal systems. Constitutional, federal and subsidiarity aspects. The European Union and the United States of America compared.* 1. Auflage – Baden Baden: Nomos Verl. – Ges., 1996 footnote 21.
Koen Lenaerts, *Is de Europese Unie federaal,* Tijdschrift voor Bestuurswetenschappen en Publiek Recht, vol 50 (1995) no 11, 607.

132 For the different doctrines on federal power granted in the Constitution see the subsequent sections.

133 Which is made up of the House of Representatives and the Senate.

134 The letter of the President of the Constitutional Convention submitting the proposed Constitution to the President of Congress stated: "The friends of our country have long seen and desired, that the power of making war, peace, and treaties, that of levying money and regulating commerce, and the correspondent executive and judicial authorities should be fully and effectually vested in the general government of the Union: But the impropriety of delegating such extensive trust to one body of men is evident – Hence results the necessity of a different organization."

135 If state law conflicts with federal law.

136 Nowak Rotunda 1995, 319: Even when it does not use its powers, Congress may impliedly occupy the field.

authority of the United States, shall be the supreme law of the land; and the judges in every state shall be bound thereby, anything in the Constitution or laws of any state to the contrary notwithstanding."

3.2.4 Grant of Authority to the Federation and its Institutions to Economically Integrate the States' Markets

Unlike the states that have a general "police power"[137] the Federation and its institutions have been enumerated federal powers and can only act on those granted to them in the Constitution.[138]

However, in the case of *Marbury v. Madison*[139] the Supreme Court exercised its constitutional authority to interpret the Constitution, and interpreted it to include constitutional review. This means that the Supreme Court by using its authority to interpret the Constitution, had found that it also has the authority to interpret the compatibility of federal and state laws with the federal Constitution.[140]

Rather than detailed limits to the authority of the states to regulate, limits to the liberty of market participants to act, and detailed tasks and objectives for the institutions to accomplish, the federal Constitution grants the authority to integrate the markets of the states in a general grant of regulatory authority to the federal Congress. The Commerce Clause simply grants the Congress the authority "to regulate commerce with foreign nations, Indian tribes and among the states".[141]

The general clause that authorizes Congress to liberalize trade allows room for interpretation. Rather than summing up the obstacles and barriers that need to be eliminated or the limits of state authority, the Constitution leaves it to Congress and the Supreme Court to determine whether there is federal authority to regulate, and, if so, what the limits of states' authority to regulate are and indirectly, what the limits of the market participants to act are.[142]

Two predominant doctrines have dominated the interpretation of the Commerce Clause and its effect on the authority of the Federation to integrate the states' markets and the authority of the states to regulate the market. As the Constitution does not explicitly prohibit the states from regulating interstate commerce, the concurrent powers doctrine interprets the authorization to the federal Congress not to exclude the states from regulating commerce among

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[137] The inherent power to protect the health, safety, welfare or morals of persons within their jurisdiction. Ronald D. Rotunda, John E. Nowak, *Treatise on Constitutional Law, substance and procedure*, third edition, Volume 1, St. Paul, MN West Group, 1999, 337.

[138] The interpretation of the enumerated powers however have varied in time, resulting in different doctrines. See subsequent section.

[139] *Marbury v. Madison* 5 U.S. 137 (1803).

[140] Kathleen M. Sullivan, Gerald Gunther, *Constitutional Law*, fifteenth edition, Foundation press New York, NY, 2004, 10.
Lenaerts 1988, 16.

[141] Article 1, section 8, subsection 3 United States Constitution.

[142] The Commerce Clause has the power to command only the federal government. It is a limit on federal government power, one that allows the federal government to limit state power, but does not act directly on the states unless the Congress passes legislation. There are no constitutional limits on the liberty of market participants to act. The Constitution reserves power to the states, or to the people, but it never limits the power, or grants power, to non-government actors.

themselves under certain circumstances. Others view the authorization to the federal Congress as an exclusive power. As the Commerce Clause was included in the Constitution to stop the states from imposing interstate obstacles and barriers, the exclusive power doctrine interprets the power of the Commerce Clause to necessarily exclude states' regulatory power.

The question, whether by the mere grant of the power to Congress the power of the states to regulate is surrendered, or whether this power remains with the states until the Congress exercises the power was first answered in 1829, in the case of *Wilson v. Black Bird Creek Marsh Co.*[143] The Supreme Court found that the power given to Congress did not amount to a surrender of power by the states to regulate "matters that have a remote and considerable influence on commerce."

The Black Bird Creek Marsh Company was authorized to construct a dam across the Black Bird Creek by an act of legislation of the State of Delaware. After the dam was erected and placed in the creek, the navigation of the creek was obstructed. The question the Court needed to answer was whether the state Act was in conflict with the power of the United States "to regulate commerce with foreign nations and among the several states."[144] Congress had passed no law regulating navigation on small creeks. Had it done so the Court stated, "we should feel not much difficulty in saying that a state law coming in conflict with such act would be void."[145] The Court ruled that "we do not think that the act empowering the Black Creek Marsh Company to place a dam across the creek, can, under all the circumstances of the case, be considered as repugnant to the power to regulate commerce in its dormant state[146], or as being in conflict with any law passed in the subject."[147]

For the first time in its history, the Supreme Court used the term 'dormant' in reference to the Commerce Clause. The state could regulate within its police powers, affecting commerce, when Congress left its powers granted by the Commerce Clause dormant. The problem with the origin of power or police power theory was finding the criteria to test whether state law affecting interstate commerce was allowed.[148] In *Cooley v Board of Wardens*[149] in 1851, the Court introduced a new test for state regulation of commerce in the absence of Congressional legislation.[150] It held that:

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143 *Willson v. Black-Bird Creek Marsh Co.*, 27 U.S. 245 (1829).

144 *Willson v. Black-Bird Creek Marsh Co.*, 27 U.S. 245 (1829), paragraph 252.

145 Supremacy Clause.
Willson v. Black-Bird Creek Marsh Co., 27 U.S. 245 (1829), paragraph 252.

146 The Commerce Clause does not only affect the states and market participants when Congress uses its authority to regulate, it can affect them without congressional regulation as well. The Supreme Court has derived a negative implication on the power of the states from the express grant to Congress to regulate commerce among the states. This so called dormant Commerce Clause power, allows the Supreme Court to interpret the silence of the Congress over matters of commerce, and interpret the authority of the states regarding matters of interstate commerce.
See Gerald Gunther and Kathleen M. Sullivan, *Constitutional law*, thirteenth edition, the foundation press inc 1997, 259, and Lenaerts 1988, 16.

147 Nowak.Rotunda 1995, 285.
Willson v. Black-Bird Creek Marsh Co., 27 U.S. 245 (1829), paragraph 252.

148 Nowak Rotunda 1995, 285.

149 *Cooley v. Board of Wardens*, 53 U.S. 299 (1851).

150 Nowak Rotunda 1995, 286.

> "The mere grant of such a power to Congress, did not imply a prohibition on the states to exercise the same power; that it is not the mere existence of such a power, but its exercise by Congress, which may be incompatible with the exercise of the same power by the states .... Either absolutely to affirm or deny that the nature of this power requires exclusive legislation by Congress, is to lose sight of the nature of the subjects of this power, and to assert concerning all of them, what is really applicable but to a part."[151]

By defining the nature of Congress' Commerce Clause power, the Court determined whether it deprived the states of their power to regulate pilots. If the nature of the power required that a similar authority should not exist in the states, the power to regulate is excluded from the states. This is selective exclusiveness.[152]

The Supreme Court changed from selective exclusiveness in the 1850s to the exclusive power doctrine in the 1860s. The exclusive power doctrine, or dual federalism, required the limits of the Congressional power under the Commerce Clause to be defined. According to dual federalism, based on the tenth amendment[153], states were allowed to regulate everything not specifically delegated to the federal government in the Constitution. The Commerce Clause granted the federal government the authority to regulate commerce among the states, only granting Congress the power to regulate commerce that moves across state lines. According to dual federalists, intrastate[154] commerce and interstate non-commerce[155] were beyond the reach of federal regulation.

In the 1930s, with the New Deal, dual federalism was abandoned.[156] The Supreme Court broadened the definition of the Commerce Clause in the decision *United*

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151 *Cooley v. Board of Wardens*, 53 U.S. 299 (1851), paragraph 319.

152 Sullivan Gunther 2004, 253.

153 Tenth Amendment: "The powers not delegated to the United States by the Constitution, nor prohibited by it to the states, are reserved to the states respectively, or to the people." Ratified December 15, 1791.

154 Interstate commerce became intrastate commerce when the activity across state lines was interrupted by a local activity.
Coe v. Town of Errol, 116 U.S. 517, 527 (1886): "goods do not cease to be part of the general mass of property in the state, subject, as such, to its jurisdiction, and to taxation in the usual way, until they have been shipped, or entered with a common carrier for transportation to another state or have been started upon such transportation in a continuous route or journey."

155 *Kidd v. Pearson*, 128 U.S. 1 (1888), Commerce did not include manufacturing production and storage.
Little, Bruce, *A case of judicial backsliding: artificial restraints on the commerce power reach of the Sherman Act*, in: University of Illinois law review, volume 1985, no 1 at 168.
Paul v. State of Virginia, 75 U.S. 168 (1868), paragraph 183: " Issuing a policy of insurance is not a transaction of commerce".

156 Little 1985, 173.
"Our conclusion is unaffected by the Tenth Amendment which provides: "the powers not delegated to the United States by the Constitution, nor prohibited by it to the states, are reserved to the states respectively, or to the people." The Amendment state but a truism that all is retained which has not been surrendered. There is nothing in the history of its adoption to suggest that it was more than declaratory of the relationship between the national and state governments as it had been established by the Constitution before the Amendment or that its purpose was other than to allay fears that the new national government might seek to exercise powers not granted, and that the states might not be able to exercise fully their reserved powers. *Darby*, at 118, 123; *McCulloch v. Maryland*, 4 Wheat 361; *United States v. Ferger*, 250 U.S.

States v. Darby[157] thereby expanding the legislative powers of Congress. Instead of defining interstate and intrastate, the Supreme Court looked at the economic impact of the activity on interstate commerce to determine the scope of the Commerce Clause power. *United States v. Darby*[158] overruled the dual federalism interpretation.[159] The Supreme Court referred to *Gibbons v. Ogden* where Marshall stated: "The power of Congress over interstate commerce is complete in itself, may be exercised to its utmost extend, and acknowledges no limitations other than are prescribed in the Constitution."[160] This power could not "be enlarged nor diminished by the exercise or non-exercise of state power", however.[161]

The Supreme Court found that "[t]he power of Congress over interstate commerce is not confined to the regulation of commerce among the states. It extends to those activities intrastate which so affect interstate commerce or the exercise of the power of Congress over it as to make regulation of them appropriate means as to the attainment of a legitimate end, the exercise of the granted power of Congress to regulate interstate commerce ..."[162]

In the 1946 case of *Prudential Insurance co v. Benjamin* the Supreme Court introduced cooperative federalism which allowed the federal Congress to grant the states powers that are within its own Commerce Clause powers. In the 1851 *Cooley v. Board of Wardens*[163] case the Supreme Court had ruled that the nature of the subject that was regulated determined who could regulate. If the Court found a subject to be of a nature to require exclusive federal regulation, the states were excluded from regulating and the Congress could not grant the states the power to regulate. In *Prudential Insurance Co v. Benjamin* the Supreme Court re-interpreted. It found that Congress has the authority to sanction state regulation that has been found contrary to the dormant Commerce Clause by the Supreme Court, granting the Congress broader powers in regulating commerce among the states.[164]

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199 (1919). "

157 *U.S. v. Darby*, 312 U.S. 100 (1941).

158 *U.S. v. Darby*, 312 U.S. 100 (1941).

159 Which had viewed the Tenth Amendment as a positive grant of power to the states.

160 *Gibbons v. Ogden*, 22 US 1 (1824), paragraph 196.

161 *U.S. v. Darby*, 312 U.S. 100 (1941), paragraph 114: "The power of Congress over interstate commerce 'is complete in itself, may be exercised to its utmost extent, and acknowledges no limitations, other than are prescribed by the Constitution.' *Gibbons v. Ogden*, supra, 9 Wheat. 196. That power can neither be enlarged nor diminished by the exercise or non-exercise of state power."

162 *U.S. v. Darby*, 312 U.S. 100 (1941), paragraph 118: "The power of Congress over interstate commerce is not confined to the regulation of commerce among the states. It extends to those activities intrastate which so affect interstate commerce or the exercise of the power of Congress over it as to make regulation of them appropriate means to the attainment of a legitimate end, the exercise of the granted power of Congress to regulate interstate commerce. See McCulloch v. Maryland, 4 Wheat. 316, 421. Cf. United States v. Ferger, 250 U.S. 199, 39 S.Ct. 445)."

163 *Cooley v. Board of Wardens*, 53 U.S. 299 (1851). Selective exclusiveness.

164 Sullivan Gunther 2004, 254. "To the Cooley court, once the court found a Commerce Clause restriction, congress could not remove it. 'If the Constitution excluded the state from making any law regulating commerce, certainly congress cannot re-grant or in any manner reconvey to the states that power.' That aspect of Cooley clearly has been overruled: congress is now viewed as having authority to consent to state regulations of commerce that would otherwise be barred by the dormant commerce power. See *Prudential Insurance co v. Benjamin*. 1946".

The grant of authority to the Federation and more particular to the federal Congress to integrate the states' markets is subject to interpretation. Although the Commerce Clause grants Congress the authority to regulate commerce among the states, the extent of that authority is dependent on the interpretation of the clause by the Supreme Court as is the limiting effect on states' authority to regulate. The general grant of authority to regulate commerce and the interpretation thereof in various doctrines have impacted the legal development of market integration in general and the insurance market integration in the United States in particular.

3.2.5 Grant of Authority to Integrate the Insurance Markets

The American Constitution does not mention insurance at all; not in the Commerce Clause, which is the article included for the liberalization of interstate commerce in the United States, nor in any other article of the Constitution.[165] Whether the Federation has the authority to integrate the United States insurance markets and the extent to which the Constitution and federal regulations can limit both states and market participants, depends on the interpretation of the Commerce Clause power.[166]

That "commerce among the states" includes the business of insurance was established in 1943, in the case of *United States of America v. South-Eastern Underwrites Association et al.*[167] The United States Supreme Court ruled that the Commerce Clause encompasses the business of insurance, establishing Congress' authority to regulate the insurance markets.

The South-Eastern Underwriters Association and its membership of nearly 200 private fire insurance companies and 27 individuals, were indicted in the district court for alleged violations of the federal Sherman Anti-Trust Act.[168] The members of the South-Eastern Underwriters Association controlled 90% of the fire insurance and 'allied lines' sold by stock fire insurance companies in six states. The association and its members were charged with conspiracy in the form of a continuing agreement and concert of action to fix premium rates, agent's commissions as well as employing boycotts, coercion and intimidation of the insurance companies, agents and consumers. This was the type of conduct outlawed by the Sherman Act. The Sherman act is a federal law that has been enacted on the basis of Congress' power in the Commerce Clause, and prohibits "every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states."

Lenaerts 1988, 15: Cooperative federalism.

165 Nor does it mention most areas of business or law by name.

166 The United States Constitution in general and the Commerce Clause in particular, as opposed to legislation, sets up only the barest power structure and individual and states rights: article 1, section 8 subsection 3 United States Constitution: The Congress shall have the power to regulate Commerce with foreign nations, and among the several states, and with the Indian Tribes.

167 *U.S. v. South-Eastern Underwriters Association*, 322 U.S. 533 (1944).

168 Congress passed the Sherman Anti-Trust Act (15 USCS §§ 1-7) in July 1890, in order to prevent or suppress devices or practices which create monopolies or restrain trade or commerce by suppressing or restricting competition and obstructing the course of trade.

The Attorney General of Missouri attempted to stop the rate fixing by the South-Eastern Underwriters Association. A complaint was filed with the Department of Justice that resulted in a federal investigation. As a result, a criminal indictment was brought against the South-Eastern Underwriters Association.

The South-Eastern Underwriters Association argued that there was no requirement for insurance companies to conform to the standards of business conduct established by the federal Sherman Act because "the business of insurance is not commerce." Because the Sherman Act was created on the basis of and shaped according to the limits of the Commerce Clause, and it had long been established in 1868 in *Paul v. Virginia*[169] and subsequent cases that the business of insurance was not commerce under the Commerce Clause, the Sherman Act could not apply to the business of insurance. Long standing Supreme Court case law forced the district court to rule that despite the interstate character of many of the transactions "the business of insurance is not commerce"[170] and consequently "insurance" contracts could not be considered "interstate commerce" or "interstate trade" and that therefore the Sherman Act did not apply to the South-Eastern Underwriters Association.

This long standing Supreme Court case law dated back seventy-five years to the 1868 case of *Paul v. Virginia*.[171] At that time insurance was much more local than in 1943 when insurance had become an interstate business. The insurance industry had challenged the legislative powers of the states to regulate the insurance industry. The insurance industry contended that the Constitutions' Commerce Clause limited states from regulating interstate commerce, which in their opinion included the business of insurance.

Paul was a Virginia resident and an appointed agent of several insurance companies incorporated in the State of New York. To be able to work as an agent for foreign (i.e., out-of-state) insurance companies, he applied to the proper Virginia officer of the district for a license. The Virginia statute, an Act of the Virginia legislature, provided that insurance companies not incorporated under the laws of the State of Virginia, are not allowed to carry on its business within the State of Virginia without first obtaining a license for that purpose. It further stated that a license cannot be received until the company has deposited with the Treasurer of the State of Virginia, bonds of a specified character in an amount varying from $30,000 to $50,000. A subsequent Act declared that no person shall, without a license authorized by law, act as an agent for any foreign insurance company.

Neither Paul nor the insurance companies he worked for complied with these requirements and the license was refused. Paul acted as an agent for the New York companies despite the fact that he did not have a license from the State of Virginia.

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169 *Samuel Paul v. the Commonwealth of Virginia (Paul v. Virginia)*, 75 U.S. 168 (1868).

170 Since the Supreme Court in *Paul v. Virginia* held that a Virginia State statute which regulated foreign insurance companies did not offend the Commerce Clause because "issuing a policy of insurance is not a transaction of commerce" (paragraph 183), the statement was repeated, and was broadened in cases similar to *Paul v. Virginia*. This decision placed the authority to regulate insurance with the states rather than with the federal government and the authority to regulate inter-state trade in insurance with the state institutions rather than with the federal Congress. In *Hooper v. California*, 155 U.S. 648 (1894) the statement was reaffirmed and the court added that "the business of insurance is not commerce."

171 *Paul v. State of Virginia*, 75 U.S. 168 (1868).

For the violation of the Statute he was convicted and sentenced to pay a fine of $50. The Supreme Court of Virginia affirmed the decision.

Paul submitted that the state statute conflicted with the Commerce Clause which authorizes Congress "to regulate commerce with foreign nations and among the several states." Paul argued "that these provisions of the Virginia statute are essentially and distinctly a regulation of commerce between Virginia and other states," concluding that the state statute was invalid. The statute could only be found valid if the business of insurance were not included within the term "commerce." Paul referred to *Gibbons v. Ogden*[172] for its interpretation of "commerce" where Chief Justice Marshall had said: "Commerce undoubtedly is traffic, but it is something more: it is intercourse. It describes the commercial intercourse between nations, and parts of nations, in all its branches." According to Paul and supported by the earlier Supreme Court decision in *Gibbons v. Ogden*, because the business of insurance is commerce the Virginia statute was in violation of the Commerce Clause.

In *Paul v. Virginia*, however, the United States Supreme Court disagreed. It was forty years after *Gibbons v. Ogden* and the Supreme Court used a much narrower interpretation of the Commerce Clause power[173] and determined that "issuing a policy of insurance is not a transaction of commerce."[174] As issuing an insurance policy was not commerce, the Commerce Clause did not apply and the states, not Congress, held the power to regulate.

In every case[175] following *Paul v. Virginia* that challenged the Supreme Court's interpretation of the Commerce Clause, state legislation or acts were at issue and state authority to regulate had been challenged. Never were Acts of Congress at issue or was the federal authority to limit the regulatory freedom of the states challenged. In the *South-Eastern Underwriters* case, however, an Act of Congress was at issue for the first time. The Supreme Court was not asked to decide whether

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[172] *Gibbons v. Ogden*, 22 US 1 (1824).

[173] The doctrine of dual federalism had made its entry in legal thinking. See the previous section.

[174] *Paul v. Virginia*, 75 U.S. 168 (1868), paragraph 183: "The defect of the argument lies in the character of their business. Issuing a policy of insurance is not a transaction of commerce. The policies are simple contracts of indemnity against loss by fire, entered into between the corporations and the assured, for a consideration paid by the latter. These contracts are not articles of commerce in any proper meaning of the word. They are not subjects of trade and barter offered in the market as something having an existence and value independent of the parties to them. They are not commodities to be shipped or forwarded from one state to another, and then put up for sale. They are like other personal contracts between parties which are completed by their signature and the transfer of the consideration. Such contracts are not interstate transactions, though the parties may be domiciled in different states. The policies do not take effect – are not executed contracts – until delivered by the agent in Virginia. They are, then, local transactions, and are governed by local law. They do not constitute a part of the commerce between the states any more than a contract for the purchase and sale of goods in Virginia by a citizen of New York whilst in Virginia would constitute a portion of such commerce."

[175] *Hooper v. California* 155 U.S. 648, *Ducat v. Chicago* 10 Wall.(U.S.) 410, *Liverpool & L.Life & Fire Ins. Co v. Massachusetts* 10 Wall.(U.S.) 566, *Fire Assoc.. of Phila. v. New York* 119 U.S. 110, *Noble v. Mitchell* 164 U.S. 367, *New York L. Ins. Co. v. Cravens* 178 U.S. 389, *Nutting v. Massachusetts* 183 U.S. 553, *Northwestern Mut. L. Ins. Co. v. Wisconsin* 247 U.S. 132, *National Union F. Ins. Co. v. Wanberg* 260 U.S. 71, *Bothwell v. Buckbee Mears Co.* 275 U.S. 274, *Colgate v. Harvey* 296 U.S. 404.

states were competent to regulate the business of insurance, but whether a Congressional Act created under the Commerce Clause applied to insurance transactions stretching across state lines thus limiting the freedom of market participants to act.[1-6]

The Supreme Court in the 1943 in the *South-Eastern Underwriters* case was asked:

> "... not to uphold another state law, but to strike down an Act of Congress which was intended to regulate certain aspects of the methods by which interstate insurance companies do business: and in so doing, to narrow the scope of the federal power to regulate the activities of a great business carried on back and forth across state lines."[1-7]

Justice Black delivered the opinion of the Court.[1-8] To answer this question the Court had to explain which part of commerce was subject to federal power. Justice Black found his answer in "some of the great cases" that interpret the Commerce Clause.[1-9]

1-6 *U.S. v. South-Eastern Underwriters Association*, 322 U.S. 533 (1944), paragraph 534.

1-7 *U.S. v. South-Eastern Underwriters Association*, 322 U.S. 533 (1944), paragraph 545.

1-8 Justice Stone dissented and based his conclusion on the interpretation of commerce in light of the insurance business starting from *Paul v. Virginia*. He argued that "in the seventy five years since the decision of *Paul v. Virginia* the Supreme Court has adhered to the view that the business of insurance is not interstate commerce." Justice Stone supported an unbroken line of decisions beginning with *Paul v. Virginia*. His conclusion with regard to the first question is that the formation of insurance contracts, and the business of insurance, is not commerce within meaning of the Commerce Clause. It is not excluded form state regulation and control. He states: "This conclusion seems, ... correct on principle and in complete harmony with the uniform rulings by which this Court has held that the formation of all types of contract which do not stipulate for the performance of acts of interstate commerce, are likewise not interstate commerce."

Justice Jackson, who dissented in part, was of the opinion that "the Court consistently sustained the right of the states to represent the public interest in this enterprise. It did so, wisely or unwisely, by resort to the doctrine that insurance is not commerce and hence is unaffected by the grant of power to Congress to regulate commerce among the several states. ... The whole structure of insurance regulation and taxation as it exists today has been built upon this assumption."

He stated that if the question whether the business of insurance is commerce under the Commerce Clause had been asked for the first time he would have answered it affirmatively. Justice Jackson was of the opinion that the business of insurance is commerce and when it is conducted over state lines it would be interstate commerce and subject to Congressional power. However, since this was not the first time that the question had been considered he suggested a different path to achieve the same result. He reasoned that Congress has regulatory power over every activity which is held to be interstate commerce, and when it acts in relation to such a subject, it often has been held that it has "occupied the field" to the exclusion of the states. The federal legislation defines the regulation and outside the federal regulation the activity is free. Justice Jackson's suggested path was to nationalize insurance supervision by legislation and not by Court decisions.

He concluded that the court should affirm the prior decisions in which it held that the business of insurance is not commerce. Although not held to be commerce, or interstate in character, the business of insurance could be reached by Congress "to prohibit specific activities in its conduct that substantially burden or restrain interstate commerce." This suggested solution would leave state regulation unimpaired as long as it did not conflict with the federal regulation.

1-9 *U.S. v. South-Eastern Underwriters Association*, 322 U.S. 533 (1944), paragraph 549.

Justice Black found the answer to the question in the cases in which the Constitutional interpretation of the extent of the Commerce Clause was unrelated to insurance: *Gibbons v.*

He found "the most widely accepted general description" of commerce subject to federal power in the 1824 case of *Gibbons v. Ogden*.[180] In 1944[181] the Supreme Court returned to the 1824 broad description of commerce subject to federal regulation: "Commerce, undoubtedly, is traffic, but it is something more, it is intercourse. It describes the commercial intercourse between nations, and part of nations, in all its branches."

In *Gibbons v. Ogden* Justice Marshall concluded that the Constitution grants the authority to govern intercourse among the states with the federal government and the authority to legislate commerce among the states with the federal Congress:

> "The power granted to Congress is a positive power. It is the power to legislate concerning transactions which, reaching across state boundaries, affect the people of more states than one; to govern affairs which the individual states, with their limited territorial jurisdictions, are not fully capable of governing."[182]

This led to the conclusion, according to Justice Black in *South-Eastern Underwriters*, that the business of insurance which conducts activities across state lines was not exempt from the authority of the federal government and the regulatory authority of Congress.[183] The business of insurance constitutes "commerce among the several states" and is therefore subject to regulation by Congress under the Commerce Clause. The Supreme Court stated that "no commercial enterprise of any kind which conducts its activities across state lines has been held to be wholly beyond the regulatory power of Congress under the Commerce Clause".[184] The business of insurance was no exception to that rule. For the first time since the Court handed down *Paul v. Virginia* seventy-five years earlier, the insurance industry was subject to federal regulation under an expansive Commerce Clause. *South-Eastern Underwriters* established the authority of the federal government to regulate the insurance market, creating the possibility to liberalize it by limiting both member states as well as market participants in their freedom to regulate and act on the insurance markets.

4 Conclusion

Over the years the European Community has developed into a "legal entity comprised of states for the purpose of pursuing certain common ends and which has been given, to this effect, the power to exercise limited but direct jurisdiction over their citizens, but where for all other fields of public action the individual states maintain their full autonomy."[185] Although not a federation, the European Community resembles the organizational structure of a federal system.

The European states joined in an intergovernmental Community with supranational powers. This cooperation aimed to "promote a harmonious development of economic activities, a continuous and balanced expansion, an

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Ogden 9 Wheat 1, *Lottery case* 188 U.S. 321, *Hoke v. United States* 227 U.S. 308, *United States v. Simpson* 252 U.S. 465, *Brooks v. United States* 267 U.S. 432, *Thornton v. United States* 271 U.S. 414, *Pensacola Teleg. Co. v. Western U. Teleg. Co.*, 96 U.S. 1.

180 *U.S. v. South-Eastern Underwriters Association*, 322 U.S. 533 (1944), paragraph 550.

181 The 1930's new deal abandoned dual federalism.

182 *U.S. v. South-Eastern Underwriters Association*, 322 U.S. 533 (1944), paragraph 552.

183 *U.S. v. South-Eastern Underwriters Association*, 322 U.S. 533 (1944), paragraphs 550-553.

184 *U.S. v. South-Eastern Underwriters Association*, 322 U.S. 533 (1944), paragraph 553.

185 Pernice 1996, footnote 21.

increase in stability, an accelerated standard of living and closer relations between the states belonging to it."[186] It required common action to eliminate the barriers which divide Europe, to ensure economic and social progress, as well as concerted action to remove existing obstacles in order to guarantee steady expansion and a proper functioning of the common market.

The E(E)C Treaty authorized the Community to bind member states and, together with Community institutions, limit states in their authority to regulate and market participants in their liberty to act in order to eliminate intentional barriers and minimize obstacles to interstate trade. The Community is based on the rule of law and the member states' sovereign rights have been limited by the Treaty. The member states must comply with Community law which supercedes state law, is directly applicable, conferring obligations on member states, but also granting enforceable rights to its nationals. The Treaty contains specific prohibitions for states and market participants alike, and attributes selective and specific authority to the Community and its institutions to integrate markets.

The United States of America is a federation. It too is a "legal entity comprised of states for the purpose of pursuing certain common ends and which has been given, to this effect, the power to exercise limited but direct jurisdiction over their citizens, but where for all other fields of public action the individual states maintain their full autonomy."[187] The federal structure was chosen after the Confederation could not solve interstate trade problems. The Articles of Confederation did not grant authority to the Confederation and its institution to limit states' and market participants' freedom to regulate and act. The Confederation was unable to minimize obstacles and eliminate intentional barriers to interstate trade.

In the new Federation the states did not only surrender their international sovereignty, they also limited their interstate sovereignty. The Federation can bind states in matters of war, peace, and treaties, that of levying money and regulating commerce with foreign nations and the Indian tribes, and are limited by the Constitution with regard to fiscal matters, monetary matters, and matters of interstate commerce.

In the Constitution a general authority to regulate commerce among the states was included so the Federation and its institutions would be able to minimize the obstacles and eliminate the intentional barriers to interstate trade which the confederation had been unable to do. This general authority contains no prohibitions, selective grants of authority or tasks for the Federation and the institutions as exist in the EC Treaty. There is no mention made of economic integration, elimination of barriers and limiting states' and market participants' freedom to regulate or act, leaving it to Congress how to use this authority.

The economic integration of markets, the elimination of intentional barriers and minimizing obstacles to free and fair interstate trade to accomplish the proper functioning of their common market, was one of the reasons for establishing a European Economic Community by the European states and a Federation by the confederate states. The means chosen were the same. Create an organization that not only binds the states, as in a traditional international organization or in the confederation that preceded the Federation, but that limits their sovereignty and

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[186] Article 2 EC Treaty.

[187] Pernice 1996, footnote 21.

that grants the institutions the authority to limit the states' authority to regulate and the market participants' liberty to act.

In this chapter I have described the differences in the forms of organization and grants of authority chosen by the European states and the American states to accomplish the same objective, a proper functioning (common) market where intentional barriers are eliminated and obstacles are minimized among the states. In the subsequent chapter I describe the objective of state insurance market regulation: the protection of the interests on the insurance market for a proper functioning of the state market.

Chapter 3

The Objective of Insurance Market Regulation

1 Introduction

In the previous chapter, I described the objective of economic integration as the elimination of intentional barriers and the minimization of obstacles to free and fair interstate trade to accomplish a proper functioning of the common market. Where, for the purpose of economic integration, state regulations and market participants' acts may be considered obstacles and barriers that need to be eliminated, for purposes of state insurance market regulation these regulations and acts form part of the states' insurance law structure that assures the proper functioning of the state insurance market. The elimination of these regulations and acts may undermine the interests that member states aim to protect, and disturb the established balance between the interests that are being protected.

This chapter elaborates on variations in the rules and regulations that govern access to the state insurance market, the organization of the state insurance market, and the behavior of state market participants. I will describe the interests involved, and provide examples of the numerous ways in which interests are protected by state regulation.

Section 2 begins with a brief history of insurance regulation. How insurance regulation developed from the simple regulation of contractual relationships to cover all interactions and activities in the insurance market. Section 3 divides the interests state regulation protects into three categories: the interests of the consumers of insurance services, the interests of the insurance providers, and the interests of the state (other than as consumer or provider of insurance services), in the insurance market. This section provides examples of the different ways in which states (used to) protect these interests as well as the variation in the intensity of state regulation.

I do not aim to be exhaustive in recounting either the interests of the insurance market or state regulations. I define the objective of states' insurance regulation as the protection of the interests in the states' insurance markets to assure its proper functioning, and provide a sample of these insurance market interests and the variety of ways in which states could, and have regulated, to protect them. Section 4 summarizes and concludes the chapter.

2 History of Insurance Regulation

One of the oldest recorded regulations with regard to the transfer of risk can be found in the Babylonian Code of Hammurabi from 2250 B.C. The Babylonians traded outside their local markets. To encourage trade with other markets despite the distances and danger and to increase trade (which could be very profitable), merchants developed a loan for traders with an element that eliminated the trader's risk. Among other trade matters, the Code of Hammurabi regulated this loan.

The loan was given to the trader by the merchant, either in the form of money or goods, in return for interest. The trader could buy or borrow goods from the

merchants to trade in other markets. Included in the loan was the understanding that when the merchandise arrived safely in the other markets and was traded, the trader had the obligation to repay the loan with interest or a percentage of the profits. The attractiveness, and success, of this loan was the extra clause. Because trading over distances was profitable but very dangerous, it was difficult to find traders who were willing to take great (physical and economic) risks. It was in the merchants' interest to trade their goods[188], and with this form of loan the merchant rather than the traders bore the risk. The law did not obligate traders to repay the loan if the goods were lost due to robbery or accident.[189] This Babylonian loan, stipulated in a Code, is the first recorded form of (mutual) insurance[190] in history.[191]

While mutual insurance implies interest by the insurer in the goods he insures, non-mutual insurance involves a party that is willing to insure goods he has no interest in. The Roman regulation in the *Corpus Juris Civilis*[192] of a maritime loan very much resembled the Code of Hammurabi in its regulation of loans for trade and each parties' obligations. The Romans, however, not only used the form of mutual insurance for trade, they also introduced non-mutual insurance.

As early as 215 B.C.[193] the Roman government insured the merchandise of traders against loss by accident if they undertook the dangerous task of delivering goods from Rome to the battlegrounds in Iberia. The Roman government had no interest in the merchandise, it wanted to encourage traders to bring goods to its people. In return for insurance the government did not receive a premium but saw its interest in rendering services to its people taken care of.[194] All the traders that took their merchandise to Iberia were insured by the Roman government.

In addition to trade insurance, other forms of insurance developed separately from trade. The family units and later medieval guilds[195] are responsible for the development of a system of mutual insurance against fire. These family units were self-contained and their members helped one another to rebuild a home lost through fire. Later mutual liability fell on all members of a society, a village or guild.[196] A development took place from assisting members of the same community, whether that was a family unit or a village, to the creation of a mutual fund in which

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188 C.F. Trenerry, *The Origin and early History of Insurance, Including the Contract of Bottomry*, 1926, P.S. King & Son, Ltd, 58.

189 Trenerry 1926, 53.

190 Mutual insurance implies an interest of the insurer in the goods he insures. This first form of insurance was a mutual insurance (or bottomry). Parties entered into an agreement that the lender would not be repaid in case of loss of the (ship and) merchandise by accident. If the goods were traded as planned the borrower was to repay the loan and pay the prize for the loan in the form of profits or high interest on the loan made available to him.

191 Trenerry 1926, 53.

192 Sixth century (529-535).
See for further reading H. F. Jolowicz, *Historical Introduction to the Study of Roman Law*, 2nd ed, Cambridge: University Press 1952.; H. F. Jolowicz *Roman Foundations of Modern Law* Roman foundations of modern law, Oxford, Clarendon press, 1957; A.T. von Mehren, *The civil law system: cases and materials for the comparative study of law*, Boston [etc.]: Little, Brown and comp. 1957.

193 Trenerry 1926, 108. Found in a passage from Livy.

194 Trenerry 1926, 114.

195 Trenerry 1926, 243.

196 Trenerry 1926, 248.

every member had to pay their share in the 13th century A.D.[197] Non-mutual insurance against fire and other losses developed much later.[198] State regulation of fire insurance, as with trade insurance, remained limited to the contractual relationship of the parties.

Although governments regulations laying down insurance rules appear more regularly from the 14th century, they continue to focus on the contractual relationship of the insurer and the policy holder.[199] It is not until the Industrial Revolution mass migrations to the cities, and the modernization of society with its consequent increase in the use of insurance, that regulations begin to include supervision of insurance providers and the operation of the insurance industry in the market.

The expansion of overseas commerce, the growing industrial cities with large populations and warehouses, increased not only the demand for insurance services, but the supply of insurance products as well.[200] In addition to the initial *ad hoc* underwriters, the 18th century saw the formation of underwriter organizations to collect premiums, gather reserves and settle losses.[201] This development from ad-hoc and limited insurable interests into an economic activity in which huge fortunes and many interests were at stake resulted in the regulation of the insurance markets extending beyond contractual relationships.

Until the beginning of the 19th century, the contractual freedom had prevailed under the assumption of equality between the insurer and the insured. State regulation concerned itself solely with the contractual relationship of the parties. The developments in the 19th century made clear that weaker parties to a contract existed and that they needed their interests protected. The state became aware that insurance companies and individual policyholders were not always equal contractual parties and that both policyholders and the insured needed state regulation to protect their interests against those of the underwriter organizations.[202] In addition to protecting the consumer interests, states started to protect policyholder interests in the insurer's solvency of the insurer by regulating the financial supervision of underwriters' activities.

The competition among insurers led to charging premiums that were insufficient to cover losses when they occurred which in turn resulted in bankruptcies. In the

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197 Trenerry 1926, 256.

198 It is not until the 17th century that documentation of contracts by private persons that offer non-mutual insurance against fire start to appear. Dorhout Mees mr T.J., vierde druk *Schadeverzekeringsrecht*, W.E.J. Tjeenk Willink, Zwolle 1967, 24.

199 Dorhout Mees 1967, 10.

200 Trenerry 1926, 186.

201 Harold E. Raynes, *A History of British Insurance*, 1964, Pitman Publishing Co., p. 73.

202 Duijkersloot, A.P.W. (1995) *Europese integratie verzekeringsbedrijf en systemen van overheidstoezicht*, Universiteit van Amsterdam, Amsterdam, p. 12.
Borgesius, J. (1974) *Dienstenverkeer, vestigingsrecht en verzekeringsbedrijf in de Europese Economische Gemeenschap*, Kluwer, Deventer, p. 23.
Wansink, J.H. (1997) *Verzekering, een juridisch product in een kritische buitenwereld*, Het Verzekerings-Archief 74, 102.
Fritz Reichert-Facilides, Hans Ulrich Jesserun d'Oliveira eds., *International Insurance Contract Law in the EC*, Proceedings of a Comparative Law Conference held at the European University Institute, Florence, May 23-24, 1991, Kluwer Law and Taxation Publishers, Deventer the Netherlands, 1993, at 4.

American states of New Hampshire, Massachusetts, and Vermont commissions were created to supervise the insurance industry, and in particular the solvency of insurance providers. Elizur Wright, commissioner of the State of Massachusetts, saw a law passed that obligated life insurance companies to form technical reserves.[203] Between the end of the 19th century and the early 20th century most north American and western European states developed insurance regulation that provided rules and regulations for insurance companies and their supervision.[204]

Insurance market regulation was soon thereafter expanded to include the investment of capital, policy rates, market access, taxation of insurance companies and competition. With the expansion of insurance services the interests of the insurance market increased in kind and number, triggering a growth of state insurance market regulation.

3 The Protection of the Interests on the Insurance Market

Insurance is the transfer of financial consequences of risk materialization. While the objective of insurance is the protection of one interest, that of the insured against the financial consequences of risk materialization, the objective of state regulation is the protection of the interests in the insurance market. Although these interests include the interests of the policyholder, they are not limited to them. They also include the interests of the provider of insurance products and the interests of the state.[205]

Although the interests in the state insurance markets are comparable, and the objective of state regulation is the same, i.e., the protection of the interests in their market to assure its proper functioning, the appreciation of these interests and the protection provided varies per state as does the states' insurance market regulation.

Interests in the insurance market can be divided into three categories: consumer interests, insurance provider interests, and state interests. The objective of state insurance regulation is to protect these three categories of interests, to a lesser or greater degree, simultaneously. In the subsequent sub-sections I discuss these three categories and some of the regulations that protect them.[206]

3.1 Regulations Protecting the Interests of the Consumer

The consumer on the insurance market is the party that transfers risk for a price, or the party for whom risk is transferred for a price, against the financial consequences of risk materialization.[207] Consumers of insurance services pay for services they may

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[203] Borgesius 1974, p. 17.

[204] See for developments in the Netherlands, France, Italy, Belgium, Luxembourg, Germany, United Kingdom, Denmark and Ireland: Borgesius 1974, 17 *et sqq*.

[205] Other than as a consumer of insurance services or a provider of insurance services.

[206] This papragraph does not attempt to give an exhaustive list of interests on the insurance market nor an exhaustive list of existing state regulations. It merely gives a sample of the various insurance market interests and the state insurance regulations that protect these interests.

[207] This definition of consumer interests includes the interests of the policyholder as well as the interests of the insured. Reinsurance activities by insurers are excluded from this definition.

require in the future.[208] This gives consumers a twofold interest: buying insurance services and relying on the insurance service if and when risk materializes. The state regulations that protect these interests can be divided into two categories, those that make insurance services available and affordable and those that protect (future) satisfaction of insurance claims.

3.1.1 Availability and Affordability

To transfer risk and claim coverage of the financial consequences of risk materialization, risks first have to be insurable. If insurance is not offered, is too expensive, or reserved for a select group only, risk cannot be transferred, i.e. insured.

There are various manners in which insurance services are made both available and affordable by state regulation. If the market is allowed to work, along with state anti-trust regulations to assure competitiveness in the insurance market, insurance can be offered at an affordable price. If, however, despite the demand for insurance services and competition in the market there is lack of supply or the service remains too expensive, state regulation can aid in the availability of (affordable) insurance.

The lack of affordable insurance services can be related to a certain group of consumers or the place where the risk is situated. In the United States as well as in the states of the European Community, regulations have been implemented to ensure that affordable insurance is available to consumers for whom it would be otherwise unavailable or unaffordable under regular market conditions. These state regulations that protect consumer interests take many forms. From regulations regarding the supply of insurance, to policy rates, and the availability of state sponsored insurance.[209]

> "Of the 146.2 million private passenger automobiles insured in the United States in 1995, 5.4 million, or 3.6 percent of the total market, were insured through residual market[210] mechanisms. The residual market's 3.6 percent share of the total market is the lowest since 1972. In the past 25 years, a high of 7.4 percent was recorded in 1978.
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> The number of private passenger autos insured through residual market mechanisms is not distributed evenly among all states. Depending upon such factors as government regulations and industry competition, the size of the residual market varies dramatically from one state to another. For example, the resi-

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[208] Reversed production cycle. One pays for a service that one may require well into the future.

[209] These regulations are not limited to protecting the interest of the consumers in the availability of these insurances, but also protect the state's interest in executing its public policy tasks.

[210] "The residual market (also known as the "shared market") consists of those consumers who are unable to purchase automobile insurance through the voluntary market due to a variety of factors, such as their driving history or status as first-time drivers. Due to these factors, insurers expect that the future experience of these drivers will be higher than the predictions of losses and expenses underlying their voluntary market rates. For the vast majority of jurisdictions, this business is shared among the companies in two ways: (1) applications in the residual market are divided equitably through direct company assignment of the applicant, or (2) participation in the results of various pooling mechanisms."
https://www.aipso.com/faq_residual.asp

dual market mechanisms in such states as Utah, Ohio and South Dakota are utilized to insure fewer than 150 private passenger autos. In contrast, in each of the ten largest states, more than 100,000 private passenger autos are insured through the residual market. These ten states comprise 94.9 percent of the countrywide private passenger residual market business. "[211]

"The California Automobile Assigned Risk Plan (CAARP) was created in 1947 by the state legislature with the essential purpose to provide automobile liability insurance to those who "in good faith" are entitled to but are unable to procure such insurance through ordinary methods. The statute indicates a legislative intent to encourage drivers to seek insurance in the voluntary market using the assigned risk plan only as a last resort."[212]

"The Minnesota Automobile Assigned Risk Plan (MNAIP) became effective December 18, 1942. The name was changed to the Minnesota Automobile Insurance Plan. The Plan became statutory effective January 1, 1972. All insurers writing automobile insurance in Minnesota are required to participate in the MNAIP. All agents and brokers holding a valid license to transact automobile insurance in the state of Minnesota are eligible to submit applications to the Plan. Applicants must declare and certify that they have tried and failed to obtain automobile insurance in Minnesota within the preceding 60 days and have been unable to obtain such insurance at rates not exceeding those applicable under the Plan."[213]

"The New York Automobile Insurance Plan (NYAIP) is the central mechanism established pursuant to article 53 of the New York Insurance Law to provide auto liability and physical damages coverages to those insured who are unable to obtain such auto insurance in the voluntary market. All insurers writing automobile insurance in New York State must participate in the NYAIP by providing such insurance.

All agents and brokers holding a valid license to transact automobile insurance business in New York State must be certified by the Governing Committee in accordance with Standards and procedures approved by the Superintendent of Insurance prior to submitting applications to the Plan. Applicants must declare and certify that they have tried and failed to obtain automobile insurance in New York State within the preceding 60 days and have been unable to obtain such insurance at rates not exceeding those applicable under the plan."[214]

"A health insurance "mandate" is a requirement that an insurance company or health plan cover (or offer coverage for) common – but sometimes not so common – health care providers, benefits and patient populations." "In 1965, only seven benefits were mandated by the states; today, the Council for Affordable Health Insurance (CAHI) has identified more than 1,800 mandated benefits and providers. More are on their way. In January 2004 alone, CAHI followed the introduction of 295 new mandates in states across the country. This number only increased as the legislative sessions progressed.

"... several states have adopted legislation that requires health insurers to

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[211] http://www.aipso.com/faq_residual.asp
[212] http://www.aipso.com/ca/
[213] http://www.aipso.com/mn/
[214] http://www.aipso.com/ny/

accept anyone who applies, regardless of their health status, known as "guaranteed issue." Or they limit insurers' ability to price a policy to accurately reflect the risk an applicant brings to the pool, known as "community rating" or "modified community rating."[215]

"Minnesota Comprehensive Health Association was established in 1976 by the Minnesota Legislature to offer policies of individual health insurance to Minnesota residents who have been turned down for health insurance by the private market, due to pre-existing health conditions. MCHA is sometimes referred to as Minnesota's "high risk pool" for health insurance or health insurance of last resort.

Currently, about 30,000 Minnesota residents are insured by MCHA throughout the State of Minnesota. Minnesota Comprehensive Health Association is a non-profit Minnesota corporation, organized under Chapter 317 of Minnesota law. MCHA is not a state agency. It is regulated by the Minnesota Department of Commerce. A nine-member board of directors provides policy direction to MCHA. An executive staff manages the administration of the risk pool. Since its first year of operation in 1977, MCHA has contracted with an outside organization to perform day to day operations of the plan.[216]

"New York offers many state-sponsored programs aimed at ensuring New Yorkers have access to quality, affordable health care. New York's Child Health Plus program, which has been helping families provide health insurance for their children since 1991, has been a model for children's health insurance programs across the nation. In December 1999, the New York Legislature adopted the Health Care Reform Act – HCRA 2000. The HRCA 2000 package of health care initiatives included two new programs – Family Health Plus and Healthy New York – aimed at making sure New Yorkers are provided with greater access to more affordable health care coverage."[217]

In the Netherlands about 10 million people (population 16 million) are insured in the "Ziekenfonds" (public health care insurance). Every employed individual with an annual income under 33,000 euro, every self-employed individual with an annual income under 21,050 euro, and individuals with state benefits have access to public health care. Acceptance by *Ziekenfonds* insurers is obligatory. All those with an annual income above these limits are required to have private insurance. This current system will be replaced in 2006 by the "Zorgverzekeringswet" (health care insurance law), a single healthcare insurance system for all Dutch citizens, becomes law. Insurers are obliged to accept everyone and cannot refuse applicants with a predisposition. The state drafts a compulsory standard insurance policy. Children under 18 pay no premium. The new compulsory health care insurance system is financed through a zorgtoeslag[218] (higher contributions for higher incomes).

(Before Community regulation of the insurance markets) in Germany, the

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215 *Health insurance mandates in the States 2004*, Council for affordable health insurance, Prepared by: Victoria Craig Bunce, Director of Research & Policy, JP Wieske, Director of State Affairs, July 2004, http://www.nahu.org/government/issues/mandated_health/CAHI_Mandates_2004.pdf

216 http://www.mchamn.com/

217 http://www.nyhpa.org/index_new.cfm?page_id=42

218 Wet op de Zorgtoeslag. http://www.minvws.nl/dossiers/zorgverzekering/default.asp

state set the maximum price of insurance. The policy conditions as well as the price needed to be approved by the government before being offered to the public. This way the German government ensured that affordable insurance was offered to individuals. If the price set by the state was too low for insurers to offer insurance, the government offered the insurance instead. Health care, even today still not harmonized in the European Union, is still controlled by the German state, both price and policy conditions, as will be in the Netherlands, for the standard insurance package, with the introduction of the new compulsory healthcare insurance system.

In the United Kingdom, "the National Health Service or NHS as it is more commonly known, was set up on the 5th July 1948 to provide healthcare for all citizens, based on need, not the ability to pay. The NHS is funded by the taxpayer and managed by the Department of Health, which sets overall policy on health issues. It is the responsibility of the Department of Health to provide health services to the general public through the NHS."[219]

3.1.2 Satisfaction of the Insurance Claim

The state insurance market regulations that protect consumer insurance claims consist of two categories: the continuance of the insurance policy and the effectuation of the claim.

Consumers' interests with regard to the continuation of the policy are protected in various manners in different jurisdictions. Continuation of the policy is threatened by cancellation of the contract by the insurance provider, either due to breach of contract or misrepresentation by the policyholder or insured, or due to the bankruptcy of the insurance provider.

States' insurance contract law regulates the cancellation of the policy by one of the contractual parties. It regulates the conditions under which an insurance policy may be canceled. Because consumer interest in the continuation of the policy is great, cancellation of the policy by the insurance provider is often limited and governed by strict rules. To eventually effectuate a claim for coverage the consumer must understand the policy, or contract, and the rights and obligations thereof for the continuation of the policy. Unclear policy terms and "small print" can be misinterpreted or simply missed which could lead to a denial of an insurance claim. The states' approach to clear policy conditions varies between regulation requiring the prior approval of policy conditions, consumer protection rules for insurance contracts, and their judicial review.

"Germany had (prior to Community regulation) a long standing tradition of requiring approval by the supervisor of contract conditions and premium rates. In Germany it was believed that close and detailed control of policy conditions and premium rates increased transparency in the market, minimizing differences between companies and making it easier for potential policyholders to choose between available products.[220]

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[219] http://www.nhs.uk/Default.aspx

[220] Jean Lemaire; Krupa Subramanian, *Insurance regulation in Europe and the United States*, S.S. Huebner Foundation monograph series; 16, Philadelphia, PA: S.S. Huebner Foundation for

In the United States "Policy forms, including applications and endorsements, for property and casualty insurance are frequently subject to filing and approval requirements. A standard fire insurance policy is required by statute in some states including New York, with some variations from state to state."[221]

In the USA all states have a supervisory institution or insurance commissioner whose task it is to supervise the insurance providers in the state. It grants licences and authorizes insurers to do business. " Because the variety of insurance policy forms (including riders, endorsements, and schedules) is virtually unlimited, and because thorough regulatory scrutiny of all forms prior to their use is not always possible, most state insurance laws include the provision which states that any policy issued in violation of the insurance laws is automatically deemed to be amended to conform to the applicable requirements."[222]

"Another very common kind of statutory provision, essential to creating a valid and enforceable insurance contract between the parties, concerns the representations made by the insured to the insurer prior to, or at the time of, policy issuance. State insurance laws usually provide that, at least with respect to life and health insurance, any statements (such as statements about a person's health) made by or on behalf of the insured or other applicant as part of the application for insurance, or otherwise to induce the issuance of a policy, are deemed to be "representations" and not "warranties". Whereas a breach of warranty in itself can make an insurance contract voidable (i.e., invalid at the insurer's option) a representation must be false and "material" in order to produce the same effect. A representation generally is not material to the making of the contract unless the insurer would have refused to make the contract if it had known the representation was false."[223]

"Life and health insurance policy forms, including group policies and certificates of coverage, riders, endorsements, and applications, usually must be filed with the regulator and approved before use. The variety of the required, prohibited, and permissible provisions in the various jurisdictions is enormous, most notably in the area of mandated health insurance coverages, where as many as 800-odd different requirements can be counted."[224]

In Europe, "to some extent in France, but even more in Germany, the insured may withhold information or give wrong information without the insurer being able to cancel the policy or withhold the payment of claims."[225]

Insurance Education, Wharton School, University of Pennsylvania, 1997, 8.
For more information about Germany see Duijkersloot 1995 and Borgesius 1974.

221 Peter M. Lencsis, *Insurance Regulation in the United States*, an overview for business and government, Quorum books, Westport Connecticut, London, 1997, 63.

222 About half of the states do require insurers to submit their policy language and proposed rates before use, but about half allow insurers to start using the language, at their chosen rate, and only a very few will be required to change the language or price after the fact.

223 Lencsis 1997, 61-62.

224 Lencsis 1997, 62.

225 Jörg Finsinger, *European market integration and the European insurance industry: reasons for trade, barriers to entry, distribution channels, regulation and price levels*, Research report / Centre for European Policy Studies. Financial Markets Unit; 4, Centre for European Policy Studies. Financial Markets Unit, Brussels, 1990.

In case of involuntary cancellation of the policy, due to the application for a letter of licence or moratorium, or the bankruptcy of the insurer, state regulations can protect consumers' interests by continuation of the policy. These regulations can either provide for the continuation of the company or, if the company goes bankrupt, the continuation of the policy with another insurance provider.

If the continuation of the company is possible, regulations provide for individuals, supervisory agencies or institutions to assume control over the insurer and continue or reorganize the business in the interest of the policyholders.[226] If continuation of the company is impossible, state regulation can provide for a transfer of policies to insurers that assume (part of) the bankrupt insurers responsibilities[227], or provides for guarantee funds that limit the consumer damages.[228]

Consumer interest in a solvent insurance provider is related both to the continuation of the policy, as well as the effectuation of the claim. For both the continuation of the policy and claim satisfaction, the insurer needs to be solvent. Where the insurance provider is solvent, the threat of involuntary cancellation of the policy by the insurance provider is absent, and the effectuation of the claim is, at least financially, possible.

Consumer interest in the solvency of the insurer is protected by insurer supervision regulation that, although generally found in state insurance market regulations, can greatly vary per state.[229] There are many forms of insurance supervision. The most commonly used distinction is between normative supervision structures and material supervision structures. Normative supervision is ex-post supervision where within the leeway of state-imposed general rules, the insurance provider is free to perform its business. State regulations generally contain solvency rules combined with a requirement to publish an annual report. State interference is limited to supervision afterwards with, if necessary, the authority to interfere in the management of the insurance company. Material supervision on the other hand is ex-ante supervision where detailed government regulation dominates the supervision structure. The rules vary from prior approval of insurance policies to compulsory imposition of insurance rates. The supervision is not repressive as with normative supervision but rather preventive.[230]

To effectuate a claim in case an insurer denies, refuses or is unable to satisfy the claim, state regulations can protect consumer interests in several ways. These vary from the possibility to effectuate the insurance contract before a court of justice, the

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[226] In the Netherlands the "opvangregeling leven" was integrated on 22 December 2001 in the 'Wet toezicht verzekeringsbedrijf (WTV)' the Dutch law on the supervision of insurance providers. It is a state regulation that provides for the injection of capital in life insurance companies to prevent bankruptcy which was introduced after bankruptcy of life insurer Vie D'or.

[227] In the Netherlands this is covered by the WTV where the insurance supervisor (De Nederlandsche Bank) is granted the authority to install a 'noodregeling', appoint a curator to see if the insurer and the policies can be saved or work with the insurer to transfer the policies to another insurer.

[228] Takahiro Yasui, *Insurance and private pensions compendium for emerging economies, book 1 part 1:2)b Policyholder Protection Funds: Rationale and Structure*, Organisation for Economic Co-operation and Development, 2001.

[229] Borgesius 1974, 27.

[230] Vermaat, A.J., *Zicht op toezicht*, in: het Verzekeringsarchief, volume 70 1993 nr 1, 70.

financial supervisory authority, or placing complaints before an independent disciplinary college, and in case the insurer is unable to pay, the provision of guarantee funds created for victims of insolvent insurance providers.

In the Netherlands one can sue in court unless the insurance contract stipulates a different conflict resolution procedure. In the UK you can take your case to court although the FSA advises using the independent complaint scheme because it is quicker and there is usually no charge.

"Unlike other European markets, in Italy the so-called insurance Ombudsman does not exist. However national legislation has entrusted it with competence concerning in particular transparency in relations between undertakings and policyholders, as well as information for consumers. ISVAP, the Italian supervisory body for private insurance carries out these functions vis-a-vis all undertakings operating on the Italian market, including those having their head office in another EU country and operating in Italy by way of establishment or of free provision of services."[231] In the UK there were two independent complaints schemes: Ombudsman and arbitration. They fused in 2001 and formed a new single organization called the Financial Ombudsman Service. This provides a one-stop shop and makes it easier to know where to go if you cannot resolve your complaint with the firm.[232]

In the Netherlands the *Ombudsman Zorgverzekeringen* handles complaints regarding health insurance, the *Stichting Klachteninstituut Verzekeringen* all other insurances, and the *Ombudsman Pensioenen* addresses complaints about pension funds. *De Nederlandsche Bank* supervises Dutch insurance providers and pension Funds.[233]

In the State of California, USA, the California Insurance Guarantee Association (CIGA) and the California Life and Health Insurance Guarantee Association (CLHIGA) meet the obligations of insolvent insurers by administering and disbursing covered claims. Generally recovery is not 100%. Valid policyholder claims that are either not covered by insurance guarantee associations or are in excess of the limits paid by the insurance guarantee associations are administered by CLO (Conversation & Liquidation Office). The purpose of the CLO is to protect policyholders whose insurance companies are experiencing severe financial problems. In order to assist insurance consumers, the commissioner applies to the Superior Court of California for a conservation order to place a financially troubled company in conservatorship. When the commissioner becomes the conservator of a company, an investigation by the CLO is initiated to determine if the company can be rehabilitated. Every effort is made to enable the company to regain a strong financial footing. However, if it appears that the company cannot be saved at the time of liquidation or at a later date, then the commissioner applies to a court for permission to liquidate the company.[234] The guarantee fund only applies to California based insurers.

"In the USA there are, typically, two guaranty funds in each state, one for

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231 www.isvap.it/isvpreuk.htm

232 http://www.financial-ombudsman.org.uk/default.htm

233 http://www.dnb.nl/

234 California department of insurance (www.insurance.ca.gov/CLO/CLO_Home.htm).

property liability policies and one for life-health. Except for New York state these fund work on a post-insolvency assessment basis. In the even of an assessment, companies are assessed an amount of that in proportion to the amount of premiums they write in that line of business. In New York, companies pay an annual premium into the state insurance fund which is available to fund liabilities to policyholders."[235]

In the EU, France, Ireland, and the United Kingdom have general policyholder protection funds. These funds cover a "wide range of insurance classes, both compulsory and non-compulsory, including most of the products of an insurance company if not particularly specialised."[236] "Austria, Denmark, The Netherlands, Portugal, Spain and Sweden have no fund."[237] In the Netherlands however the law: "Wet Opvangregeling" of 22 December 2001 provides for preventative measures to aid a life insurer through difficult times. The objective is to assure the continuity of the policies through a temporary measure, externally financed. The discussion for a policyholder protection fund is ongoing. Belgium, Germany, Italy, and France have a fund to protect the victims of road accidents only."

In the UK, the Financial Services Compensation Scheme (FSCS) (created on 1 December 2001 when the Financial Services and Markets Act 2000 came into force at which time the Investors Compensation Scheme, Policyholders' Protection Scheme, Deposit Protection Scheme and Building Societies Investor Protection Scheme merged) may act if it decides that an insurance company is in such serious financial difficulties that it may not be able to honor its contracts. The Scheme will first try to ensure continuity of insurance by asking other firms to take on the contracts so that the customers' policies remain intact. If that is not possible then the Scheme compensates to eligible policy holders. These are policyholders insured by authorized insurance companies in the UK, or in some cases in the European Economic Area (EEA), the Channel Islands or Isle of Man. The level of policy protection differs depending on the type of insurance policy. When insurance is compulsory (for example car insurance) full compensation is possible. The Scheme is funded by the industry and covers deposit insurance and investments.[238]

3.2 Regulations Protecting the Interests of Insurance Providers

The insurance provider is the party that assumes the financial consequences of risks for a price. It does so on the basis of a risk assessment and the accumulation and investment of the collected premiums.

The interests of the insurance provider are, like the consumer's, twofold. The solvency, viability and profitability of the insurance provider depends on accurate risk assessment in combination with the accumulation and investment of capital. The interests of the insurance provider then are accurate risk assessment (economic function)[239] and sufficient capital accumulation (capital function).[240] The state

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235 Lemaire 1997, 48.

236 Yasui/Organisation for Economic Co-operation and Development, 2001.

237 Lemaire 1997.

238 Www.fsa.gov.uk/consumer/consumer_help/compensation/mn_insurance.html
See also www.fscs.org.uk

239 Holsboer, J.H., *Repositioning of the Insurance Industry in the Financial Sector and its Economic*

regulations that protect the interests of the insurance provider mainly concern the interest in accurate risk assessment. The state regulates the accumulation and investment of capital, for example rules on tax advantages. However, most statues regarding the investment of reserves mainly aim to protect consumer interests of the consumer – in a solvent insurer – and the state – in a reliable and financial healthy industry.[241]

3.2.1 Risk Assessment

An insurance provider assumes risk for a price based on risk assessment. Assuming risk requires charging sufficient premiums for claims. The premium is based on risk assessment as well as expected investment revenues. Without accurate risk assessment an insurer is unable to determine the premium necessary for the accumulation of sufficient capital to satisfy the consequences of the risk.

Risk assessment is based on statistics. Some statistics are available and easily accessible to insurance providers, such as life expectancy statistics for the risk assessment of life insurance. Other statistics not readily available are collected by the insurance provider based on its own data. The insurance provider has an interest in accessing as much risk-data as possible. After all, with more information risk assessment accuracy increases and the insurance provider can better determine the price for a particular risk.

When statistics on risks are not public and available only in the data collections of the various insurance providers, cooperation between insurance providers in the exchange of data increases the overall accuracy of risk assessment. Cooperation between companies, however, can disturb competition. Although working in trusts and jointly determining the price of goods or services is generally forbidden to avoid market disruptions and maintain competitive forces, states' insurance regulation sometimes allow cooperation to protect insurance providers interests in their need to collect and exchange risk data for accurate risk assessment. States that allows insurers to work together for risk assessment purposes do so mainly for data acquisition. This regulation may exempt insurers from anti-trust legislation and allow direct cooperation between insurance providers in order to share risk-data. Through direct cooperation, or indirect cooperation through a third organization, insurance providers jointly collect statistical data for risk assessment. Contrary to anti-trust regulation for the maintaining of competitive forces, states' insurance regulations allows insurance providers to jointly determine the risk, but not the price[242] of risk transfers either by providing each other with information or through a third party.[243]

Role, in The Geneva Papers on Risk and Insurance, vol.24 no 3 July 1999, at 278.

[240] Holsboer 1999, 278.

[241] See section 3.3.2.

[242] Rating agencies in the USA are forbidden to determine the price of risks. They can provide the assessment of the risk but need to leave the determination of the price of risk to the insurers.

[243] In the USA "Even before passage of the McCarran-Ferguson Act, the judicially created "state action" doctrine made the federal antitrust laws inapplicable to certain business activities undertaken to comply with mandatory provisions of state law. This doctrine, which is associated primarily with the Supreme Court's 1943 decision in Parker v. Brown (317 U.S. 341), holds that the Sherman Act in particular was not intended to, and therefore does not, apply to

In the United States of America "many property-liability insurance companies submit their loss information to advisory organizations, which pool the data to compute trended loss costs. The insurance services office (ISO) originally owned and controlled insurance companies, provides rating and actuarial services related to property-liability insurance, including the development of policy forms. It computes and publishes trended loss data for most property and liability insurance lines other than workers compensation. The National Council on Compensation insurance (NCCI) performs similar services for workers compensation insurance. Historically these organizations computed advisory rates form the loss information furnished by its member insurers and filed these rates with the state for approval. Thus, the member companies saved the time and expense involved with rate filing. In the 1980's however, this system was criticized as being anti-competitive. Critics charged that these bureaus were a form of price fixing because the member companies were essentially charging the same rates. In response to the outcry, the ISO, in 1989, and the NCCI in 1990, announced that it would stop providing advisory rates to its members, rather it would now only publish trended loss costs. To these costs, insurers could develop and add their own factors for expenses, profits, and contingencies. Interestingly, no rating bureau exists in the life and health insurance industry."[244]
European Competition law allows cooperation among insurance providers with regard to the joint calculation of premiums and studies of risks.[245]

3.2.2 Accumulation and Investment of Capital

The capital function of an insurance provider is the accumulation and investment of capital necessary to assume risk. When a risk is accurately assessed it is the task of the insurer to accumulate and assure sufficient funds for the settlement of valid claims. It is in the interest of the insurance provider to accumulate sufficient funds.

State regulation however is aimed not at facilitating the interest of the insurance provider, but regulates insurance investments to assure the solvency of insurers and steers or even limits the insurance provider in his choice where and in what to invest. While some state regulations provide tax incentives for investment, other

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business activities that are conducted under a state legislative mandate." "Although substantial uncertainty exists, it is generally thought that the state action doctrine would even in the absence of the McCarran-Ferguson Act, immunize certain insurance industry collective activities such as statistical gathering and rate making if those activities were affirmatively required by state law." "Related to the state action doctrine is the "Noerr-Pennington" doctrine, which is derived from two Supreme Court cases, Eastern Railroad Presidents Conference v. Noerr Motor Freight, Inc.(365 U.S. 127, 1961) and United Mine Workers v. Pennington (381 U.S. 657, 1965) decided in 1961 and 1965 respectively. This doctrine states generally that collective activities aimed at seeking legislative or regulatory changes are exempt form the application of the antitrust laws, primarily because of the First Amendment's guarantee of freedom of speech. The activities of insurance companies in this regard are no exception." Peter Lencsis 1997, 6-7.

[244] Lemaire 1997, 37.

[245] Commission Regulation (EC) No 358/2003 of 27 February 2003 on the application of article 81(3) of the Treaty to certain categories of agreements, decisions and concerted practices in the insurance sector (Text with EEA relevance), Official Journal L 053, 28/02/2003 P. 0008-0016. See chapter 5.

state regulations prohibit certain investment practices and place limits on the freedom of insurers in their investment choices, and stipulate the amounts as well as the location of investment.[246]

> Before Community regulation, in Belgium insurers were limited in their freedom to keep capital. The law required technical reserves to be deposited in Belgium's national bank. This included the technical reserves of insurance companies that sell insurance in Belgium. In the Netherlands, the "Wet op het Levensverzekeringsbedrijf"[247] (Law on life insurance business), as well as the "Wet op het Schadeverzekeringsbedrijf"[248] (Law on non-life insurance business), had different requirements for access to the market for national and foreign insurers. Although all insurers were required to maintain a reserve, foreign insurers were specifically required to hold the reserve in the Netherlands.[249]
>
> Since the enactment of European insurance regulation, the localization of the technical reserves is required in the European Union, not differentiating between the member states. Exceptions to this rule are allowed, that is, member states can, and some do, allow insurance providers to deposit their technical reserves outside the European Union.
>
> In the United States every state has its own regulation concerning the investments of insurance providers.[250]

3.3 Regulations Protecting the Interests of the State

States vary in their regulation and protection of their national insurance market.[251] As I have shown, these interests include consumer as well as insurance providers' interests in the insurance market. These interests also include those of the state, apart from its role as a consumer or provider.

The interests of the state in the insurance market differ from those of consumers and insurance providers. While the consumer and insurer interests in the insurance market are all related to risk transfer, the state's interests are, in addition to safeguarding the consumer and the insurance provider in risk transfer, the proper functioning of the market through the preservation of the confidence in, and the integrity and stability of the national financial system.[252] The regulation of the state's

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246 In the interest of the policyholder, to assure the solvency and the presence of assets in case of bankruptcy of the insurer, or in the interest of the state, the financial market economy, investing money in the economy of the state.
Lencsis, 1997.

247 Wet van 22 December 1922, Stb. 716.

248 Wet van 23 September 1964 Stb 409 houdende bepalingen ten aanzien van het schadeverzekeringsbedrijf.

249 See Borgesius 1974, 107.

250 www.cornell.law.edu/topics/state_statutes3.html#insurance

251 For reading on three strands of regulation theory which seek to explain the reasons for government intervention in the insurance market of Anglo-American countries see: Adams, M.B. and Tower, G.D., Theories of Regulation: Some Reflections on the Statutory Supervision of Insurance Companies in Anglo-American Countries, *Geneva Papers on Risk and Insurance* 1994 nr 71, 156-177.

252 Committee of financial markets, Cross border trade in financial services: economics and regulation, *Financial Markets Trends*, 75, march 2000, 39.

interests in the insurance market can be divided between regulations on the transfer of risk and regulations on the national financial system.

3.3.1 Transfer of Risk

State regulations that affect the transfer of risk are abound. As I described above, they include regulations consumer interests, to wit – accessible, clear, and affordable insurance, protection against insurer bankruptcy, confusing small print in insurance contracts, as well as providing recourse. The regulations that protect insurance provider interests include rules on gathering information for the correct assessment of risk, the protection against insurance fraud, and the freedom to share information and accumulate capital.

State regulations however include more than the protection of consumer and insurer interests in the insurance market. State regulations also protect the state's interest in the transfer of risk for reasons of public policy. An example of public policy regulation is compulsory insurance. To protect traffic participants state regulations require all motor vehicle owners to carry insurance. This compulsory insurance protects the victim of a traffic incident against the inability of the liable party to reimburse costs or to pay damages. In addition to the state regulation making motor vehicle insurance compulsory, state regulation exists that makes motor vehicle insurance accessible to ensure liability is covered. Another example of public policy insurance regulation is health insurance. The cost of western medical care is becoming increasingly unaffordable to a large group of consumers. States may find they have a public interest in the medical as well as the financial well-being of its citizens and regulate the availability and affordability of health care services.

Compulsory pension schemes, unemployment insurance and disability insurance, are all examples of state insurance market regulation that protect the interest of the public in making these insurances available (by the state or through private companies) and affordable (through a system of solidarity, tax relief and tax incentives as well as compulsory price systems). In addition, these state regulations protect the interest of the state in spreading risk and cost.

3.3.2 The National Financial System

The insurance market is a financial market in which many interests and huge fortunes are at stake. Because the insurance industry is a financial industry that accumulates vast amounts of capital, the industry has an impact on the capital market of the state. It is in the interest of the state to preserve confidence in a stable and financial healthy insurance industry, and maintain the integrity and stability of the national financial system.[253]

An example of state regulation that protects the interest of the state in the national financial system is insurer supervision regulation. Supervisory regulation aims to protect consumers against insurance provider failure.[254] It also protects the states' interest in maintaining financially healthy insurance providers and the preservation of the confidence in the integrity and stability of the insurance

[253] Committee of financial markets 2000, 39.
[254] Committee of financial markets 2000, 39.

industry. While the purpose of insurer supervision is similar, if not the same, among state regulations, the form of insurance supervision can differ greatly.[255]

Another example of state regulation for the protection of the state interest in the national financial system are the regulations that encourage, and sometimes even make investments in the state by insurance providers compulsory. Regulations that encourage investment can vary from tax incentives to legal requirements to keep technical reserves and more in denominated assets within the state borders.[256]

4 Conclusion

Although all these interests and the regulations that protect them can be described separately from other interests in and regulations of the state insurance markets, neither they nor their regulations exist separately and independently. The choice for protecting one interest effects another interest. Regulation that protects consumers interests in having insurance claims satisfied does not exist separately from regulation that protects insurance providers in making accurate risk assessments and accumulating sufficient capital.[257] Also, regulations that protect the interest of the state in the transfer of risk do not exist separately from regulations that protect the consumer's interest in available and affordable insurance, nor from regulations that protect the insurer in accurate risk assessment and capital accumulation. The choice to protect one interest is not made independently from other interests simply because they do not exist separately or independently from each other.

All state regulation of the insurance market protect interests in the insurance market. The strict and elaborate national supervisory rules and insurance regula-

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255 There are many forms of insurance supervision. They all exist somewhere in between no government interference at all to state insurance companies. The most commonly used distinction is between normative supervision structures and material supervision structures. Normative supervision is ex-post supervision where within the leeway of state imposed general rules the insurance provider is free to perform its business. The state rules generally contain solvency rules combined with rules on the publication of an annual report. State interference is limited to supervision afterwards with, if necessary, the competence to interfere in the management of the insurance company. Material supervision on the other hand is ex-ante supervision where detailed government regulation dominates the supervision structure. The rules vary from prior approval of insurance policies to compulsory imposition of insurance rates. The supervision is not repressive as with normative supervision but rather preventive.
Vermaat 1993, 70.

256 See 3.2.2.
For example Belgium, see *Hanns-Martin Bachmann v Belgian State*, Case C-204/90, ECR [1992] Page I-00249.
The localization principle in European regulation requires insurance providers to maintain their technical reserves within the European Community. In the USA the states have the liberty to require insurance providers to maintain a technical reserve in the states among other rules regarding investments and capital.

257 See chapters 4 and 5, *Commission of the European Communities v Federal Republic of Germany*. Case 205/84, ECR [1986] Page 03755, *Commission of the European Communities v French Republic*. Case 220/83. ECR [1986] Page 03663, *Commission of the European Communities v Kingdom of Denmark*. Case 252/83. ECR [1986] Page 03713, *Commission of the European Communities v Ireland*. Case 206/84, ECR [1986] Page 03817.) and *Verband der Sachversicherer e.V. v Commission of the European Communities*. Case 45/85, ECR [1987] Page 00405.

tions demonstrate the economic, political and social need for an accessible, financially healthy and trustworthy insurance system.

Because insurance concerns itself with contracts in which the insured pays for performance sometimes well in the future, the reverse production cycle[258], financial health of the insurance company is of great importance. The solvency of insurers is, if not guaranteed, at least enhanced through strict supervision of their financial position and "special treatment"[259] in competition law. Supervisory institutions throughout Europe and the United States are granted the power to intervene if the insurer fails to meet obligations to their insured.[260] Insurance products are made available by government regulation based on the belief that certain insurances should be available and affordable for all [261], for example health insurance. All of this is done to protect the interests of the insured, the insurance providers and the state in the insurance market.

The regulation of the business of insurance has resulted in protected state insurance markets. Although the objective is the protection of interests in the insurance market to assure its proper functioning, and not (necessarily) the protection of the market, because the valuation of interests differs, as do the regulations that protect them, barriers and obstacles to free and fair interstate trade can, and in some cases have formed.[262]

The intensive state regulation of the insurance services industry and obstacles and barriers to foreign competitors limit free and fair interstate trade on the insurance markets among the member states of the European Community and the states of the United States. One of the objectives of both unions is the liberalization of trade. The method to accomplish trade liberalization in both is the same, limiting member states' authority to regulate and market participants' liberty to act in order to eliminate intentional obstacles and minimize barriers to free and fair market access. However, the elimination or minimization of what is considered an obstacle or barrier to free and fair interstate trade and the proper functioning of the common

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[258] A.J.H.Verkerk-Kooijman *Convergentie van toezichtssystemen in de Europese Unie*, Financiënreeks; 95-6, Den Haag: Ministerie van Financiën, Centrale Directie Voorlichting, 1995, 204.

[259] Allowing insurance providers to cooperate to make accurate risk assessments and premium calculations.

[260] OECD Insurance Committee Secretariat, *Insurance and private pension compendium for emerging economies, Book 1 part 2:3, Insurance solvency supervision: compilation of country reports*, 2001.

[261] Duijkersloot 1995, 12.

[262] States gradually started passing statutes to protect domestic insurance companies from out of state competitors, to protect their citizens from insolvent and fraudulent insurance companies, and to handle liquidation of insolvent insurance companies. With industrialization state taxation revenues from the domestic insurance industry grew. Because of the financial interest the states held in the local insurance companies, the state governments often granted these companies a monopoly. Only when the local insurance companies were unable to offer all kinds of insurance, the states would allow foreign insurance companies to do business within their territory. Often discriminatory taxes would be applied to these out-of-state companies. Claude C. Lilly, *A History of Insurance Regulation in the United States*, 29 CPCU Annals 99 (1976), 100. Meier, Kenneth J., *the Political economy of regulation*, state university of New York, 1988, at 51.

market, can harm the interests of insurance consumers, insurance providers, and the state, and the proper functioning of the states' insurance markets.

To assure the proper functioning of the markets both interstate as well as intrastate, insurance market integration needs to accommodate the state insurance market interests. While the objective, liberalization of trade, as well as the method, limiting the authority of states to regulate and the liberty of market participants to act, are the same in the European Community and the United States, their institutional structure and grants of authority differ, as does the legal development of their insurance market integration.

In the next three chapters I describe the legal development of insurance market integration in the European Community and the United States. Chapter 4 and 5 describe the legal development of insurance market integration in the European Community and chapter 6 describes the legal development of insurance market integration in the United States of America.

Chapter 4

Legal Development of Insurance Market Integration in the European Community

Treaty and Case Law

1 Introduction

In chapter 2 we have seen that the main objective of cooperation in the European Community was economic integration. This includes the economic integration of insurance markets. As I have described, economic integration is accomplished by removing the obstacles and barriers to free and fair market access. The elimination and minimization of these barriers and obstacles is realized by limiting state authority to regulate and the market participants' liberty to act. This is accomplished either by prohibitions in the Treaty or by the creation of secondary regulation. As seen in chapter 2, the Treaty provides the institutional structure and grants authority to eliminate intentional barriers and minimize obstacles to free and fair interstate trade in the articles on the freedom to provide services[263] and those on the freedom of establishment[264], which are complemented by[265] rules on fair competition.[266]

In the EC Treaty the freedoms include the right "to take up and pursue activities ... under the conditions laid down for its own nationals by the law of the country where such establishment is effected"[267], and the right to provide services "under the same conditions as are imposed by that state on its own nationals."[268] The Treaty's competition rules state that "all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade

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[263] Articles 49-55 EC Treaty.

[264] Articles 43-48 EC Treaty.

[265] Kapteyn 2003, 647.
Kapteyn/Gormley 1998, 837.

[266] Articles 81-86 EC Treaty.

[267] In *Jean Reyners v. Belgian State*, 2/74, ECR [1974], page 0631 the European Court of Justice established direct effect. It determined that "after the expiry of the transitional period (1970) the directives provided for by the chapter on the right of establishment have become superfluous with regard to implementing the rule on nationality, since this is henceforth sanctioned by the treaty itself with direct effect"(paragraph 30). Despite the fact that the condition, enact a directive, to implement the rule on nationality was removed with the finding of direct effect in Reyners, directives continue to be important for their ability to place much greater pressure on member states to adjust their legislation than court decisions do.

[268] In *Johannes Henricus Maria van Binsbergen v Bestuur van de Bedrijfsvereniging voor de Metaalnijverheid*. Case 33/74, ECR [1974] Page 01299 the ECJ ruled that the provision of article 59 became "unconditional on the expiry of the (transitional) period" (paragraph 24) and "have direct effect" (paragraph 27) and "abolish all discrimination against the person providing the service by reason of his nationality or the fact that he is established in a member state other than that in which the service is provided" (paragraph 25).

between member states and which have as their object or effect the prevention, restriction or distortion of competition within the common market ..."[269] are prohibited and "any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market in so far as it may affect trade between member states."[270]

In this and the subsequent chapter I will describe the legal development of insurance market integration in the European Community. I begin in this chapter with the limits to the regulatory authority of the states and the limits to the liberty of the market participants to act in the Treaty text and case law. First I define 'freedom to provide services' and 'freedom of establishment', and determine the meaning of fair competition[271] in the Treaty. The definition of 'freedom' is not static. I will use some of the leading cases to demonstrate the evolution of the definition of freedom of establishment and freedom to provide services in the Treaty, and the resulting limits to state regulatory authority. I use a similar approach to define limits on the liberty of the market participants to act.

After I have established what the limits to the states' authority to regulate and the limits to the market participants' liberty to act in the Treaty are, i.e. the obstacles and barriers to free and fair market access, I describe the justifications provided in the Treaty and those developed in case law that allow for these obstacles and barriers to be maintained, i.e. that accommodate state insurance market interests.

The cases discussed demonstrate the evolution of the respective freedoms and the justifications. They include, but are not limited to, insurance cases. The cases used are the (ex post facto) leading cases in the defining of the limits and exceptions to the limits in the freedom of establishment and the freedom to provide services and are, because the freedoms apply to insurance, of paramount importance to the business of insurance.

In the next chapter I describe the limits to the freedom of states and market participants and the exceptions to these limits in the secondary regulation, i.e. the three generations insurance directives and the Council regulation regarding fair trade in insurance.

2 Limits to State Regulatory Authority Freedom of Establishment and Freedom to Provide Services

To define "freedom" of establishment for insurance providers and the "freedom" to provide insurance services, three questions need to be answered. The first regards the definitions of establishment and services. Determining the difference between establishment and services is relevant because state regulations and acts that are (im)permissible are not the same for the freedom of establishment and the freedom to provide services, i.e., the definition of what constitutes an obstacle or barrier differs.

The Treaty distinguishes between services and establishment, as does the ECJ in its definitions of (im)permissible state regulations and acts. In the case *Manfred*

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[269] Article 81 EC Treaty.
[270] Article 82 EC Treaty.
[271] Articles 81-83 EC Treaty (ex. articles 85-87).

Säger v Dennemeyer & Co. Ltd. the ECJ for example found that "a member state may not make the provision of services in its territory subject to compliance with all the conditions required for establishment and thereby deprive of all practical effectiveness the provisions of the treaty whose object it is, precisely, to guarantee the freedom to provide services".[272] Before determining the obstacles and barriers to the freedom of establishment and the freedom to provide services, and the consequential limits to the authority of the states to regulate, establishment and provision of services are defined.

The second and third questions regard the process of defining the obstacles and barriers to the two freedoms and their justifications in the Treaty and case law.

2.1 Establishment v. Services

The Treaty provides a definition of service in article 49 and 50 EC[273]: "services are normally provided[274] for remuneration[275] by nationals who are established in a state

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[272] *Manfred Säger v Dennemeyer & Co. Ltd.* Case C-76/90, ECR [1991] Page I-04221, paragraph 13.: "A member state may not make the provision of services in its territory subject to compliance with all the conditions required for establishment and thereby deprive of all practical effectiveness the provisions of the treaty whose object it is, precisely, to guarantee the freedom to provide Säger."
Opinion of Advocate General Jacobs, paragraph 23: "there are obvious differences between the situation of a person who permanently establishes himself in a member state and the situation of a person who merely provides services in a member state, whether occasionally or on a regular basis. It does not seem unreasonable that a person establishing himself in a member state should as a general rule be required to comply with the law of that state in all respects. In contrast, it is less easy to see why a person who is established in one member state and who provides services in other member state should be required to comply with all the detailed regulations in force in each of those states. To accept such a proposition would be to render the notion of a single market unattainable in the field of services."
Anthony Arnull, *The European Union and its court of justice*, Oxford University Press, 1999, 332.

[273] Ex article 60 EEC Treaty.

[274] Although initially the emphasis lay on the service provider, providing, selling services without restrictions across state borders, freedom to provide services has been interpreted by the European Court of Justice to include the freedom of the (insurance) service consumer to buy services without restrictions in member states of the European Community other than its own *(Graziana Luisi and Giuseppe Carbone v Ministero del Tesoro.* Joined cases 286/82 and 26/83. ECR [1984] Page 00377, *Ian William Cowan v Trésor public.* Case 186/87. ECR [1989] Page 00195), as well as the movement across borders of (insurance) services without restrictions while both the (insurance) service provider and the (insurance) consumer remain static. (*Van Binsbergen* 33/74 dienstverlener, *Luisi and Carbone* 286/82 and 26/83 dienstontvangers, *Commission of the European Communities v Kingdom of the Netherlands* (*Mediawet*) Case C-353/89. ECR [1991] Page I-04069, 76/90 *Säger* and 384/93 *Alpine Investments Service*).
Kapteyn 2003, 620.
Kapteyn/Gormley 1998, 752.
Arnull 1999, 338-339.

[275] Kapteyn 2003, 618.
Kapteyn/Gormley 1998, 749-750.
Belgian State v René Humbel and Marie-Thérèse Edel. Case 263/86. ECR [1988] Page 05365, paragraph 17: "The essential characteristic of remuneration thus lies in the fact that it constitutes consideration for the service in question and is normally agreed upon between the provider and the recipient of the service."

of the Community other than that of the person for whom the services are intended"[276], and; "are those activities that are not governed by the provisions relating to freedom of movement for goods, capital and persons." The definition of service has been further clarified in case law. In 1986 for example, in the insurance case of the *Commission v. Germany* (205/84) German insurance legislation required insurance undertakings to be authorized in the Federal Republic of Germany (FRG) to provide the particular insurances. In this case the ECJ clearly distinguished between activities that fall within the freedom of establishment and those that fall within the freedom to provide services.[277] The ECJ used "permanency" to distinguish between establishment and services. It found that "if a person or an undertaking maintains a permanent base in a member state or only an office it cannot avail itself of the right to provide services in that state but will be governed by the law on freedom of establishment"[278], i.e., needs to conform to the legislation of the host member state.

In 1991 in the case of *R. v. Secretary of state for transport, ex p. Factortame*[279] the Court spoke of an 'indefinite period' and 'fixed establishment' in addition to "permanent base" to distinguish establishment from the provision of services. It defined establishment as "the actual pursuit of an economic activity through a fixed establishment in another member state for an indefinite period."[280] And in 1994, in *Gebhard v. Consiglio dell' Ordine degli Avvocati e Prociratori di Milano*[281], the Court interpreted the concept of establishment, as "allowing a Community national to participate, on a stable and continuous basis, in the economic life of a member state other than his state of origin and to profit therefrom, so contributing to economic and social interpenetration within the Community in the sphere of activities as self-employed persons."[282] With regard to services the Court stated: "in contrast, where the provider of services moves to another member state, the provision of the chapter on services, in particular the third paragraph of article 60, envisage that he is

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276 Guide to the Case Law of the European Court of Justice on Articles 59 et seq. EC Treaty. European Commission 1/1/1999: Cross border character. Principle: "it has been consistently held that 'the Treaty rules governing freedom of movement and acts adopted to implement them cannot be applied to activities which have no factor linking them with any of the situations governed by Community law and which are confined in all respects within a single member state' (joined cases c-64/94 and c-65/96 *Land Nordrheidn-Westfalen v. Uekcher and Jacquet v Land Nordrhein-Westfalen* [1997] ECR I-3171 apr. 16; case c-134/95 *USL no 47 di Biella v INAIL* [1997] ECR I-195, par 19 and case c-332/90 *Steen v Deutsche Bundespost* [1992] ECR I-341 par 9)".
Kapteyn 2003, 620.
Kapteyn/Gormley, 752.

277 John A. Usher, *The law of money and financial services in the European Community*, 1994, Clarendon Press Oxford, p. 66.
Craig de Búrca 1998, 762.

278 Craig, de Búrca 1998, 762.

279 *The Queen v Secretary of State for Transport, ex parte Factortame Ltd and others.* Case C-221/89. ECR [1991] Page I-03905, paragraph 20.

280 Craig de Búrca 1998, 727.

281 *Reinhard Gebhard v Consiglio dell'Ordine degli Avvocati e Procuratori di Milano.* Case C-55/94, ECR [1995] Page I-04165.

282 *Reinhard Gebhard v Consiglio dell'Ordine degli Avvocati e Procuratori di Milano.* Case C-55/94, ECR [1995] Page I-04165, paragraph 25.

to pursue his activity there on a temporary basis."[283] Temporary "has to be determined in the light, not only of the duration of the provision of the service, but also of its regularity, periodicity or continuity" and that "the fact that the provision of services is temporary does not mean that the provider of services within the meaning of the Treaty may not equip himself with some form of infrastructure in the host member state (including an office, chambers, or consulting rooms) in so far as such infrastructure is necessary for the purposes of performing the service in question."[284]

Although the latter two cases are not cases involving the business of insurance, their outcome is relevant to the business of insurance as they define the meaning of establishment and services in the context of the Treaty freedoms. As such they apply to the business of insurance. Where in the 1986 insurance case[285] establishment was defined as maintaining a permanent basis, making the host member states laws applicable, after *Gebhard*[286] in 1994, (insurance) companies that maintain a permanent base but pursue their business activities on a temporary basis are not established but provide services. To find establishment and apply host member state laws a fixed establishment for an indefinite period is required.

As I mentioned in the introduction to this section, the relevance in defining establishment and services lies in the (im)permissibility of state regulations and acts, which differs, as the subsequent section will show, whether it involves the establishment in a host member state or the provision of services.

2.2 Identifying the Obstacles and Barriers

Articles 43 (ex 52) and 49 (ex 59) EC Treaty prohibit the member states from regulating or acting in a manner that restricts the freedom of establishment or the freedom to provide services. In the General Programs[287] the Council set out the general conditions under which the freedoms could be attained. It laid down a general definition with which to identify restrictions to the integration of the European markets:

> "Any measure which, pursuant to any provision laid down by law, regulation or administrative action in a member state, or as the result of the application of such

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283 *Reinhard Gebhard v Consiglio dell'Ordine degli Avvocati e Procuratori di Milano*. Case C-55/94, ECR [1995] Page I-04165, paragraph 26.

284 *Reinhard Gebhard v Consiglio dell'Ordine degli Avvocati e Procuratori di Milano*. Case C-55/94, ECR [1995] Page I-04165, paragraph 27.
Lonbay, J, noot Gebhard in CMLR 1996 vol 33 nr 5 p.1081. The Courts view in *Commission v. Germany* that a permanent presence automatically meant establishment was altered with *Gebhard*.
Craig de Búrca 1998, 762. "However, in Gebhard, advocate general Léger declared that the fact that someone opened an office or chambers in order to provide occasional services within a member state while having their permanent establishment in another member state could not of itself give rise to an irrefutable presumption of fraud or evasion of national requirements by that person: instead, the onus is on the state in each case to prove the existence of such fraud."

285 *Commission of the European Communities v Federal Republic of Germany*. Case 205/84, ECR [1986] Page 03755.

286 *Reinhard Gebhard v Consiglio dell'Ordine degli Avvocati e Procuratori di Milano*. Case C-55/94, ECR [1995] Page I-04165.

287 See also chapter 2.

a provision, or of administrative practices prohibits or hinders nationals of other member states in their pursuit of an activity as a self-employed person *by treating nationals of other member states differently from nationals of the country concerned.*"[288]

For establishment and restriction to the freedom to provide services as:

"Any measure which, pursuant to any provision laid down by law, regulation or administrative action in a member state, or as the result of the application of such a provision, or of administrative practices prohibits or hinders the person providing services in his pursuit of an activity as a self-employed person by *treating him differently form nationals of the state concerned.*"[289]

According to the Council this includes:

"Any requirements imposed pursuant to any provision laid down by law, regulation or administrative action or in consequence of any administrative practice, in respect of the provision of services are also to be regarded as restrictions where, *although applicable irrespective of nationality, their effect is exclusively or principally, to hinder"*

- "the taking up or pursuit of such activity by foreign nationals" for restrictions on the freedom of establishment,

and

-"*the provisions of services by foreign nationals*" for restrictions on the freedom to provide services.

The General Programs defined restriction in terms of discrimination, whether direct "treating him differently from nationals of the state concerned" or indirect "although applicable irrespective of nationality their effect is exclusively or principally to hinder the taking up or pursuit of such activity, the provision of services, by foreign nationals."[290] The European Court of Justice first confirmed this interpretation of restriction in its case law, but later extended it to include equally applicable measures that as much as hinder or substantially impede interstate trade.[291] In addition to defining restrictions, the General Programs planned the drafting of directives for the market integration before the end of the 12 year period[292] in which the common market was to be established.[293]

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288 My emphasis.

289 My emphasis.

290 Craig de Búrca 1998, 734.

291 Craig de Búrca 1998, 733.
Kapteyn 2003, 526.
Kapteyn/Gormley 1998, 626.
Reinhard Gebhard v Consiglio dell'Ordine degli Avvocati e Procuratori di Milano. Case C-55/94, ECR [1995] Page I-04165, *Dieter Kraus v Land Baden-Württemberg.* Case C-19/92 ECR [1993], Page I-01663, *Manfred Säger v Dennemeyer & Co. Ltd.* Case C-76/90, ECR [1991] Page I-04221, *Alpine Investments BV v Minister van Financiën.* Case C-384/93, ECR [1995] Page I-01141, *Jessica Safir v Skattemyndigheten i Dalarnas Län, formerly Skattemyndigheten i Kopparbergs Län.* Case C-118/96. ECR [1998] Page I-01897.

292 Article 3 of the original, 1957, Treaty establishing the European Economic Community (EEC) required for the economic integration of the markets of the member states the establishment of a common market. The common market was to be established within 12 years, in three stages of four years each.

293 Establishment: non-life insurance by the end of the second stage (article IV C) and life insurance between the start of the third stage and the end of the second year of the third stage (article IV D).

In the subsequent sub-sections I use a selection of ECJ case law to demonstrate the development of the definition of the freedoms and the resulting limits to the state authority to regulate establishment and the provision of services.

2.2.1 Freedom of Establishment

2.2.1.1 Direct Discrimination

The freedom of establishment prohibits discriminatory state regulations. In 1974 in the case of *Reyners v. Belgium*[294] the ECJ affirmed that Treaty provisions on the freedom of establishment essentially provide for "the equal treatment with nationals"[295], and require the elimination of discrimination on grounds of nationality. Although the Community had not implemented all measures in the General Programs, the ECJ found that because "the rule on equal treatment with nationals is one of the fundamental legal provisions of the Community" it is "capable of being directly invoked by nationals of all the other member states."[296] The transitional period had expired and the ECJ found that secondary legislation was not required to support the prohibition of discrimination on the grounds of nationality to apply to the right of establishment. It stated "article 52 (...) imposes an obligation to attain a precise result, the fulfillment of which had to be made easier by, not made dependent on, the implementation of a program of progressive measures."[297] The freedom of establishment "is henceforth sanctioned by the Treaty itself with direct effect."[298]

In the ECJ case *Reyners*, a Belgian Royal Decree allowed only Belgian nationals to use the title of avocat and thus practice. Belgian law was found to be contrary to the freedom of establishment as it discriminated on the basis of nationality. It discriminated against a Dutch national, Reyners, who had a Belgian law degree but was refused admission to the Belgian bar because of his Dutch nationality.

Since the ECJ in *Reyners* found that the freedom of establishment limits member states directly – without the need for secondary legislation- in their authority to regulate, the interpretation of the freedom of establishment has been extended from discriminatory state regulations to national measures without distinction to nationality that as much as hinder or make establishment less attractive.

Services: non life insurance by the end of the second year of the third stage (article VC) and life insurance by the end of the third stage.

294 *Jean Reyners v Belgian State.* Case 2-74, ECR [1974] Page 00631.

295 *Jean Reyners v Belgian State.* Case 2-74, ECR [1974] Page 00631, paragraph 24.

296 *Jean Reyners v Belgian State.* Case 2-74, ECR [1974] Page 00631, paragraphs 24-25.

297 *Jean Reyners v Belgian State.* Case 2-74, ECR [1974] Page 00631, paragraph 26.
Craig de Búrca 1998, 735.

298 *Jean Reyners v Belgian State.* Case 2-74, ECR [1974] Page 00631, paragraph 30.
Alexandra Prechal, *Directives in European Community law: a study on EC directives and their enforcement by National Courts*, Brouwer Uithof, 1995, 276: " direct effect is the obligation of a Court or another authority to apply the relevant provisions of Community law, either as a norm which governs the case or as a standard for legal review."
For direct effect see; *NV Algemene Transport- en Expeditie Onderneming van Gend & Loos v Netherlands Inland Revenue Administration.* Case 26-62, ECR English special ed. [1963] 0001 and *Flaminio Costa v E.N.E.L,* Case 6/64, ECR English special ed. [1964] 0614.

2.2.1.2 Indirect Discrimination and National Measures without Distinction to Nationality

In 1977 the ECJ interpreted the prohibitions in the freedom of establishment to include national measures that, although applicable without distinction to nationality, have a discriminatory effect.[299] In the case of *Thieffry v Conseil*[300] a Belgian advocate had applied for admission to the Paris bar, but was denied on the grounds that he did not offer a French diploma. This was done despite the fact that his Belgian diploma (doctor of laws) had been recognized by a French university as being equivalent to the French licenciate's degree in law.

The ECJ found that in the General Program for the abolition of restrictions on freedom of establishment[301] "the council proposed to eliminate not only overt discrimination, but also any form of disguised discrimination, by designating in title III(b) as restrictions which are to be eliminated, 'any requirements imposed pursuant to any provision laid down by law, regulation or administrative action or in consequence of any administrative practice, in respect of the taking up or pursuit of an activity as a self employed person where, although applicable irrespective of nationality, their effect is exclusively or principally to hinder the taking up or pursuit of such activity by foreign national'".[302] With this interpretation of the freedom to include the prohibition of disguised or indirect discrimination, states were further limited in their freedom to regulate and act.

The ECJ went even further in subsequent case law where it interpreted the prohibition in the freedom of establishment to include, in addition to direct and indirect discrimination, national measures without distinction that, although they do not discriminate, hinder or make the exercise of the freedom of establishment less attractive.[303]

In the 1989 case of *Irène Vlassopoulou v Ministerium für Justiz, Bundes- und Europaangelegenheiten Baden-Württemberg*[304], the ECJ found that the freedom of establishment prohibited state regulations that, even though applicable irrespective of nationality, hinder in any other way the exercise of the freedom.[305] Mrs. Vlassopoulou was a Greek lawyer, registered with the Athens Bar, who had worked in Germany for a law firm since 1983. When in 1988 she applied to work as a

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299 Confirmed the General Programs.

300 *Jean Thieffry v Conseil de l'ordre des avocats à la cour de Paris.* Case 71-76, ECR [1977] 765.

301 Official Journal of the European Communities 32/62.

302 *Jean Thieffry v Conseil de l'ordre des avocats à la cour de Paris.* Case 71-76, ECR [1977] 765, paragraph 13.

303 *Reinhard Gebhard v Consiglio dell'Ordine degli Avvocati e Procuratori di Milano.* Case C-55/94, ECR [1995] Page I-04165, paragraph 37.
Craig de Búrca, 1998, 745. "The ECJ has moved away – initially in a gradual way but more recently quite decisively – from the emphasis on unequal treatment."

304 *Irène Vlassopoulou v Ministerium für Justiz, Bundes- und Europaangelegenheiten Baden-Württemberg.* Case C-340/89, ECR [1991] Page I-02357.

305 *Irène Vlassopoulou v Ministerium für Justiz, Bundes- und Europaangelegenheiten Baden-Württemberg.* Case C-340/89, ECR [1991] Page I-02357, paragraph 15: " It must be stated in this regard that, even if applied without any discrimination on the basis of nationality, national requirements concerning qualifications may have the effect of hindering nationals of the other member states in the exercise of their right of establishment guaranteed to them by Article 52 of the EEC Treaty."

Rechtsanwaltin (lawyer) she was refused on the grounds that she did not have the qualifications required by German law. The required qualifications included studying law at a German university, passing the First State Examination, completing a preparatory training period and then passing the Second State Examination.

The ECJ was asked whether article 52 of the EEC Treaty[306] is infringed when "a Community national who is already admitted and practicing as a lawyer in her country of origin and for five years has been admitted in the host country as a legal adviser (Rechtsbeistand) and also practices in a law firm established there can be admitted as a lawyer in the host country only in accordance with the statutory rules of that country?".[307] The ECJ found that national requirements, even when they apply without any discrimination on the basis of nationality, may have the effect of hindering nationals of the other member states in the exercise of their right of establishment guaranteed to them by article 52 of the EEC Treaty. Article 52 could be infringed if the national rules take no account of the knowledge and qualifications already acquired by the person concerned in another member state.[308] The ECJ found that article 52 of the EEC Treaty requires states to "examine to what extent the knowledge and qualifications attested by the diploma obtained by the person concerned in his country of origin correspond to those required by the rules of the host state."[309] In 1993, in the case of *Dieter Kraus v Land Baden-Württemberg*[310], German law required both German nationals as well as non-nationals to apply for authorization to use academic titles they had obtained in a foreign establishment of higher education before they could use these in the Federal Republic of Germany. The ECJ found that "articles 48 and 52 preclude any national measure governing the conditions under which an academic title obtained in another member state may be used, where that measure, even though it is applicable without discrimination on grounds of nationality, is liable to hamper or to render less attractive the exercise by Community nationals, including those of the member state which enacted the measure, of fundamental freedoms guaranteed by the Treaty."[311]

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306 Article 43 EC Treaty.

307 *Irène Vlassopoulou v Ministerium für Justiz, Bundes- und Europaangelegenheiten Baden-Württemberg*. Case C-340/89, ECR [1991] Page I-02357, paragraph 5.

308 *Irène Vlassopoulou v Ministerium für Justiz, Bundes- und Europaangelegenheiten Baden-Württemberg*. Case C-340/89, ECR [1991] Page I-02357, paragraph 15.

309 *Irène Vlassopoulou v Ministerium für Justiz, Bundes- und Europaangelegenheiten Baden-Württemberg*. Case C-340/89, ECR [1991] Page I-02357, paragraph 23.

310 *Dieter Kraus v Land Baden-Württemberg*, Case C-19/92, ECR [1993], Page I-01663.

311 *Dieter Kraus v Land Baden-Württemberg*. Case C-19/92, ECR [1993], Page I-01663. Paragraph 32: "The situation would be different only if such a measure pursued a legitimate objective compatible with the Treaty and was justified by pressing reasons of public interest (see to that effect, judgment in Case 71/76 Thieffry v Conseil de l' Ordre des Avocats à la Cour de Paris [1977] ECR 765, paragraph 12: "That article is therefore directed toward reconciling freedom of establishment with the application of national professional rules justified by the general good, in particular rules relating to organization, qualifications, professional ethics, supervision and liability, provided that such application is effected without discrimination." and 15:"It follows from the provisions cited taken as a whole that freedom of establishment, subject to observance of professional rules justified by the general good, is on of the objectives of the Treaty."). It would however also be necessary in such a case for application of the national rules in question to be appropriate for ensuring attainment of the objective they pursue and not to go beyond what is necessary for that purpose (see judgment in Case

Also in *Reinhard Gebhard v. Consiglio dell'Ordine degli Avvocati e Procuratori di Milano*[312] the ECJ interpreted freedom of establishment to prohibit more than just discrimination, either direct or indirect.[313] Gebhard was a German national authorized to practice as a Rechtsanwalt (lawyer) in Germany. He had lived and worked in Italy since 1978, first as a collaborator and later as an associate member of a set of chambers of lawyers. When in 1989 Gebhard opened his own chambers he used the title avvocato.

As a national of another member state however, Gebhard was not allowed to open his own chambers under Italian law. Italian law allowed nationals of other member states who were authorized to practice as lawyers in the member state from which they came, to work on a temporary basis in Italy, i.e. providing services, it did however not permit establishment on the territory of the Republic either of chambers or of a principal or branch office.

The ECJ first determined whether the prohibition of establishment was allowed under the Treaty. It stated that "under the terms of the second paragraph of article 52, freedom of establishment is to be exercised under the conditions laid down for its own nationals by the law of the Country where the establishment is effected."[314] A national rule prohibiting the establishment of nationals from other member states is therefore not allowed.

Second, it answered whether the conditions for the use of professional titles were allowed under the Treaty. The ECJ found that in case of establishment one should in principle comply with the conditions of the host member state.[315] This includes conditions regarding the use of professional titles. It added however, that these national regulations or measures may not "hinder or make less attractive the exercise of fundamental freedoms guaranteed by the Treaty".[316] While the ECJ struck down the Italian law that prohibited establishment of non-nationals, it let the Italian rule on the use of professional titles stand.[317]

In this particular case, the ECJ emphasized that in the ten years that Gebhard had worked in Italy "no criticism has been made of him in relation to his activities in

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C-106/91 Ramrath v Ministre de la Justice [1992] ECR I-3351, paragraphs 29 and 30). "

312 *Reinhard Gebhard v Consiglio dell'Ordine degli Avvocati e Procuratori di Milano*. Case C-55/94, ECR [1995] Page I-04165.

313 *Reinhard Gebhard v Consiglio dell'Ordine degli Avvocati e Procuratori di Milano*. Case C-55/94, ECR [1995] Page I-04165, paragraph 37.

314 *Reinhard Gebhard v Consiglio dell'Ordine degli Avvocati e Procuratori di Milano*. Case C-55/94, ECR [1995] Page I-04165, paragraph 33.

315 *Jean Reyners v Belgian State*. Case 2-74, ECR [1974] Page 00631, paragraph 15.
Claude Gullung v Conseil de l'ordre des avocats du barreau de Colmar et de Saverne. Case 292/86, ECR [1988] Page 00111, paragraph 31.

316 Unless they can be justified. See *Reinhard Gebhard v Consiglio dell'Ordine degli Avvocati e Procuratori di Milano*. Case C-55/94, ECR [1995] Page I-04165, paragraph 37: "It follows, however from the Court's case law that national measures liable to hinder or make less attractive the exercise of fundamental freedoms guaranteed by the Treaty must fulfil four conditions: they must be applied in a non-discriminatory manner; they must be justified by imperative requirements in the general interest; they must be suitable for securing the attainment of the objective which they pursue; and they must not go beyond what is necessary in order to attain it."
Craig de Búrca 1998, 746.

317 Without distinction to nationality.

those chambers"[318] and that "member states must take account of the equivalence of diplomas and, if necessary, proceed to a comparison of the knowledge and qualifications required by their national rules and those of the person concerned."[319] It emphasized that the national rule could not be used to hinder access. Especially in the case of *Gebhard*, who had worked in Italy for ten years, refusal of acceptance into the Milan bar could very well be interpreted as such hindrance.

The Treaty limits found by the ECJ prohibit discriminatory state regulation, state regulation that has a discriminatory effect and national measures without distinction that as much as hinder or make establishment less attractive. Although the establishment of insurance providers has been regulated in the three generations of insurance directives[320], the ECJ case law remains relevant for determining obstacles and barriers that have not been covered in secondary Community regulation.

2.2.2 Freedom to provide Services

2.2.2.1 Direct Discrimination

Just like the freedom of establishment, the freedom to provide services prohibits discriminatory state regulation. In the 1974 case of *Johannes Henricus Maria van Binsbergen v Bestuur van de Bedrijfsvereniging voor Metaalnijverheid*[321] the ECJ established that the prohibition of discrimination in article 49 (ex)59 EC has "direct effect and may therefore be relied on before national courts."[322]

Van Binsbergen, of Dutch nationality, acted as a legal representative before the *Centrale Raad van Beroep* (Netherlands Court of Appeal in social security matters). During the course of the proceedings he changed residency from the Netherlands to Belgium. As a consequence his capacity to represent a party before the *Centrale Raad van Beroep* was contested based on a Dutch law that only allows persons established in the Netherlands to act as legal representatives before the *Centrale Raad van Beroep*.

The ECJ found that, "the national law of a member state cannot, by imposing a requirement as to habitual residence within that state, deny persons established in another member state the right to provide services, where the provision of services is not subject to any special condition under that national law applicable."[323]

The ECJ stated that the provision of the Treaty article 4959 became "unconditional on the expiry of the (transitional) period" and "have direct effect" which means that it can be relied upon before a national court as far as they seek to

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[318] *Reinhard Gebhard v Consiglio dell'Ordine degli Avvocati e Procuratori di Milano.* Case C-55/94, ECR [1995] Page I-04165, paragraph 5.

[319] *Reinhard Gebhard v Consiglio dell'Ordine degli Avvocati e Procuratori di Milano.* Case C-55/94, ECR [1995] Page I-04165, paragraph 38.

[320] See chapter 5.

[321] *Johannes Henricus Maria van Binsbergen v Bestuur van de Bedrijfsvereniging voor de Metaalnijverheid.* Case 33-74, ECR [1974] Page 01299.

[322] *Johannes Henricus Maria van Binsbergen v Bestuur van de Bedrijfsvereniging voor de Metaalnijverheid.* Case 33-74, ECR [1974] Page 01299, paragraph 27.

[323] In this case a court where representation by an advocaat (lawyer) is not obligatory. *Johannes Henricus Maria van Binsbergen v Bestuur van de Bedrijfsvereniging voor de Metaalnijverheid.* Case 33-74, ECR [1974] Page 01299, paragraph 17.

"abolish all discrimination against the person providing the service by reason of his nationality or the fact that he is established in a member state other than that in which the service is provided."[324]

That the "freedom to provide services" encompasses more than freedom from discriminatory rules and regulations, was established in subsequent case law.

2.2.2.2 Indirect Discrimination and National Measures without Distinction to Nationality or Place of Establishment

The ECJ case of *Säger*[325] firmly established that the freedom to provide services prohibits all measures without distinction if they interfere with the freedom to provide services. Säger complained that Dennemeyer, a company incorporated under English law and having its registered office in the United Kingdom, was guilty of unfair competition. Dennemeyer offered a service of patent renewal without holding the licence that the *Rechtsberatungsgesetz* (law on legal advice) requires for attending to legal affairs on behalf of third parties. According to this law only persons holding a licence issued by the competent authority may attend to legal affairs for third parties or pay fees on their behalf. The national court asked for a preliminary ruling by the ECJ to decide whether German law could require a service provider to comply with this German law.

The ECJ stated that "article 59[326] of the Treaty requires not only the elimination of discrimination against a person providing services on the ground of his nationality but also the abolition of any restriction even if it applies without distinction to national providers of services and to those of other member states, when it is liable to prohibit or otherwise impede the activities of a provider of services established in another member state where he lawfully provides similar services."[327]

Although equal treatment is important for the freedom to provide services[328], national treatment alone does not suffice to eliminate (intentional) barriers and minimize obstacles that hinder the freedom to provide services.[329] The ECJ found

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[324] *Johannes Henricus Maria van Binsbergen v Bestuur van de Bedrijfsvereniging voor de Metaalnijverheid.* Case 33-74, ECR [1974] Page 01299, paragraphs 24, 25 and 27.

[325] *Manfred Säger v Dennemeyer & Co. Ltd.* Case C-76/90, ECR [1991] Page I-04221.

[326] Article 49 EC Treaty.

[327] *Manfred Säger v Dennemeyer & Co. Ltd.* Case C-76/90, ECR [1991] Page I-04221, paragraph 12.

[328] Apart from the direct effect of the prohibition of discrimination on the grounds of nationality or establishment. *Johannes Henricus Maria van Binsbergen v Bestuur van de Bedrijfsvereniging voor de Metaalnijverheid.* Case 33-74, ECR [1974] Page 01299, paragraph 25.

[329] Usher 1994, 71: "This was realized in the earlier cases such as van Binsbergen or Coennen (37/74 1974 ecr 1229, 39/75 1975 ecr 1547) which in fact both involved the provision of services across a border by persons who were nationals of the country in which the service was to be provided but resident in another member state."
"Coennen illustrates the difficulties of classification in this area mentioned in the context of freedom of establishment. It involved a Dutch national acting as an insurance intermediary who resided in Belgium and had an office in the Netherlands, faced with Dutch requirement that he should reside in the Netherlands. This was treated by the court as restricting his freedom to provide services. Yet according to the criteria laid down into (later) German insurance case (205/84 *Commission v.. Germany* 1986 ecr 3755) the office as a permanent presence would constitute establishment so that the question of freedom to provide services

obstacles and barriers to the freedom to provide services, not only in national rules with distinction to nationality or place of residence, but also in national rules without distinction that, although allowed in case of establishment, would be "liable to prohibit or otherwise impede the activities of a provider of services established in another member state where he lawfully provides similar services" and deprive the freedom to provide services of all practical effectiveness. The ECJ stated "In particular, a member state may not make the provision of services in its territory subject to compliance with all the conditions required for establishment and thereby deprive of all practical effectiveness the provisions of the Treaty whose object is, precisely, to guarantee the freedom to provide services."[330]

The ECJ in its case law restricts states more in the regulatory authority with regard to the provision of services than it allows with regard to establishment. In the *Alpine Investments case*[331] the ECJ supplemented its *Säger* ruling that national rules without distinction that constitute an obstacle to the freedom to provide cross-border services are not restricted to rules imposed by the state of destination of the service. Rules imposed by the member state of the service's origin can also constitute an obstacle or barrier to the freedom to provide services.

Alpine Investments BV was granted an exemption by the Dutch Ministry of Finance to hold the (legally required) licence to act as an intermediary in security transactions. The exemption however was subject to restrictions and conditions with a view to preventing undesirable developments in securities trading.[332] Alpine Investments BV was consequently prohibited by the Dutch Ministry of Finance from contracting individuals, in as well as outside of the Netherlands, by telephone without their prior written consent to offer them financial services (cold calling). Alpine challenged the restrictions on cold calling outside the Netherlands for restricting its freedom to provide services. The *College van Beroep voor het Bedrijfsleven* (Administrative Court for Trade and Industry) asked for a preliminary ruling to interpret article 59[333] of the Treaty.

The ECJ stated that "Although a prohibition such as the one at issue in the main proceedings is general and non-discriminatory and neither its object nor its effect is to put the national market at an advantage over providers of services from other member states"[334], "such a prohibition deprives the operators concerned of a rapid and direct technique for marketing and for contacting potential clients in other member states and can therefore constitute a restriction on the freedom to provide cross-border services."[335] In addition to asking whether the national rules that apply without distinction cause a disadvantage to out-of-state service providers, the ECJ

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could not arise."

Usher 1994, 72: "The aim of freedom to provide services is the removal of obstacles and barriers rather than equal treatment with host-state nationals."

330 *Manfred Säger v Dennemeyer & Co. Ltd.* Case C-76/90, ECR [1991] Page I-04221, paragraph 13.

331 *Alpine Investments BV v Minister van Financiën.* Case C-384/93, ECR [1995] Page I-01141.

332 Article 8 (2) Wet Effectenhandel van 30 Oktober 1985.

333 Article 49 EC Treaty.

334 *Alpine Investments BV v Minister van Financiën.* Case C-384/93, ECR [1995] Page I-01141, paragraph 35.

335 *Alpine Investments BV v Minister van Financiën.* Case C-384/93, ECR [1995] Page I-01141, paragraph 28.

asked whether the national rule "substantially impedes the ability of persons established in its territory to provide intra-Community services."[336]

The ECJ reasoned that where *Säger* established that article 59 EC Treaty prohibits national rules without distinction imposed by the member state of destination that form restrictions to the freedom to provide services, this principle should apply to all restrictions on the provision of services, regardless of the place where they are imposed, member state of origin, member state of destination, or third member state if the service is provided there.[337]

The ECJ in *Alpine* referred to the concept of the common market as established in *Schul v Inspecteur der Invoerrechten en Accijnzen*.[338] "It involves the elimination of all obstacles to intra-Community trade in order to merge the national markets into a single market bringing about conditions as close as possible to those of a genuine internal market."[339] The ECJ concluded that the prohibition "directly affects access to the market in services in the other Member states" and "therefore that rules of a member state which prohibit providers of services established in its territory from making unsolicited telephone calls to potential clients established in other member states in order to offer their services constitute a restriction on freedom."[340]

As with the freedom of establishment, the limits to the authority of the states to regulate lie in discriminatory regulation, regulation that has a discriminatory effect and national measures without distinction to nationality or place of establishment. Where for establishment the states' regulations may not hinder or make less attractive the establishment of insurance providers in the state, for insurance services the state regulations may not substantially impede the ability to provide interstate insurance services. This includes the prohibition to require compliance with all conditions for establishment.

The difference in prohibitions for states between the freedom of establishment and the freedom to provide services lies in the national measures without distinction. For establishment states are allowed to require compliance with all conditions for establishment as far as these do not discriminate, have a discriminatory effect and hinder or make establishment less attractive. For services however besides discriminatory regulation and regulation that has a discriminatory effect, the ECJ

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336 Craig de Búrca 1998, 784-785.

337 *Alpine Investments BV v Minister van Financiën*. Case C-384/93, ECR [1995] Page I-01141, paragraph 30.

338 *Gaston Schul Douane Expediteur BV v Inspecteur der Invoerrechten en Accijnzen, Roosendaal*. Case 15/81, ECR [1982] Page 01409.

339 *Gaston Schul Douane Expediteur BV v Inspecteur der Invoerrechten en Accijnzen, Roosendaal*. Case 15/81, ECR [1982] Page 01409, paragraph 33.

340 *Alpine Investments BV v Minister van Financiën*. Case C-384/93, ECR [1995] Page I-01141, paragraph 38: "A prohibition such as that at issue is imposed by the member state in which the provider of services is established and affects not only offers made by him to addressees who are established in that state or move there in order to receive services but also offers made to potential recipients in another member state. It therefore directly affects access to the market in services in the other member states and is thus capable of hindering intra-Community trade in services."
Paragraph 39: "The answer to the second question is therefore that rules of a member state which prohibit providers of services established in its territory from making unsolicited telephone calls to potential clients established in other member states in order to offer their services constitute a restriction on freedom".

interprets the Treaty to prohibit the states to require compliance with all conditions for establishment, which deprives the freedom to provide services of all practical effectiveness, as well as every state regulation that substantially impedes the ability to provide intra-Community services. As in establishment, the freedom to provide insurance services has been regulated in the three generations of insurance directives.[341] The ECJ case law however remains relevant for determining the obstacles and barriers that are not covered in secondary Community regulation.

2.3 Justifications

2.3.1 Treaty

Now that Treaty limits to state regulatory authority have been described with the ECJ case law interpretations of the freedom of establishment and the freedom to provide services, the next step is the description of the exceptions to these limits in the Treaty and case law. As explained in the introduction, the cases that are used to demonstrate the evolution of the justifications include, but are not limited to insurance cases. Because the Treaty's freedoms apply to the business of insurance, the justifications for the obstacles and barriers to the freedoms also apply to insurance. Where the Treaty provides justifications for state regulations with as well as without distinction to nationality or place of establishment, the European Court of Justice has developed additional justifications that in principle only apply to national measures without distinction to nationality or place of establishment. This so called 'rule of reason' justification was first developed in case law regarding the freedom to provide goods, and later applied to the freedom of establishment and the freedom to provide services as well.[342]

Treaty articles 45 sq. EC (ex article 55 sq.) and 55 EC (ex article 66)[343], provide justifications for member states' rules that have been identified as obstacles and barriers to the freedom of establishment or the freedom to provide services. These justifications apply to both state rules with and without distinction to nationality or place of establishment[344], but only if they meet the conditions laid down in articles 45 sq. and 55 EC. They must protect official authority, public policy, public security or public health, and the regulation must be necessary as well as proportionate.

Justification based on the rule of reason can, contrary to the Treaty justifications, in principle not apply to discriminatory state regulations. It only applies to national rules without distinction to nationality or place of establishment that are prohibited by the freedom of establishment and the freedom to provide services, and then only if the conditions developed in case law are met. Also, neither the Treaty justification, nor the justification developed in case law (the rule of reason) apply to areas that have been regulated by Community regulation. Interesting however is the fact that the conditions and reasoning developed by the ECJ for its rule of reason, have been

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341 See chapter 5.

342 Kapteyn 2003, 560.
Kapteyn/Gormley 1998, 675.

343 Which makes the provisions of the articles 45 sq. EC applicable to services.

344 Kapteyn 2003, 550
Kapteyn/Gormley 1998, 658.

used for the 'general good' justification that is included in Community regulation regarding the business of insurance.[345]

2.3.2 Case Law

2.3.2.1 Rule of Reason: Services

The ECJ introduced the rule of reason for national rules without distinction that are prohibited by the freedom to provide services in the case of *Van Binsbergen*.[346] Although in the specific case of *van Binsbergen* the Dutch rule was found discriminatory, and the rule of reason could therefore not apply[347], the ECJ added that in the case of national rules without distinction to nationality or place of establishment, "(...) specific requirements imposed on the person providing the service cannot be considered incompatible with the Treaty where they have as their purpose the application of professional rules justified by the general good – in particular rules relating to the organization, qualifications, professional ethics, supervision and liability – which are binding upon any person established in the state in which the service is provided (...)."[348] *Van Binsbergen* established that state regulations that are not discriminatory but do hinder the freedom to provide services can be justified when they protect the general good. This is the case only when the state rule is objectively justifiable by the need that it serves, however.[349]

In the 1980 *Webb*[350] case the Court not only confirmed its *Van Binsbergen* ruling, but further elaborated on the conditions that must be met for the rule of reason to apply. It found that "the freedom to provide services is one of the fundamental principles of the Treaty and may be restricted only by provisions which are justified by the general good and which are imposed on all persons or undertakings operating in the said state insofar as that interest is not safeguarded by the provisions to which the provider of the services is subject in the member state of his establishment."[351]

Six years after *Webb* the ECJ applied the rule of reason conditions in four insurance services cases.[352] This case law turned out to be of essential importance in

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345 See chapter 5 for the prohibitions and justifications for state authority to regulate in secondary regulation.

346 *Johannes Henricus Maria van Binsbergen v Bestuur van de Bedrijfsvereniging voor de Metaalnijverheid.* Case 33-74, ECR [1974] Page 01299, paragraphs 14 and 17.

347 In *van Binsbergen* the ECJ found that the requirement of habitual residence constituted a rule with distinction to place of residence which is prohibited by the Treaty (direct effect). This rule could only be justified with the exceptions provided for in articles 45 sq. i.e. official authority, public policy, public security or public health.

348 *Johannes Henricus Maria van Binsbergen v Bestuur van de Bedrijfsvereniging voor de Metaalnijverheid.* Case 33-74, ECR [1974] Page 01299, paragraph 12.

349 *Johannes Henricus Maria van Binsbergen v Bestuur van de Bedrijfsvereniging voor de Metaalnijverheid.* Case 33-74, ECR [1974] Page 01299, paragraph 14.

350 *Criminal proceedings against Alfred John Webb.* Case 279/80. ECR [1981] Page 03305.

351 *Criminal proceedings against Alfred John Webb.* Case 279/80. ECR [1981] Page 03305, paragraph 17.

352 *Commission of the European Communities v Federal Republic of Germany.* Case 205/84, ECR [1986] Page 03755, *Commission of the European Communities v French Republic.* Case 220/83. ECR [1986] Page 03663, *Commission of the European Communities v Kingdom of Denmark.* Case 252/83. ECR [1986] Page 03713, *Commission of the European Communities v Ireland.* Case

the legal development of insurance market integration.[353] In the 1986 case of *Commission v. Germany* the Commission brought an action under article 226 EC (ex. 169) against the Federal Republic of Germany (FRG) for failing to fulfil its obligations under the articles 49 EC (ex. 59) and 50 EC (ex. 60) on the freedom to provide services.[354] German law required insurance undertakings in the Community, that wished to provide services in the FRG for certain classes of insurance, to be established in the FRG. It also required the insurance undertakings to be authorized in the FRG to provide the particular insurances. In addition to these two requirements the law forbade insurance brokers established in the FRG to arrange insurance contracts with FRG residents for insurers established in another member state.

The requirements of establishment and authorization and the prohibition to arrange contracts for insurers established in another member state are national rules without distinction that are prohibited by the freedom to provide services. The ECJ used the rule of reason conditions to determine whether these national measures could be justified. The first condition, that the state regulations can not be discriminatory, had been met. The regulations applied to both nationals and non-nationals. The Court considered whether an imperative reason relating to the public interest existed that would justify certain restrictions on the freedom to provide insurance services. It elaborated on the special characteristics of the insurance sector, being a "particularly sensitive area from the point of view of the protection of the consumer both as a policy holder and as an insured person", "because the specific nature of the service provided is linked to future events, the occurrence of which, or at least the timing of which, is uncertain at the time when the contract is concluded" and not obtaining payment under a policy following an event giving rise to a claim may place an insured person in a "very precarious position".[355] In addition, it is very difficult, if not impossible for an insurance consumer to judge "whether the likely future development of the insurer's financial position and the terms of the contract, usually imposed by the insurer, offer him sufficient guarantees that he will receive payment under the policy if a claimable event occurs".[356]

These special characteristics of the insurance sector, and the fact that all member states had introduced prudential legislation for insurance undertakings, lead it to conclude that "there are imperative reasons relating to the public interest which may justify restrictions on the freedom to provide services". The second condition for the

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206/84, ECR [1986] Page 03817.

353 The Court in these cases introduced the concept of the "general good" in the insurance sector which has had a great impact on the development of secondary Community regulation and the legal development of insurance market integration in the European Community.
See chapter 5 and the introduction of consumer protection in the second generation of insurance directives and the realization of a block exemption from Community competition law.

354 Similar actions were brought under article 226 EC (ex. 169) to the French Republic, the Kingdom of Denmark and Ireland.

355 *Commission of the European Communities v Federal Republic of Germany*. Case 205/84, ECR [1986] Page 03755, paragraph 30.

356 *Commission of the European Communities v Federal Republic of Germany*. Case 205/84, ECR [1986] Page 03755, paragraph 30.

applicability of the rule of reason justification, that the state rule must be justified by a reason relating to the public interest, had also been met.

The Court added "provided, however, that the rules of the state of establishment are not adequate in order to achieve the necessary level of protection and that the requirements of the state in which the service is provided do not exceed what is necessary in that respect."[357] This added a third condition, the necessity of the state regulations. The ECJ in this case found that "in the present state of Community law" where at the time still considerable differences existed between member states with regard to laws on technical reserves and assets of insurance providers, and the directives had not yet made any provisions for the conditions of insurance[358], "the protection of policy holders and insured persons justify the application by the member state in which the service is provided of its own legislation concerning technical reserves and the conditions of insurance, provided that the requirements of that legislation do not exceed what is necessary to ensure the protection of policy-holders and insured persons."[359] This added a fourth condition, the state rule must be proportionate[360] to the interest it protects.

When applied to the case, the ECJ concluded that the requirement of authorization applied without distinction[361], was justified on grounds relating to the protection of the consumer[362], was necessary[363] and proportional to the interest it

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357 *Commission of the European Communities v Federal Republic of Germany*. Case 205/84, ECR [1986] Page 03755, paragraph 33.

358 *Commission of the European Communities v Federal Republic of Germany*. Case 205/84, ECR [1986] Page 03755, paragraphs 38, 39, 40.
The first generation "coordination" insurance directives (First Non-Life Council Directive and First Life Council Directive) did not harmonize the national rules concerning technical reserves nor the conditions of insurance. Only after the insurance cases were the national rules on technical provisions harmonized in Council Directive 91/674/EEC of 19 December 1991.

359 *Commission of the European Communities v Federal Republic of Germany*. Case 205/84, ECR [1986] Page 03755, paragraph 41.

360 Or suitability requirement: suitable for securing the attainment of the objective which they pursue see *Reinhard Gebhard v Consiglio dell'Ordine degli Avvocati e Procuratori di Milano*. Case C-55/94, ECR [1995] Page I-04165, paragraph 37: "It follows, however, from the Court' s case-law that national measures liable to hinder or make less attractive the exercise of fundamental freedoms guaranteed by the Treaty must fulfil four conditions: they must be applied in a non-discriminatory manner; they must be justified by imperative requirements in the general interest; they must be suitable for securing the attainment of the objective which they pursue; and they must not go beyond what is necessary in order to attain it (see Case C-19/92 Kraus v Land Baden-Wuerttemberg [1993] ECR I-1663, paragraph 32)."

361 *Commission of the European Communities v Federal Republic of Germany*. Case 205/84, ECR [1986] Page 03755, paragraph 47: "it should however be emphasized that the authorization must be granted on request to any undertaking established in another member state which meets the conditions laid down by the legislation of the state in which the service is provided."

362 *Commission of the European Communities v Federal Republic of Germany*. Case 205/84, ECR [1986] Page 03755, paragraph. 46: "only the requirement of an authorization can provide an affective means of ensuring the supervision which, having regard to the foregoing considerations, is justified on grounds relating to the protection of the consumer, both as a policy holder and as an insured person."

363 *Commission of the European Communities v Federal Republic of Germany*. Case 205/84, ECR [1986] Page 03755, paragraph 47: "those conditions may not duplicate equivalent statutory conditions which have already been satisfied in the state in which the undertakings is established, and, that the supervisory authority of the state in which the service is provided

protected.[364] The Court concluded that the rule on authorization fulfilled all the conditions for a rule of reason justification.[365]

With regard to the requirement of establishment the Court was brief: " if the requirement of an authorization constitutes a restriction on the freedom to provide services, the requirement of a permanent establishment is the very negation of that freedom" and "it has the result of depriving article 59 of the Treaty of all effectiveness."[366] A requirement like that can only be permitted if it can be shown that it is "a condition which is indispensable for attaining the objective pursued."

The German government's argument, that the establishment requirement made it possible for the supervisory authority to monitor the insurer and without that requirement it would be unable to perform its task, was not accepted by the Court. The ECJ had established in earlier case law[367] that "considerations of an administrative nature cannot justify derogation by a member state form the rules of Community law."[368] Because the authorization procedure allowed for the subjection of undertakings to "conditions of supervision by means of a provision in the certificate of authorization and to ensure compliance with those conditions, if necessary by withdrawing that certificate"[369], the ECJ did not find that "the protection of policyholders and insured persons made the establishment of the insurer in the territory of the state in which the service is provided an indispensable requirement." The requirement of establishment failed the necessity as well as the proportionality test.

As a result of these cases the Commission adjusted its proposal for the second generation of insurance directives, allowing states to maintain insurance regulation for the protection of the consumer.[370] Although the rule of reason does not apply to

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must take into account supervision and verifications which have already been carried out in the member state of establishment."

364 *Commission of the European Communities v Federal Republic of Germany*. Case 205/84, ECR [1986] Page 03755, paragraph 49: "the requirement of authorization may be maintained only in so far as it is justified on the grounds relating to the protection of policy holders and insured persons relied upon by the German government. It must also be recognized that those grounds are not equally important in every sector of insurance and that there may be cases where, because of the nature of the risk insured and of the party seeking insurance, there is no need to protect the latter by the application of the mandatory rules of his national law."
Paragraph 33: "It therefore appears that in the field in question there are imperative reasons relating to the public interest which may justify restrictions on the freedom to provide services, provided, however, that the rules of the state of establishment are not adequate in order to achieve the necessary level of protection and that the requirements of the state in which the service is provided do not exceed what is necessary in that respect."

365 *Commission of the European Communities v Federal Republic of Germany*. Case 205/84, ECR [1986] Page 03755, paragraph 51.

366 *Commission of the European Communities v Federal Republic of Germany*. Case 205/84, ECR [1986] Page 03755, paragraph 52.
Later repeated in *Manfred Säger v Dennemeyer & Co. Ltd.* Case C-76/90, ECR [1991] Page I-04221, paragraph 13.

367 *Van Luipen* Case 29/82, [1983] ECR 151.

368 *Commission of the European Communities v Federal Republic of Germany*. Case 205/84, ECR [1986] Page 03755, paragraph 54.

369 *Commission of the European Communities v Federal Republic of Germany*. Case 205/84, ECR [1986] Page 03755, paragraph 55.

370 See for details of the directives chapter 5.

areas regulated by Community law, the general good, first introduced as consumer protection in the second generation insurance directives, is interpreted based on the conditions developed in the rule of reason. The rule of reason case law provides therefor not only exceptions to the limits found in the freedom of establishment and the freedom to provide services of the Treaty, the rule of reason conditions developed in case law apply to the business of insurance and continue to determine the general good exceptions in the third generation of insurance directives.[371]

The ECJ found various state regulations protecting the "general good" to be necessary and proportional, and could justify their restrictions to the Treaty freedoms of establishment and the provision of services.

In *Hanns-Martin Bachmann v Belgium*[372] the Belgian state was granted the right to impose restrictions on the deductibility of tax contributions for life insurance policies. The tax measures by the Belgian government limited the deductibility of tax unless it had been paid to an insurer established in Belgium, which, in principle is contrary to the articles 39 and 49 of the EC Treaty. The European Court of Justice found however that the restriction protected the cohesion of the Belgian tax system and there were no less restrictive means or measures available to protect the general good.[373] Another justification used in *Bachmann*, the need to ensure adequate prudential supervision and the argument that it was difficult to check certificates relating to the payment of contributions in other member states, did not hold.[374]

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[371] See chapter 5.

[372] *Hanns-Martin Bachmann v Belgian State.* Case C-204/90, ECR [1992] Page I-00249. See also *Commission of the European Communities v Kingdom of Belgium.* Case C-300/90, ECR [1992] Page I-00305.
Direct taxation in the European Community is, contrary to the United States of America, the exclusive competence of the states. However, that does not stop the articles on freedom of establishment and freedom to provide services and the justifications to determine the limitations to the freedom of the states to tax insurance. Whether a state tax rule that applies to insurance services is prohibited by the Treaty, depends on whether it is contrary to the articles 39 and 49 EC Treaty.
Jessica Safir v Skattemyndigheten i Dalarnas Län, formerly Skattemyndigheten i Kopparbergs Län. Case C-118/96. ECR [1998] Page I-01897, paragraph 21: "It must be observed first of all that, although, as Community law stands at present, direct taxation does not as such fall within the purview of the Community, the powers retained by the member states must nevertheless be exercised consistently with Community law (see, in particular, Case C-279/93 Schumacker [1995] ECR I-225, paragraph 21)."
G. H. E. J. Wielockx v Inspecteur der Directe Belastingen, Case C-80/94, ECR [1995] Page I-02493, paragraph 16: "Although direct taxation falls within the competence of the member states, the latter must none the less exercise that competence consistently with Community law and therefore avoid any overt or covert discrimination by reason of nationality (Case C-279/93 Finanzamt Koeln-Altstadt v Schumacker [1995] ECR I-225, paragraphs 21 and 26)."

[373] *Hanns-Martin Bachmann v Belgian State.* Case C-204/90, ECR [1992] Page I-00249, paragraph 27.

[374] Communication from the Commission to the Council, the European Parliament and the Economic and Social Committee. *The elimination of tax obstacles to the cross-border provision of occupational pensions*, COM(2001) 214 final, section 3.2.
"The Court has rejected numerous defences put forward by member states to justify restrictions of the fundamental freedoms. For example, it is clear that the absence of harmonisation of member states' laws does not prevent the application of the Treaty freedoms (Case C-270/83 Avoir fiscal [1986] ECR 273, paragraph 23). In Eurowings the Court held that a member state could not impose higher taxation on the leasing of equipment from another

Neither did the arguments of the Dutch government in the *Wielockx*[375] case with regard to its rule that denied a non-resident the right to deduct from his taxable income the provision he had made to a pension reserve, which right was granted to residents. In *Wielockx* the ECJ found a Dutch rule contrary to article 43 of the EC Treaty. The Dutch rule denied a non-resident the right to deduct from his taxable income the provision he had made to a pension reserve, a right granted to residents. Because a bilateral convention existed with the member states of residence that secured fiscal cohesion, the endangerment of the fiscal cohesion could not be used as a justification to limit the freedoms of Wielockx.[376]

In the case of *Försäkringsaktiebolaget Skandia (publ) and Ola Ramstedt v Riksskatteverket*[377] the ECJ found that article 49 EC Treaty "precludes an insurance policy issued by an insurance company established in another member state which meets the conditions laid down in national law for occupational pension insurance, apart from the condition that the policy must be issued by an insurance company operating in the national territory, from being treated differently in terms of taxation, with income tax effects which, depending on the circumstances in the individual case, may be less favorable."[378] The justifications, the need to ensure the cohesion of the national tax system and effective fiscal controls, the need to protect the basis of tax revenue of the member state concerned, and competitive neutrality were all denied by the ECJ.[379] The court found no direct connection between the deductibility of contributions and the liability to tax on sums payable by insurers as in *Bachmann*.[380] The ECJ found that in the Swedish system, "an employer who has

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member state compensating for the lower tax rates imposed on the lessor in that state (Case C-294/97 Eurowings, [1999] ECR I-7449, paragraph 43). Moreover, a member state cannot justify discrimination on the ground that its removal will entail a loss of tax revenue (Case C-264/96 ICI [1998] ECR I-4711, paragraph 28). Finally, neither the absence of reciprocity on the part of other member states ([20] Case C-270/83 Avoir fiscal [1986] ECR 273, paragraph 26.With respect to taxation of pensions and life assurance three issues merit particular attention.) nor the difficulties in obtaining information constitute valid defences."

375 Case C-80/94 *Wielockx* [1995] ECR I-2493, paragraph 25.

376 Case C-80/94 *Wielockx* [1995] ECR I-2493, paragraph 24: "As the Advocate General observed in point 54 of his Opinion, the effect of double-taxation conventions which, like the one referred to above, follow the OECD model is that the state taxes all pensions received by residents in its territory, whatever the state in which the contributions were paid, but, conversely, waives the right to tax pensions received abroad even if they derive from contributions paid in its territory which it treated as deductible. Fiscal cohesion has not therefore been established in relation to one and the same person by a strict correlation between the deductibility of contributions and the taxation of pensions but is shifted to another level, that of the reciprocity of the rules applicable in the Contracting states."
Paragraph 25: "Since fiscal cohesion is secured by a bilateral convention concluded with another member state, that principle may not be invoked to justify the refusal of a deduction such as that in issue."

377 *Försäkringsaktiebolaget Skandia (publ) and Ola Ramstedt v Riksskatteverket*, C-422/01, ECR [2003] Page I-06817.

378 *Försäkringsaktiebolaget Skandia (publ) and Ola Ramstedt v Riksskatteverket*, C-422/01, ECR [2003] Page I-06817 paragraph 62.

379 *Försäkringsaktiebolaget Skandia (publ) and Ola Ramstedt v Riksskatteverket*, C-422/01, ECR [2003] Page I-06817parapgraphs 29, 32, 41, 50.

380 *Försäkringsaktiebolaget Skandia (publ) and Ola Ramstedt v Riksskatteverket*, C-422/01, ECR [2003] Page I-06817, paragraph.33.

taken out an insurance policy with an insurer established in another member state has to wait until pension benefits are paid to his employee to enjoy the right to deduct. There is no compensatory measure to offset the disadvantage he suffers compared with an employer who takes out comparable insurance with a company established in Sweden."[381] As regards the effectiveness of fiscal controls, the ECJ found that Community law[382] provides member states a way to check whether taxpayers have actually paid their contributions to insurance companies established in another member state, and that the tax authorities concerned can require proof from the taxpayer before it decides on allowing the deduction.[383]

As to the he need to protect the basis of tax revenue of the member state concerned and the fear that taxable property may disappear[384] or be reduced[385], these do not justify the requirement of establishment, nor do tax advantages in other member states justify less favorable treatment in tax matters given to recipients of services established in those other member states.[386] As to competitive neutrality, the ECJ found that "equality of competition between different national forms of guaranteeing undertakings on occupational pensions could not be upheld at the cost of restricting the free movement of services ".[38-

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[381] *Försäkringsaktiebolaget Skandia (publ) and Ola Ramstedt v Riksskatteverket*, C-422/01, ECR [2003] Page I-06817, paragraph 35.

[382] *Försäkringsaktiebolaget Skandia (publ) and Ola Ramstedt v Riksskatteverket*, C-422/01, ECR [2003] Page I-06817, paragraph 42: " Directive 77/799 may be relied on by a member state in order to obtain from the competent authorities of another member state all the information enabling it to ascertain the correct amount of income tax (see Case C-55/98 Vestergaard [1999] ECR I-7641, paragraph 26), or all the information it considers necessary to ascertain the correct amount of income tax payable by a taxpayer according to the legislation which it applies (see Wielockx, cited above, paragraph 26, and Danner, paragraph 49)."

[383] *Försäkringsaktiebolaget Skandia (publ) and Ola Ramstedt v Riksskatteverket*, C-422/01, ECR [2003] Page I-06817, paragraph 43.

[384] *Försäkringsaktiebolaget Skandia (publ) and Ola Ramstedt v Riksskatteverket*, C-422/01, ECR [2003] Page I-06817, paragraph 51: "In that regard, as it pointed out in Danner in paragraph 55, the Court held in paragraph 34 of its judgment in Safir that, in that case, the need to fill the fiscal vacuum arising from the non-taxation of savings in the form of capital life assurance policies taken out with companies established in a member state other than the one where the saver is resident was not such as to justify the national measure at issue, which restricted freedom to provide services."

[385] *Försäkringsaktiebolaget Skandia (publ) and Ola Ramstedt v Riksskatteverket*, C-422/01, ECR [2003] Page I-06817, paragraph 53: "Finally, the Court has held that the need to prevent the reduction of tax revenue is not one of the grounds listed in article 56 of the EC Treaty (now, after amendment, article 46 EC) or a matter of overriding general interest (see Danner, paragraph 56) which would justify a restriction on the freedom to provide services. "

[386] *Försäkringsaktiebolaget Skandia (publ) and Ola Ramstedt v Riksskatteverket*, C-422/01, ECR [2003] Page I-06817, paragraph 52: "The Court has also held, in general terms, that any tax advantage resulting for providers of services from the low taxation to which they are subject in the member state in which they are established cannot be used by another member state to justify less favorable treatment in tax matters given to recipients of services established in the latter state. Such compensatory tax arrangements prejudice the very foundations of the single market (see Case C-294/97 Eurowings Luftverkehrs [1999] ECR I-7447, paragraphs 44 and 45)."

[38-] *Försäkringsaktiebolaget Skandia (publ) and Ola Ramstedt v Riksskatteverket*, C-422/01, ECR [2003] Page I-06817, paragraph 58.

In the *Alpine Investments* case[388] the restrictions imposed on cold calling outside the Netherlands were justified because they protected the integrity of the Dutch financial market.[389] The ECJ found that "article 59[390] does not preclude national rules which, in order to protect investor confidence in national financial markets, prohibit the practice of making unsolicited telephone calls to potential clients resident in other member states to offer them services linked to investment in commodities futures."[391] However, in *Safir*[392] the ECJ found that the national rules, in this case different tax regimes for capital life assurance policies, depending on whether they are taken out with companies established in Sweden or with companies established elsewhere, did not pass the rule of reason test. The reasons cited by the Swedish government to justify the impositioning of a tax on those who paid premiums to a life assurance company established in another member state, "are not such as to justify (...) elements as restrictive of the freedom to provide services as those contained in the legislation in question in the main proceedings."[393] Where the Swedish government claimed that the tax was designed to compensate for the yield tax payable by Swedish institutions, it did however, according to the ECJ, also dissuade individuals from taking out policies with companies not established in Sweden and created an unjustified obstacle to the freedom to provide services. The conditions for the rule of reason were not met as the specific restrictions were found to be unnecessary and disproportionate.

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388 *Alpine Investments BV v Minister van Financiën.* Case C-384/93, ECR [1995] Page I-01141.

389 *Alpine Investments BV v Minister van Financiën.* Case C-384/93, ECR [1995] Page I-01141. Paragraph: 44 "Maintaining the good reputation of the national financial sector may therefore constitute an imperative reason of public interest capable of justifying restrictions on the freedom to provide financial services."
Paragraph 45: "As for the proportionality of the restriction at issue, it is settled case-law that requirements imposed on the providers of services must be appropriate to ensure achievement of the intended aim and must not go beyond that which is necessary in order to achieve that objective (see Case C-288/89 Collectieve Antennevoorziening Gouda and Others v Commissariat voor de Media [1991] ECR I-4007, paragraph 15)."
Paragraph 46: "As the Netherlands Government has justifiably submitted, in the case of cold calling the individual, generally caught unaware, is in a position neither to ascertain the risks inherent in the type of transactions offered to him nor to compare the quality and price of the caller' s services with competitors' offers. Since the commodities futures market is highly speculative and barely comprehensible for non-expert investors, it was necessary to protect them from the most aggressive selling techniques."

390 Article 49 EC Treaty.

391 *Alpine Investments BV v Minister van Financiën.* Case C-384/93, ECR [1995] Page I-01141, paragraph 56.

392 *Jessica Safir v Skattemyndigheten i Dalarnas Län, formerly Skattemyndigheten i Kopparbergs Län.* Case C-118/96, ECR [1998] Page I-01897. In Safir it had to be determined whether legislation creates obstacles to the freedom to provide services and whether, should this be the case, such obstacles are justified on the grounds relied on by the Swedish Government.

393 *Jessica Safir v Skattemyndigheten i Dalarnas Län, formerly Skattemyndigheten i Kopparbergs Län.* Case C-118/96, ECR [1998] Page I-01897, paragraphs 24 and 34: "the impossibility of applying to capital life assurance policies taken out with companies not established in Sweden the same tax regime as that applied to such insurance policies taken out with companies which are established in Sweden" and "the need to fill the fiscal vacuum arising from the non-taxation of savings in the form of capital life assurance policies taken out with companies not established in Sweden."

2.3.2.2 Rule of Reason: Establishment

In establishment, as in the provision of services, the rule of reason conditions developed in case law apply to the business of insurance and continue to determine the exceptions in the general good in the third generation of insurance directives.[394] In *Kraus*[395] the ECJ was asked to apply the rule of reason to a freedom of establishment case.[396] German law required both German nationals as well as non-nationals to apply for authorization to use academic titles they had obtained at a foreign institution of higher education before they could use these in the Federal Republic of Germany. The ECJ was asked whether articles 48 (39 EC) and 52 (43 EC) of the Treaty preclude a member state from prohibiting a national to use a foreign academic title prior to obtaining administrative authorization by the competent authorities. The ECJ found that:

> "Articles 48 and 52 of the Treaty must be interpreted as meaning that they do not preclude a member state from prohibiting one of its own nationals, who holds a postgraduate academic title awarded in another member state, from using that title on its territory without having obtained an administrative authorization for that purpose, provided that the authorization procedure is intended solely to verify whether the postgraduate academic title was properly awarded, that the procedure is easily accessible and does not call for the payment of excessive administrative fees, that any refusal of authorization is capable of being subject to proceedings, that the person concerned is able to ascertain the reasons for the decision and that the penalties prescribed for non-compliance with the authorization procedure are not disproportionate to the gravity of the offence the measure was precluded by the articles 48 and 52."[397]

Kraus summed up all the conditions that need to be fulfilled for the ECJ to allow a state regulation that as much as hinders or make the exercise of the freedom of establishment less attractive. It must pursue "a legitimate objective that is compatible with the Treaty", i.e., it cannot discriminate for example[398]. it must be justified by "pressing reasons of public interest"[399] and be "appropriate for ensuring attainment of the objective" it pursues and "not go beyond what is necessary for that purpose."[400]

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394 See chapter 5.

395 *Dieter Kraus v Land Baden-Württemberg*. Case C-19/92 ECR [1993], Page I-01663.

396 *Dieter Kraus v Land Baden-Württemberg*. Case C-19/92 ECR [1993], Page I-01663, paragraph 32.

397 *Dieter Kraus v Land Baden-Württemberg*. Case C-19/92 ECR [1993], Page I-01663, paragraph 42.

398 In the United States discriminatory tax is allowed if "the discrimination between foreign and domestic corporations bears a rational relation to a legitimate state purpose." See chapter 6.

399 Case 71/76 *Thieffry v. Conseil de L'Ordre des Avocats a la Cour de Paris* [1977] ECR 765 paragraph 12: "That article is therefore directed toward reconciling freedom of establishment with the application of national professional rules justified by the general good, in particular rules relating to organization, qualifications, professional ethics, supervision and liability, provided that such application is effected without discrimination." and 15: "It follows from the provisions cited taken as a whole that freedom of establishment, subject to observance of professional rules justified by the general good, is one of the objectives of the Treaty."

400 *Dieter Kraus v Land Baden-Württemberg*. Case C-19/92. ECR [1993] Page I-01663, paragraph 32: "Consequently, Articles 48 and 52 preclude any national measure governing the conditions under which an academic title obtained in another member state may be used, where that measure, even though it is applicable without discrimination on grounds of nationality, is

The case of *Gebhard* confirmed this justification process for national measures "liable to hinder or make less attractive the exercise of fundamental freedoms." It summed up the conditions necessary for justification stating that: "They have to be applied in a non-discriminatory manner; they must be justified by imperative requirements in the general interest; they must be suitable for securing the attainment of the objective which they pursue; and they must not go beyond what is necessary in order to attain it."[401]

3 Limits for Market Participants Treaty and Case law

3.1 Treaty Limits

The limits to the market participants' liberty to act are found in the EC Treaty in articles 81 and 82 EC Treaty. These articles contain limits to market participants, while article 83 grants the Council the authority and task to regulate competition in the European Community. This section describes the limits to the market

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liable to hamper or to render less attractive the exercise by Community nationals, including those of the member state which enacted the measure, of fundamental freedoms guaranteed by the Treaty. The situation would be different only if such a measure pursued a legitimate objective compatible with the Treaty and was justified by pressing reasons of public interest (see to that effect, judgment in Case 71/76 Thieffry v Conseil de l' Ordre des Avocats à la Cour de Paris [1977] ECR 765, paragraph 12 and 15.) It would however also be necessary in such a case for application of the national rules in question to be appropriate for ensuring attainment of the objective they pursue and not to go beyond what is necessary for that purpose (see judgment in Case C-106/91 Ramrath v Ministre de la Justice [1992] ECR I-3351, paragraphs 29 and 30)."

[401] *Reinhard Gebhard v Consiglio dell'Ordine degli Avvocati e Procuratori di Milano.* Case C-55/94, ECR [1995] Page I-04165, paragraph 36: "Where the taking-up or pursuit of a specific activity is subject to such conditions in the host member state, a national of another member state intending to pursue that activity must in principle comply with them. It is for this reason that article 57 provides that the Council is to issue directives, such as Directive 89/48, for the mutual recognition of diplomas, certificates and other evidence of formal qualifications or, as the case may be, for the coordination of national provisions concerning the taking-up and pursuit of activities as self-employed persons. "
Paragraph 37: "It follows, however, from the Court' s case-law that national measures liable to hinder or make less attractive the exercise of fundamental freedoms guaranteed by the Treaty must fulfil four conditions: they must be applied in a non-discriminatory manner; they must be justified by imperative requirements in the general interest; they must be suitable for securing the attainment of the objective which they pursue; and they must not go beyond what is necessary in order to attain it (see Case C-19/92 Kraus v Land Baden-Wuerttemberg [1993] ECR I-1663, paragraph 32). "
Paragraph 38: "Likewise, in applying their national provisions, member states may not ignore the knowledge and qualifications already acquired by the person concerned in another member state (see Case C-340/89 Vlassopoulou v Ministerium fuer Justiz, Bundes- und Europaangelegenheiten Baden-Wuerttemberg [1991] ECR I-2357, paragraph 15). Consequently, they must take account of the equivalence of diplomas (see the judgment in Thieffry 71/76 ECR [1977] 765, paragraphs 19 and 27) and, if necessary, proceed to a comparison of the knowledge and qualifications required by their national rules and those of the person concerned (see the judgment in Vlassopoulou, paragraph 16)."

participants ability to act in the Treaty. Chapter 5 describes the limits in secondary regulation.

The ECJ in 1973 found that the Treaty competition rules have direct effect.[402] It was not however until 1987 that a case came before the ECJ[403] in which it confirmed that the rules on competition applied to the business of insurance.[404]

In the Case of *Verband der Sachversicherer eV*[405] the ECJ not only confirmed the authority of the Community to limit insurance market participants' liberty to act[406], it clarified the limits for the insurance market participants in the Treaty. In *Sachversicherer* the question arose whether article 81 EC Treaty (ex. article 85) applied to the facts of this particular case. Article 81(1) EC Treaty applies to an agreement between undertakings, or a decision by an association of undertakings, or a concerted practice. These agreements, decisions or concerted practices, must have as their objective or effect the prevention, restriction or distortion of the common market and they must effect trade among the member states.

In the *Sachversicherer* case the applicant, Verband der Sachversicherer eV, submitted that its recommendation to increase premiums did not constitute a decision of an association of undertakings within the meaning of article 81(1) EC, that its recommendation had neither the object nor the effect of restricting competition, that trade between the member states was not affected by the recommendation, and that the Commission[407] erred in its view that the necessary conditions which need to be met for exemption under article 81(3) EC were not satisfied.

The Court rejected all submissions. As to the first argument, that the recommendation of the Verband der Sachversicherer eV was non-binding, the Court stated that, "although it was described as a 'non-binding recommendation', it lays down in mandatory term a collective, flat-rate and across-the-board increase in premiums". According to the Court, that was the intended result which also followed from "the fact that shortly after the recommendation was notified to the members of the Verband der Sachversicherer, German re-insurance companies decided to include in their contracts of re-insurance concerning the same risks a special 'premium calculation clause' according to which premium rates which fail to conform to the recommendation are to be treated in the event of a claim as under-insurance."[408]

The additional argument that the committee of experts that produced the recommendation were not competent to adopt binding decisions for the members

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402 *BRT v.SABAM.* Case 127/73[1974] ECR 51, *SA Brasserie de Haecht v Wilkin-Janssen. Haecht II.* Case 48/72[1973] ECR 77 in Usher 1994, 41.

403 The European Commission had already applied the rules of competition on agreements between insurers in the cases of *Nuovo CEGAM* (84/191/EEC, Commission Decision of 30 March 1984) and *German Fire Insurance* (85/75/EEC Commission Decision of 5 December 1984, of which the case of *Verband der Sachversicherer e.V. v Commission of the European Communities.* Case 45/85, ECR [1987] Page 00405 is the appeal to the ECJ.).

404 See chapter 2.

405 *Verband der Sachversicherer e.V. v Commission of the European Communities.* Case 45/85, ECR [1987] Page 00405.

406 See chapter 2.

407 85/75/EEC Commission Decision of 5 December 1984.

408 *Verband der Sachversicherer e.V. v Commission of the European Communities.* Case 45/85, ECR [1987] Page 00405, paragraph 30.

of the association did not hold. The association was not only empowered to coordinate its members' activities, "especially in relation to competition", the recommendations of the specialist committee, with the task to coordinate the policy of the members with regard to rates, were deemed definitive.[409] The Court concluded that the recommendation was a decision of an association of undertakings within the meaning of article 81(1) EC.

The second submission, that the recommendation had neither as object nor the effect of restricting competition, the Court held that "it is unnecessary to consider the actual effects of an agreement if it is apparent that it has the object of preventing, restriction or distorting competition."[410] The Court found that "through the instrument of the recommendation the association sought to achieve a collective fixed-rate increase in the price of the services offered by its members"[411] which is sufficient for article 81 (1) EC to apply.

The third submission, that trade between the member states was not affected by the recommendation, was also rejected by the Court. Although foreign insurers needed to establish a branch in Germany to pursue the business of insurance in Germany, the Court stated that "the fact that the branch alone is affected by the recommendation does not exclude the possibility that the financial relationship between the branch and the parent company might be affected by that fact; and that is so regardless of the degree of legal independence of the branch."[412] This and the fact that "the increase of premiums is capable of affecting foreign insurers, who are able to offer, even by means of their branches, a more competitive service" was sufficient for the Court to conclude that trade between the member states could be effected by the recommendation.

3.2 Treaty Exceptions

The exception that the Treaty provides in article 81(3) EC (ex 85.3) requires the agreement, decision or concerted practice to contribute to improving the production or distribution of goods, or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit and which does not impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives and afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

In the 1987 case of *Verband der Sachversicherer* the ECJ, besides finding the rules of competition to apply without restriction to the insurance industry, also indicated that this conclusion "in no way implies that Community competition law does not permit the special characteristics of certain branches of the economy to be taken into account." It found that "it is for the Commission, within the framework of its

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[409] *Verband der Sachversicherer e.V. v Commission of the European Communities.* Case 45/85, ECR [1987] Page 00405, paragraph 31.

[410] *Verband der Sachversicherer e.V. v Commission of the European Communities.* Case 45/85, ECR [1987] Page 00405, paragraph 39.

[411] *Verband der Sachversicherer e.V. v Commission of the European Communities.* Case 45/85, ECR [1987] Page 00405, paragraph 41.

[412] *Verband der Sachversicherer e.V. v Commission of the European Communities.* Case 45/85, ECR [1987] Page 00405, paragraph 48.

power under article 85(3)[413] to grant exemption from the prohibitions contained in article 85(1)[414], to take account of the particular nature of different branches of the economy and the problems peculiar to them."[415]

The Commission, before Council regulation 1/2003[416] was enacted, could be asked to grant an individual exemption from article 85(1). These Commission decisions could be appealed to the ECJ. Since 1 may 2004, when Council regulation 1/2003 took effect, the system of applying for individual exemptions with the Commission was abandoned.[417]

In 1982 the Verband der Sachversicherer had filed an application with the Commission for negative clearance or exemption for premium recommendations that had as their objective to re-establish stable and viable conditions in the industrial and consequential loss insurance business.[418] The recommendation to the members to increase premium rates was reinforced by the inclusion of the "premium calculation clause" of the reinsurers which had the effect that if a risk was not rated in line with the recommendation it would be treated as being under-insured by the reinsurers.[419] Because of their strong market position the reinsurers could introduce the premium calculation clause and pressure the primary insurers to comply with the anti-competitive recommendation.[420] The Commission in this case did not find the exception of article 81(3) to apply to the recommendation. The Commission referred to the ECJ case of *Grundig-Consten*[421] where it found that "not every measure that has beneficial effects on the activities of the undertakings involved is to be regarded as an improvement in economic processes within the meaning of article 85(3)".[422] The measure must, according the the Commission, "bring appreciable objective advantages that are such as to offset the associated disadvantages for competition."[423] The Commission found this test not met by the call for across-the-board premium increases that failed to take into account the cost and revenue situations of individual insurers.[424] It added that the powers of intervention of the supervisory authorities would probably be sufficient, as well as a lesser evil, to remedy the situation of individual insurance undertakings endangering their capacity to meet the claims arising from their insurance business by failing to

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413 81(3) EC Treaty.

414 81(1) EC Treaty.

415 *Verband der Sachversicherer e.V. v Commission of the European Communities.* Case 45/85, ECR [1987] Page 00405, Paragraph 15.

416 Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty (Text with EEA relevance) Official Journal L 001, 04/01/2003 P. 0001-0025.

417 See chapter 5.

418 85/75/EEC Commission Decision of 5 December 1984 (IV/30.307 - *Fire Insurance (D)*), at 22.

419 85/75/EEC, at 26.
85/75/EEC, at 28. Both the recommendation and the premium calculation clause had been filed with and approved by the German supervisory authorities.

420 85/75/EEC, at 27.

421 *Etablissements Consten S.à.R.L. and Grundig-Verkaufs-GmbH v Commission of the European Economic Community.* Joined cases 56 and 58-64, ECR English special edition [1966], Page 00299, paragraph 348.

422 85/75/EEC, at 41.

423 85/75/EEC, at 41.

424 85/75/EEC, at 42.

make responsible provision for expenses in spite of a deterioration in their overall profitability.[425]

The Verband der Sachversicherer in the appeal to the ECJ in this case argued that all the conditions for the grant of the exemption were met: "the recommended increase in premiums was intended not only to ensure that contracts of insurance against industrial fire risks would be performed in the long term, but also to free other classes of insurance expenses for which they were not responsible".[426] The Commission took the view that its task was not "merely to check whether the aim of the recommendation was to deal with the actual problems confronting the market as a result of the continuing fall in premiums for industrial fire and consequential loss insurance and to consider whether the recommendation was a proper means of dealing with that situation, but also to assess whether the measures put into effect by the recommendation went beyond what was necessary to that end."[427] The ECJ agreed with the Commission and summarized the Treaty exception as a question of "whether the collective, fixed-rate and across-the-board increase in premiums was justified by the objective pursued." The Court concluded that it was likely that the "global nature of the increase was to result in restrictions on competition going beyond what was necessary to achieve the intended objective"[428], and denied the submission.

In other cases however the Commission did find that rate-fixing[429], standard terms of cover[430], information exchanges[431] and restrictions on contracting parties[432], although in principle prohibited in the Treaty, can be allowed, albeit under certain circumstances.[433]

In the 1983 Commission case of *Nuovo CEGAM*[434] the Commission sent a statement of objections to the New Central Engineering Insurers' Association Nuovo CEGAM. The agreement made among the members meant that instead of being in full competition with one another, a large number of direct insurers agreed to apply a common tariff of basis premiums for various types of risk which had the object and effect of restricting competition. Although in contradiction to article 81(1) of the EC Treaty, the Commission found that "the formation of an association such as Nuovo CEGAM in order to acquire the specialist expertise essential for effective performance in the sector (statistical information, studies of risk, prevention techniques), and to ensure adequate reinsurance support, can be

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425 85/75/EEC, at 44.

426 *Verband der Sachversicherer e.V. v Commission of the European Communities.* Case 45/85, ECR [1987] Page 00405, paragraph 57.

427 *Verband der Sachversicherer e.V. v Commission of the European Communities.* Case 45/85, ECR [1987] Page 00405, paragraph 58. Proportionality test.

428 *Verband der Sachversicherer e.V. v Commission of the European Communities.* Case 45/85, ECR [1987] Page 00405, paragraph 60.

429 84/191/EEC, Commission Decision of 30 March 1984 (IV/30.804 *Nuovo Cegam*). 90/25/EEC Commission Decision of 20 December 1989 (IV/32.265 *Concordato Incendio*), 85/615/EEC Commission Decision of 16 December 1985 (IV/30.373 *P&I clubs*).

430 90/25/EEC Commission Decision of 20 December 1989 (IV/32.265 *Concordato Incendio*).

431 90/22/EEC Commission Decision of 20 December 1989 (IV/32.408 *TEKO*), 90/25/EEC Commission Decision of 20 December 1989 (IV/32.265 *Concordato Incendio*).

432 85/615/EEC Commission Decision of 16 December 1985 (IV/30.373 *P&I clubs*).

433 See Merkin and Rodgers 1997, 167-173.

434 84/191/EEC, Commission Decision of 30 March 1984 (IV/30.804 *Nuovo Cegam*).

considered to be a means of improving the production and distribution of insurance services and of promoting technical and economic progress."[435] The Commission found that "the determination of standard tariffs of basic premiums by the Association's organs is acceptable given that it does not impede the members' freedom to determine the final premium for a particular risk in the light of their own commercial policy or business considerations. Hence, the insured, that is, the user, still has a choice between insurers offering different final premiums. Without a standard basic tariff the Association would have found it harder to achieve its aims of improving production and distribution, in view of the technical expertise and wide claims experience required in transacting this class of insurance business".[436] The consumers were found to receive a fair share of the benefits through the widening of the choice available both in insurance providers and technically more advanced products because of the promotion work undertaken by Nuovo Cegam.[437]

In 1981 *P&I Clubs*[438] (Protection and indemnity clubs – mutual non-profit making associations providing certain types of marine insurance) notified the Commission the text of an agreement which they intended to put into effect. This agreement was found to constitute a restriction of competition because it established a system that "has as its effect the reduction of competition between the clubs by imposing limitations on the rights of each club to quote both for vessels already insured with another club and for new or newly acquired vessels. At the same time, as a result of these limitations, the insured's freedom to choose his insurer is restricted."[439]

The objective of the agreement was to secure the operation of the P&I clubs in particular the continuity of membership, preserving the principle of mutuality, stability of premiums and continuation of the pool arrangements.[440] The Commission concluded that "the advantages resulting from the notified agreement outweigh the disadvantages stemming from the fact that an operator is not totally free to move from one club to another and that tanker quotations are subject to restrictions".[441] The advantages being the reduction of insurance premiums, a better claims handling system and speedier assistance for shipowners, elasticity of cover which all also benefits persons with a legitimate claim against shipowners[442] and the cost savings for owners and operators of ships as a result can all be expected to benefit consumers. The Commission finally concluded that the restrictions in the agreement were indispensable to the attainment of the objectives and therewith exempt.

The agreement notified by *TEKO*[443] (Technisches Kontor fuer die Maschinen-B-U-Versicherung) on cooperation in machinery loss of profits insurance in 1987 fulfilled the conditions for exemption under article 81(3). TEKO was established for the purpose of joint and mutual reinsurance of machinery loss of profits insurance risks and the advising of the companies concerned in the conclusion and handling of

435 84/191/EEC, at 19.
436 84/191/EEC, at 23.
437 84/191/EEC, at 20.
438 85/615/EEC Commission Decision of 16 December 1985 (IV/30.373 *P&I clubs*).
439 85/615/EEC, at 22.
440 85/615/EEC, at 33.
441 85/615/EEC, at 39.
442 85/615/EEC, at 32.
443 90/22/EEC Commission Decision of 20 December 1989 (IV/32.408 *TEKO*).

such insurance.[444] TEKO could be asked to carry out a risk assessment and premium calculation in individual cases[445] that would, if used, guarantee joint reinsurance.[446] Although the companies concerned were free to ask and/or use the advice, in practice the system resulted in coordination of the market behavior of the companies which restricted competition.[447] However, the cooperation resulted in "substantial rationalization and cost-saving in machinery loss of profits insurance" and companies that are able to "make use of the specialized knowledge and experience of TEKO's staff and at the same time, by jointly concluding reinsurance contracts, obtain more favorable terms and conditions."[448] Because it benefitted consumers and did not contain any restrictions that are not indispensably to the attainment of the objective of substantial rationalization and cost-saving in machinery loss of profits insurance, exemption was granted.

In 1988, in the case of *Concordato Incendio*[449] the Commission was notified on an agreement concerning the activities of a non-profit association of insurance providers. The objective of the association was to "implement the principles governing insurance by providing members with the means of establishing sound management practices and improving the quality of service".[450] Concordato among other things defines insurance criteria, draws up industrial fire insurance statistics for the calculation of required premiums, updates required premium rates and all other calculation procedures and studies preventive measures and foreign markets. Although the association only invites members to use the required premiums and leaves members "free to decide independently (...) on the loading margin (general costs, commissions, profit) to be added to the required premium in order to form the tariff rate, the notified recommendation nevertheless has the object and effect of restricting competition between undertakings which would normally be competitors."[451]

However, the agreement improves the production or distribution of industrial fire insurance by providing considerable knowledge of the sector, risk assessment and the prevention of risk and providing (easier) access to the industrial fire insurance market for insurance providers[452], while the standard conditions make it easier for consumers to compare insurance policies and rates offered. The members are free to depart from the recommendations, fix their own rates and conditions and are only under the obligation to notify their derogations if these are likely to affect the statistics which makes it possibly to guarantee the uniformity of the statistics leaving the restrictions imposed on the undertakings concerned limited to what is strictly necessary.[453] The Commission therefore granted the exemption.

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444 90/22/EEC, at 3.
445 90/22/EEC, at 7.
446 90/22/EEC, at 9.
447 90/22/EEC, at 18.
448 90/22/EEC, at 2.
449 90/25/EEC Commission Decision of 20 December 1989 (IV/32.265 *Concordato Incendio*)
450 90/25/EEC, at 2.
451 90/25/EEC, at 20.
452 90/25/EEC, at 25.
453 90/25/EEC, at 26-28.

These Commission cases have been important in the drafting of the Commission block exemption for insurance.[454] Community competition regulation, including the block exemption, is described in chapter 5.

4 Conclusion

In this chapter I have described the legal development of the limits to state authority to regulate and the limits to market participants in their liberty to act in the EC Treaty and case law, and the exceptions to these limits provided in the EC Treaty and developed in case law.[455]

As seen in chapter 2 the freedom of establishment and the freedom to provide services apply to the business of insurance. These freedoms were initially defined as prohibiting discrimination on grounds of nationality or place of establishment. With the further interpretation of the freedoms in case law, the ECJ found them to prohibit indirect discrimination, and measures that hinder or make less attractive (establishment) or substantially impede (services) the exercise of these freedoms. For the freedom to provide services, in addition to the prohibition of state rules that substantially impede out-of-state service providers, the ECJ further limited states' regulatory authority with measures that create a disadvantage to the provision of intra-Community services to service providers established within the state.

With regard to limits on the liberty of the market participants, the ECJ has interpreted the Treaty articles on competition to apply to the insurance industry. This means that insurance market participants are bound by the ECJ interpretation of the limits in Community competition law.

The justifications for the obstacles and barriers developed in ECJ case law has followed the development of the limits. With the increase in limits for states and market participants, the Treaty exceptions and ECJ case law further clarified the conditions under which state measures can be justified. Where the justifications in the Treaty require the state regulations to relate to the protection of official authority, public policy, public security or public health and apply to both discriminatory regulation as well as to state rules without distinction to nationality of place of establishment, the rule of reason applies in principle only to national rules without distinction. For the rule of reason to apply state measures must be non-discriminatory, justified by reasons relating to the public interest, suitable for accomplishing the objective pursued, and not go beyond what is necessary to accomplish it.

The Treaty exception to the limits for market participants in the Treaty, article 81.3 EC, allows agreements, decisions or concerted practices when these contribute to improving the production or distribution of goods, or to promoting technical or

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454 Both the 1992 (Commission Regulation EEC No 3932/1992 of 21 December 1992, Official Journal L398, 31/12/1992 P. 0007-0014) and 2003 (Commission Regulation (EC) No 358/2003 of 27 February 2003 on the application of article 81(3) of the Treaty to certain categories of agreements, decisions and concerted practices in the insurance sector (Text with EEA relevance), Official Journal L053, 28/02/2003 P. 0008-0016) block exemption.

455 The limits to the competence of the states to regulate and act are complemented by the limits to the liberty of market participants to act. The Treaty does not allow to the market participant that which is prohibited to the states, i.e. erect obstacles and barriers to free and fair market access.

economic progress, while allowing consumers a fair share of the resulting benefit. The Commission in its decisions based on article 81(3)[456] EC Treaty has allowed rate-fixing, standard terms of cover, information exchanges and restrictions on contracting parties because these improved the production or distribution of the service, promoted technical or economic progress while allowing consumers a fair share of the resulting benefit.

Economic integration in the European Community is accomplished by eliminating intentional barriers and minimizing obstacles to free and fair interstate trade. The removal of these obstacles and barriers is realized by limiting states' authority to regulate and market participants' liberty to act with prohibitions in the Treaty and by the creation of secondary regulation. With regard to prohibitions in the Treaty, limits on states have increased over time in conjunction with ECJ rulings, as have limits on market participants. Exceptions to these Treaty limits, both in the Treaty and developed in case law, have followed this development and have allowed member states and market participants to regulate or act despite Treaty prohibitions, albeit only under specific conditions.

In the next chapter I describe the legal development of limits to state authority to regulate and market participants liberty to act and the exceptions to these limits in secondary legislation. Chapters 4 and 5 combined describe the legal development of insurance market integration in the European Community.

[456] With Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty (Text with EEA relevance) Official Journal L001, 04/01/2003 P. 0001-0025 the notification procedure to the Commission under article 81(3) has been abandoned. See chapter 5.

Chapter 5

Legal Development of Insurance Market Integration in the European Community

Secondary Regulation

1 Introduction

The Treaty establishing the European Economic Community in general, and the General Programs in particular asked for the issuance of directives and regulations to establish the freedom to provide insurance services, and the freedom of establishment for insurance providers. The Treaty also asked to create a system ensuring that competition in the common market would not be distorted.[457] In 1994, more than thirty years after the drafting of the General Programs and 24 years after the end of the transitional period for the establishment of a common market, the third of three generations of insurance directives[458] was implemented and a regulatory structure for access to the European insurance markets was completed.

The drafting of the three generations insurance directives[459] was a complicated and time consuming process. In the 1962 General Programs on the free movement of services and the right of establishment the Council specifically geared the liberalization of the insurance market to coordination and harmonization of the insurance regulation of the member states. The Council believed that freedom of establishment for insurers in the Community could best be achieved if the conditions for access to the various national insurance markets were the same, and freedom to provide insurance services could best be achieved if the legal and administrative provisions regarding insurance contracts were coordinated and the formalities regarding the mutual recognition and execution of judgments between the member states were simplified.

Member states, represented in the Council, voted on the Commission's proposals for directives to harmonize regulation. The voting required unanimity.[460] To have all member states agree on a proposal made the coordination and harmonization of the different insurance regulatory systems a time consuming process of compromise.[461] The first, relatively easy step in Community regulation

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457 See chapter 2.

458 Besides the three generations of insurance directives that facilitate the freedom of establishment for insurance providers and the freedom to provide insurance services, several other directives, regulations and recommendations have been enacted and drafted for the integration of the insurance market. See chapter 4.

459 The subsequent generations directives amended and complemented the former directives. For a complete overview of all amendments consult the EU website: http://europa.eu.int.

460 Article 100 EEC Treaty.

461 These differences in supervision methods (normative versus material supervision see section 2.2) not only caused great discussion, it resulted in normative supervision with aspects of

regarding the Community's insurance market was taken with the Reinsurance directive in 1964.[462] This was the first in a long line of insurance directives designed to facilitate the freedom of establishment and the freedom to provide services in the European insurance markets. Along with the three generations of insurance directives that facilitate access to the insurance markets, many more topic-specific directives were implemented.[463] The implementation of three generations of insurance directives established a regime of prudential supervision that facilitated market access for insurers and their services as well as the freedom of establishment and service provision.

The first generation directives in the 1970s were concerned with the freedom of establishment. They prohibited discrimination on the grounds of nationality and introduced authorization conditions for insurers and minimum supervision requirements. The second generation directives in the late 1980s and early 1990s were concerned with the freedom to provide insurance services. They facilitated the provision of services in member states other than the home member state of the insurer without the requirement of establishment. The third generation insurance directives in the 1990s combined the principles of the first two generations into a single authorization and a licence for insurers, the concept of home country control, and mutual recognition of supervision.

The result of these three generations insurance directives has been the harmonization of authorization requirements and minimum standards in supervision legislation. Although the three generations of insurance directives did not coordinate the legal and administrative provisions regarding insurance contracts, nor did they simplify the formalities regarding the mutual recognition and execution of judgments between the member states, they did accomplish the harmonization of the conditions for access to the various national insurance markets fulfilling one of the Council's goals in the General Programs on the freedom of establishment.

The directives eliminated (intentional) barriers and minimized obstacles to market access by limiting the state regulatory authority. These same directives, however, also provide exceptions to these limits. As described in chapter four, these exceptions were first introduced in the Treaty, further developed in case law by the European Court of Justice, and subsequently introduced in the directives.

Where the ECJ has found that Community competition regulation applies to the insurance industry (*Sachversicherer*), secondary legislation exempts market participants actions from its application for certain categories of agreements, decisions and concerted practices in the insurance sector.

The European Court of Justice has played an important role in the legal development of insurance market integration in the European Community. As the

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material supervision: the possibility of a more detailed supervision by the member states with the inclusion in de the insurance directives of the general good exception, and the (especially in former material-supervision member states such as Germany) continued possibility for cooperation among insurance providers with the enactment of the Commission block exemption for the rules on competition.
See sections 2 and 3.

462 Council Directive 64/225/EEC of 25 February 1964. In reinsurance the underwriters who sell policies buy insurance with reinsurers to spread their risk. (Raynes 1964, 327.)

463 See chapter 1 section 1.

interpreter of the Treaty and Community regulations, it has aided and directed the legal development of limits on state authority and the market participants ability to act in the Treaty and secondary regulation, as well as interpreted the justifications for obstacles and barriers to free and fair interstate trade.

This chapter describes European insurance market regulation, more specifically the three generations of insurance directives that facilitate access to member states' insurance markets, and Commission regulation (EEC) No. 3932/92 dated 21 December 1992 [464] which was replaced by Commission regulation (EC) no 358/2003 of 27 February 2003 "on the application of article 81 (3) of the Treaty to certain categories of agreements, decisions and concerted practices in the insurance sector"[465] regarding competition on the insurance markets, as well as the limits to the authority of the states to regulate and liberty of market participants to act as a result of these regulations. In section 2, I begin with the objective and content of the three generations of insurance directives and their limits to states' regulatory authority. These insurance directives have facilitated insurance market access for both the establishment and provision of services. The coordination of authorization and the minimum harmonization of supervision requirements has facilitated establishment in Europe's member states. Once established in a member state, an insurance provider can provide services throughout the Community without the need for authorization or establishment in the host member state. Although three generations of insurance directives were enacted to accomplish freedom of establishment for insurance providers and free movement of insurance services on the European insurance markets, the directives also provide justifications for some of the obstacles and barriers they prohibit. I describe the limits to states' regulatory authority as a result of the three generations directives as well as the exception to the limits.

Section 3 regards the limits, or rather the lack thereof, for insurance market participants in secondary Community competition law. Section 4 concludes this chapter.

2 Limits to State Regulatory Authority The Three Generations of Insurance Directives

2.1 First Generation: Establishment

The first generation of insurance directives regulated the freedom of establishment for insurance providers. The directives coordinate state regulations with regard to market access, authorization and supervision of insurance providers, and abolish discrimination. The First non-life Council Directive is applicable to non-life direct insurance only and very specifically excludes certain insurances, operations and institutions.[466] Directive 73/239/EEC, "on the coordination of laws, regulations and

[464] Commission Regulation (EEC) No 3932/92 of 21 December 1992 on the application of article 85 (3) of the Treaty to certain categories of agreements, decisions and concerted practices in the insurance sector, Official Journal L 398, 31/12/1992 P. 0007-0014.

[465] Commission Regulation (EC) No 358/2003 of 27 February 2003 on the application of article 81(3) of the Treaty to certain categories of agreements, decisions and concerted practices in the insurance sector (Text with EEA relevance), Official Journal L 053, 28/02/2003 P. 0008-0016.

[466] Both in the preamble of the directive as well as in the articles 2-4 of directive 73/239/EEC (see

administrative provisions relating to the taking-up and pursuit of the business of direct insurance other than life assurance", was issued on 24 July 1973.

To facilitate the taking up and pursuit of the business of direct non-life insurance in the European Community, this directive made the establishment of insurance companies subject to official authorization by the member state of establishment.[467] The directive coordinates state supervisory regulation by laying down conditions[468] for granting or withdrawing[469] authorization. These conditions include minimum standards for technical reserves[470], the solvency margin[471], a guarantee fund[472], and the annual accounts[473], to ensure that insurers possess adequate resources as well as a supplementary reserve, the solvency margin, to ensure adequate protection for the insured and third parties.[474]

These coordination measures, although they introduced a Community-wide system of authorization for insurance providers, did not harmonize member states' insurance laws. It erected a common framework for market access, which left ample room for member states to regulate their insurance markets. The calculation methods for technical reserves[475] for example, or the provisions of some member states' regulations requiring the approval of general and specific policy conditions, tariffs, and documents necessary for supervision[476] were not harmonized in the first generation insurance directives and remained within the regulatory authority of the states.

The lack of harmonization of calculation methods in the first generation of insurance directives resulted, due to the ECJ decision in the insurance cases[477], in the inclusion of state justification for maintaining obstacles and barriers to free interstate insurance for reasons of the general good in both the second and third generations of insurance directives. At the time of the drafting of the first generation non-life insurance directives the calculation methods for technical reserves was the subject of studies at Community level. It was therefore decided that coordination of the calculation methods and the determination of categories of investments and the

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annex) the Council has laid down which insurances, operations and institutions were excluded from the applicability of the directive.

467 Articles 6 and 23 First Council Directive 73/239/EEC 24 July 1973.

468 Articles 6, 7, 8, 9, 10, 11, 24, 25 First Council Directive 73/239/EEC 24 July 1973.

469 Article 22 First Council Directive 73/239/EEC 24 July 1973.

470 It did not however harmonize the methods of calculation (Judgment of the Court of 4 December 1986. Case 205/84, ECR [1986] Page 03755, paragraph 38).
Article 15 First Council Directive 73/239/EEC 24 July 1973.

471 Articles 16, 25, 26 First Council Directive 73/239/EEC 24 July 1973.

472 Article 17 First Council Directive 73/239/EEC 24 July 1973.

473 Articles 19, 27 First Council Directive 73/239/EEC 24 July 1973.

474 Preambule First Council Directive 73/239/EEC 24 July 1973 on the coordination of laws, regulations and administarative provisions relating to the taking up and pursuit of the business of direct insurance other than life assurance.

475 Technical reserves of sufficient amount to meet their underwriting liabilities.
Article 15 First Council Directive 73/239/EEC 24 July 1973.

476 Article 10.3 First Council Directive 73/239/EEC 24 July 1973.

477 *Commission of the European Communities v Federal Republic of Germany*. Case 205/84, ECR [1986] Page 03755, *Commission of the European Communities v French Republic*. Case 220/83. ECR [1986] Page 03663, *Commission of the European Communities v Kingdom of Denmark*. Case 252/83. ECR [1986] Page 03713, *Commission of the European Communities v Ireland*. Case 206/84, ECR [1986] Page 03817. See chapter 4.

valuation of assets should be the subject of subsequent directives.[478] It was not however until 19 December 1991 that Council Directive 91/674/EEC "on the annual account and consolidated accounts of insurance undertakings" was enacted.[479]

Council Directive, 73/240/EEC, on "abolishing restrictions on freedom of establishment in the business of direct insurance other than life assurance"[480], adopted together with the first non-life insurance directive, required national treatment of insurers from other member states.[481] This made establishment in other member states possible under the same conditions, and with the same rights as nationals of the host member states, eliminating discrimination. It also prohibited member states from aiding nationals who wished to establish themselves in another member state if that aid was liable to distort the conditions of establishment.[482]

It took the Council eleven years, from the 1962 General Program to the adoption of the insurance directives in 1973, to agree on minimum coordination of authorization conditions and supervision requirements, leaving all other member states' insurance laws intact. As seen in chapter 2, Council directives such as national treatment directive 73/240/EEC," had become superfluous with regard to implementing the rule on nationality"[483] after the 1974 *Reyners*[484] and *van Binsbergen*[485] decisions. Here the European Court of Justice found that the Treaty freedoms of establishment and provision of services had direct effect which meant that discriminatory state regulations could be challenged before a national court.

As for life insurance, six years after the First Council Directives on the business of direct non-life insurance, the Council issued, on 5 March 1979, the First Council Directive 79/267/EEC "on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of direct life assurance."[486] It resembled the 1973 directive on non-life insurance, coordinating conditions for authorization[487] and minimum supervision requirements.[488] Like the first generation non-life insurance directive, the first generation life insurance directive excluded

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478 Preamble to Council Directive 73/239/EEC.

479 See section 2.3.

480 Council Directive 73/240/EEC 24 July 1973.

481 Articles 1 and 2 Council Directive 73/240/EEC 24 July 1973.

482 Article 5 of Council Directive 73/240/EEC 24 July 1973.

483 In *Jean Reyners v. Belgian State.* Case 2/74, ECR [1974], page 0631 the European Court of Justice established direct effect. It determined that "after the expiry of the transitional period (1970) the directives provided for by the chapter on the right of establishment have become superfluous with regard to implementing the rule on nationality, since this is henceforth sanctioned by the treaty itself with direct effect."(paragraph 30) Despite the fact that the condition, enact a directive, to implement the rule on nationality was removed with the finding of direct effect in *Reyners*, directives continue to be important for their ability to place much greater pressure on member states to adjust their legislation than court decisions do.

484 *Jean Reyners v. Belgian State.* Case 2/74, ECR [1974], page 0631.

485 *Johannes Henricus Maria van Binsbergen v Bestuur van de Bedrijfsvereniging voor de Metaalnijverheid.* Case 33-74, ECR [1974] Page 01299.

486 First Council Directive 79/267/EEC 5 March 1979 (No longer in force, repealed by 2002/83/EC).

487 Title I section A articles 6-12, section C article 26 First Council Directive 79/267/EEC 5 March 1979 (No longer in force, repealed by 2002/83/EC).

488 Title I section B articles 15-25 (technical reserves article 17, solvency margin articles 18, 19, guarantee fund article 20, annual account article 23) First Council Directive 79/267/EEC, 5 March 1979 (No longer in force, repealed by 2002/83/EC).

several insurances, operations and organizations.[489] And like Council Directive 73/239/EEC it did not provide for calculation methods for the technical reserves but rather left them to be determined by the member states' rules or established practices.

This directive prohibited[490] new insurance companies from simultaneously issuing non-life and life insurance policies.[491] This prohibition was included to safeguard the interests of both life insurance policy holders and non-life insurance policy holders. To avoid that the financial obligations of non-life insurance business be borne by life insurance business, which is much less susceptible to large and sudden variations in loss incidence, life and non-life insurance funds needed to be strictly divided.[492]

These first generation insurance directives of 1973 and 1979 coordinated official authorization conditions and minimum standards for supervision, while applying the national laws of the member states without discrimination. It had been a slow and complicated process of compromise to achieve this result. The decisions making veto right of the member states in the Council, in combination with the requirement in the General Programs for the coordination of member states' rules, laws and regulations, complicated and slowed the integration of the European insurance markets.

Unanimity is difficult to achieve on a matter such as insurance which permeates the economy and law of every member state, and where great variation in states' regulatory structures exists.[493] It therefore was not until after the introduction of the White Paper "on completing the internal market"[494] and the subsequent amendments to the Treaty brought on by the Single European Act of the late 1980's[495], that insurance market integration accelerated.

Rather then attempting to harmonize state laws, the White Paper introduced a new approach to economic integration. Three key elements had to create (insurance) market integration: the harmonization of essential standards rather than details, mutual recognition of rules and regulations, and home country control of the insurance provider. These three elements, together with the introduction of qualified majority voting for economic integration harmonization measures[496], made decision-making in the European Community less complicated. The second

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489 Preamble to the directive as well as articles 2-4.
Preamble: "Whereas certain mutual associations which, by virtue of their legal status, fulfil requirements as to security and other specific financial guarantees should be excluded from the scope of this directive; whereas certain organizations whose activity covers only a very restricted sector and is limited by their articles of association should also be excluded".

490 Amended in article 18 of the Second Council Directive on direct life insurance 90/619/EEC of 8 November 1990 (No longer in force, repealed by 2002/83/EC) and article 16 of the Third Council Directive on direct life insurance 92/96/EEC of 10 November 1992 (No longer in force, repealed by 2002/83/EC).

491 Articles 13, 14 First Council Directive 79/267/EEC 5 March 1979 (No longer in force, repealed by 2002/83/EC).

492 Merkin Rodger 1997, 7.

493 See Clifford Chance, *Insurance Regulation in Europe*, Lloyd's list practical guides, Lloyd's of London press ltd 1993, chapter 9.

494 COM (85) 310.

495 See chapter 2.

496 Article 100A EC Treaty.

and third generation of insurance directives were issued soon after the implementation of the Single European Act.

2.2 Second Generation: Provision of Services

Where the first-generation of insurance directives facilitated the establishment of insurers within the European Community, the second-generation of insurance directives facilitated the freedom to provide services in all member states. The process of drafting the first insurance directives had shown that it was very difficult to reach agreement on common standards among the member states of the European Community.[497] Rather than attempting to harmonize details of member states' insurance legislation, the second generation of insurance directives followed the newly introduced approach to economic integration: the harmonization of essential standards only, the mutual recognition of member states' rules and regulations rather than the harmonization thereof, and home country control.

On 22 June 1988 the Second Council Directive 88/357/EEC "on the coordination of laws, regulations and administrative provisions relating to direct insurance other than life assurance and laying down provisions to facilitate the effective exercise of freedom to provide services and amending directive 73/239/EEC" was issued. This insurance directive facilitated the freedom to provide insurance services in the internal insurance market and amended the first non-life insurance directive. Like the first non-life insurance coordination directive[498], the second coordination directive excluded a number of insurances, operations, and institutions from its reach, leaving their regulation exclusively to individual member states.[499]

The directive provides a definition of establishment to determine if the authorization and supervision laws of the host member state apply, or, in the case of the provision of services, the authorization and supervision laws of the home member state of the insurer.[500] While the first generation of insurance directives accomplished freedom of establishment by eliminating discrimination, introducing and coordinating authorization requirements, and setting minimum supervision standards, the second generation of insurance directives allowed insurers to sell insurance services in other member states without having to fulfill all establishment requirements, which would, as the ECJ found in *Säger*, deprive the freedom to provide services of all practical effectiveness.[501]

The directive introduced normative control[502] and partly abolished the material control that the first generation of insurance directives allowed. Member states

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497 Merkin Rodger 1997, 3.

498 Council Directive 73/239/EEC.

499 Preamble and title III (article12) of Council Directive 88/357/EEC.

500 "Any permanent presence of an undertaking in the territory of a member state is considered and shall be treated in the same way as an agency or branch, even if that presence does not take the form of a branch or agency, but consists merely of an office managed by the undertakings's own staff or by a person who is independent but has permanent authority to act for the undertaking as an agency would." Article 3 Directive 88/357/EEC.

501 *Manfred Säger v Dennemeyer & Co. Ltd.* Case C-76/90, ECR [1991] Page I-04221, paragraph 13.

502 There are many forms of insurance supervision. They all exist somewhere in between no government interference at all to state insurance companies. The most commonly used distinction is between normative supervision structures and material supervision structures.

could no longer "lay down provisions requiring the approval or systematic notification of general and special policy conditions, scales of premiums, or forms and other printed documents which the undertaking intends to use in its dealings with policy-holders."[503] Although the directive introduced normative control, it applied to large risks insurance only and host-state authorization measures to protect consumers of mass risk insurance[504] from out-of-state insurers continued to be allowed.[505]

As already mentioned in chapter 4, the Commission reviewed and rewrote its initial proposal for the second generation of insurance directives as a result of the ECJ judgment in the "insurance cases".[506] Instead of fully liberalizing the provision of insurance services by way of mutual recognition of the authorization and supervision of the home member state, it adjusted its proposal to integrate the ECJ's ruling. In the insurance cases the ECJ found that consumers of mass risk insurance in Europe needed protection. It found that because the first generation "coordination" insurance directives[507] did not harmonize the national rules concerning technical reserves[508] nor the conditions of insurance[509], and considerable differences still existed between states' rules concerning technical reserves and assets, a member state was justified in the "application of its own legislation concerning technical reserves and the conditions of insurance, provided that the requirements of that legislation do not exceed what is necessary to ensure the protection of policyholders and insured persons."[510]

Although the special protection of mass risk insurance policy holders was originally not part of the Commission proposal for the second generation of

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Normative supervision is ex-post supervision where within the leeway of state imposed general rules the insurance provider is free to perform its business. The state rules generally contain solvability rules combined with rules on the publication of an annual report. State interference is limited to supervision afterwards with, if necessary, the competence to interfere in the management of the insurance company. Material supervision on the other hand is ex-ante supervision where detailed government regulation dominates the supervision structure. The rules vary from prior approval of insurance policies to compulsory imposition of insurance rates. The supervision is not repressive as with normative supervision but rather preventive.
See Vermaat 1993, 70.

503 Articles 9 and 18 of Council Directive 88/357/EEC.

504 The distinction between mass and large risk distinguished policyholders who were directly in need of protection and policyholders who were not. Mass risk insurance is insurance bought by private persons, while large risk insurance is insurance of a more commercial nature.

505 Article 9, 18 and 5(d) Council Directive 88/357/EEC.

506 *Commission of the European Communities v Federal Republic of Germany*. Case 205/84, ECR [1986] Page 03755, *Commission of the European Communities v French Republic*. Case 220/83. ECR [1986] Page 03663, *Commission of the European Communities v Kingdom of Denmark*. Case 252/83. ECR [1986] Page 03713, *Commission of the European Communities v Ireland*. Case 206/84, ECR [1986] Page 03817.

507 Directive 73/239/EEC (non-life) and Directive 79/267/EEC (life).

508 *Commission of the European Communities v Federal Republic of Germany*. Case 205/84, ECR [1986] Page 03755, paragraphs 38-39.

509 *Commission of the European Communities v Federal Republic of Germany*. Case 205/84, ECR [1986] Page 03755, paragraph 40.

510 *Commission of the European Communities v Federal Republic of Germany*. Case 205/84, ECR [1986] Page 03755, paragraphs 39, 40, 41.

insurance directives, the conclusions of this judgment were adopted into the second generation of insurance directives.[511] It introduced consumer protection as an interest of the general good which provided member states with the possibility to impose additional requirements on insurance service providers. The Commission had set out to limit member states' authority to regulate in order to eliminate all obstacles and barriers, i.e. additional authorization and establishment requirements, including any material, prior systematic control that could interfere with the freedom to provide insurance services. The directive however only placed limits on the regulatory authority of the member states with regard to the freedom to provide large risk insurance, requiring that the sale of large risk insurance services across borders be possible without prior authorization or supervision by the host member state. The directive allowed host member states to restrict the freedom to provide "certain sectors of insurance"[512], i.e., mass risk insurance.[513]

The second life insurance directive[514] resembles the second non-life insurance directive. It also allowed host member states to maintain consumer protection measures.[515] Host member state authorization measures for the provision of life insurance services continued to be allowed, not based on the nature of the risk insured, as in non-life "mass" insurance, but based on the actions of the parties to the insurance.[516] Two groups of policyholders were distinguished: those who actively solicited life insurance with an out-of-state insurance provider and those offered life insurance by an out-of-state insurance provider.[517] For the first group of policy-holders and insured persons supplementary host member state authorization measures for the insurance provider were not allowed in the second generation insurance directive. For the second group of policy-holders and insured persons however, supplementary authorization measures are justified on consumer protection grounds, *if* the rules of the home member state are insufficient to achieve the necessary level of protection, *and* the requirements of the host member state do not go beyond what is necessary.[518]

The subsequent third-generation of insurance directives further limited the regulatory authority of member states by creating a single licence in combination with home country control and mutual recognition and eliminating the distinction between mass and large risks and solicited and unsolicited life insurance.[519]

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511 Merkin Rodger 1997, 9. The result of the insurance cases was that the Commission adjusted its initial plan to integrate the Court's rulings. It introduced the distinction between mass and large non-life insurance and solicited and unsolicited life insurance to distinguish between consumers in need of additional host member state protection and those not in need of additional protection.

512 *Commission of the European Communities v Federal Republic of Germany*. Case 205/84, ECR [1986] Page 03755, paragraph 49.

513 Kapteyn 2003, 560.
Kapteyn/Gormley 1998, 675.

514 Council Directive 90/619/EEC.

515 See articles 19, 13 and 14 Council Directive 90/619/EEC.

516 Because the distinction between mass and large risks could not be applied to life insurance, the solution adopted was between "ordinary policyholders and policyholders who had taken the initiative in seeking the commitment". Merkin Rodger 1997, at 11.

517 Article 13 Council Directive 90/619/EEC.

518 Article 19 Council Directive 90/619/EEC.

519 Duijkersloot 1995, 104.

2.3 Third Generation: Single Licence

The third-generation of insurance directives[520], non-life and life[521], completed the regulatory structure for access to the European insurance market. It introduced a 'single licence' for insurers. This single licence makes the home member state authorization a passport for access to the insurance markets of the European Community. Insurance services can be provided either directly from the home member state to the host member state or via a branch or agency in the host member state. Reciprocal recognition of the home state authorization and supervision is required by all member states, leaving authorization and supervision to the home member state of the insurer rather than to the host member state.[522]

The discrepancies that existed between the national rules on the calculation of technical reserves and assets were eliminated by Council Directive 91/674/EEC dated 19 December 1991 "on the annual accounts and consolidated accounts of insurance undertakings". This supplement to the insurance directives has brought about the minimum harmonization needed to allow mutual recognition of authorizations and prudential control systems. The result is a single authorization that is valid throughout the Community, and supervision by the home member state of the insurance undertaking only.

Despite the elimination of the discrepancies that existed between the national rules on calculation methods for technical reserves and assets however, the consumer protection exception that was introduced in the second generation insurance directives has been maintained in the third generation insurance directives in the form of a general good exemption. This general good exemption offers (continuous and new) opportunities for host member states to circumvent the limitations placed on their regulatory authority in secondary legislation if the general good so requires.[523]

Despite the fact that the third generation of insurance directives abolished prior authorization and supervision by host member states, they retained some power to apply stricter authorization or supervision measures on out-of-state insurers (as well as their inter-state insurers[524]).[525] Also, the host member state can act if the home

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520 Completing and amending the prior generations of insurance directives.

521 Council Directive 92/49/EEC and Council Directive 92/96/EEC (no longer in force, repealed by 2002/83/EC).

522 Authorization is valid for the entire Community (article 7 Council Directive 92/49/EEC and article 7 Council Directive 92/96/EEC) and financial supervision of an insurance undertaking is the sole responsibility of the home member state (article 8 Council Directive 92/49/EEC and article 9 Council Directive 92/96/EEC).

523 The general good exception in the third generation insurance directives makes "material control a posteriori" possible. See Kalkman, Hendriksen, Bongaarts, *Algemeen belang als blokkade voor de vrijheid van dienstverrichting door verzekeraars in de interne markt*, het Verzekeringsarchief 1992 v 69 nr 2, 177.

524 "The third insurance directives stipulate that, in so far as certain of their provisions define minimum standards, a home member state may lay down stricter rules for insurance undertakings authorized by its own competent authorities. Third Council Directive 92/49/EEC, recital 8, and Third Council Directive 92/96/EEC (No longer in force, repealed by 2002/83/EC), recital 9.I-487." Commission Interpretative Communication – Freedom to provide services and the general good in the insurance sector Official Journal C 043, 16/02/2000 P. 0005-0027, 17.

member state of the insurer fails to stop or prevent infringements by the insurer of the host member state's law[526], and as previously seen, it has been granted the authority to impose restrictions on an insurance undertaking that is authorized and supervised in another member state to comply with its general good provisions.

Neither third generation insurance directives, non-life insurance nor life insurance, define "general good". As seen in the previous chapter, the ECJ, as long as the Council does not define general good, determines whether the use is justified based on its rule of reason conditions developed in its case law.[527] As seen in the previous chapter, although conditions for the justification in the general good are similar in both the freedom of establishment and the freedom to provide services, as in the application of the rule of reason, the assessment of the proportionality of a restriction can differ depending on the freedom it restricts. Restrictions that are proportionate in establishment may be disproportionate in the provision of services. In *Säger* for example, we have previously seen that the ECJ emphasized that making the provision of services subject to all conditions required for establishment deprives the freedom to provide services of all practical effectiveness.[528]

Exceptions in "the general good" have taken on several forms in ECJ "rule of reason" case law. From consumer protection[529], to professional rules intended to protect the recipient of services[530], the cohesion of the tax system[531], the good reputation of the national financial sector[532], etc.[533]

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525 Commission Interpretative Communication – Freedom to provide services and the general good in the insurance sector Official Journal C 043, 16/02/2000 P. 0005-0027, 20: "The Third Directives expressly forbid any prior or systematic substantive control of insurance policies and policy documents (Articles 6(3), 29 and 39 of Directive 92/49/EEC and Articles 5(3), 29 and 39 of Directive 92/96/EEC (No longer in force, repealed by 2002/83/EC).), irrespective of the name given by the national authorities to the system used, whether it involves the prior approval of policies and scales of premiums or their simple, systematic notification with tacit approval or with the deposit of documents before they can be used. "Prior or systematic approval is henceforward authorized only in those cases explicitly provided for in the Community directives. Such is the case with compulsory insurance (e.g. compulsory third-party motor insurance [article 30(2) of Directive 92/49/EEC.] or health insurance which is a substitute for a statutory system of social security [article 54(1) of Directive 92/49/EEC.], where member states may require that the general conditions of that insurance be communicated before use but, under no circumstances, approved. As for life assurance, the member state of origin may require systematic notification of the technical bases used for calculating scales of premiums and technical provisions [article 29 of Directive 92/96/EEC and article 5(3) of Directive 79/267/EEC.)"(No longer in force, repealed by 2002/83/EC.) Commission Interpretative Communication – Freedom to provide services and the general good in the insurance sector Official Journal C 043, 16/02/2000 P. 0005-0027, 20.

526 Article 40 Council Directive 92/49/EEC and article 40 Council Directive 92/96/EEC (no longer in force, repealed by 2002/83/EC, article 46).

527 The differences in interpretation of the Community rules and the resulting legal uncertainty led to the adoption of the Commission Interpretative Communication – Freedom to provide services and the general good in the insurance sector (Official Journal C 043, 16/02/2000 P. 0005-0027) as part of the European Council's Action Plan (Implementing the framework for financial markets, COM 1999 232, 11/5/1999).

528 *Manfred Säger v Dennemeyer & Co. Ltd.* Case C-76/90, ECR [1991] Page I-04221, paragraph 13.

529 *Commission of the European Communities v Federal Republic of Germany.* Case 205/84, ECR [1986] Page 03755.

530 *Johannes Henricus Maria van Binsbergen v Bestuur van de Bedrijfsvereniging voor de Metaalnijverheid.* Case 33-74, ECR [1974] Page 01299.

The introduction of the general good as an exception to Community regulation in the third generation of insurance directives allows the states to maintain regulations that are found to be obstacles or barriers to the integration of the insurance markets but that pursue a legitimate objective compatible with the Treaty, are justified by pressing reasons of public interest, not discriminatory, and appropriate for attaining the objective it pursues without going beyond what is necessary for that purpose.[534]

3 Limits for Market Participants Secondary Legislation

As detailed in the previous chapter, the EC Treaty contains competition rules that apply to the insurance industry. Articles 81 and 82 EC Treaty contain direct limits to market participants. Their objective is to maintain fair competition in the common market. Although the articles refer only to goods, in the 1987 case of *Verband der Sachversicherer eV v European Commission*[535] the European Court of Justice confirmed that the rules on competition apply to insurance services and that the Community had the authority to limit insurance market participants in their liberty to act.[536]

Article 83(1) EC Treaty contains the procedure for the regulation of the system of fair trade as laid down in articles 81 and 82 of the Treaty. It requires the Council, on a proposal from the Commission and after having consulted the European Parliament, to adopt regulations that "give effect to the principles set out in Articles 81 and 82". Article 83(2)(b) EC Treaty states that "the regulations or directives referred to in paragraph 1 shall be designed in particular to lay down detailed rules for the application of article 81(3), taking into account the need to ensure effective supervision on the one hand, and to simplify administration to the greatest possible extent on the other." Article 81 (3) EC Treaty provides for exemptions to the general prohibition if the agreement, decision or concerted practices contribute to fair trade.[537]

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531 *Hanns-Martin Bachmann v Belgian State.* Case C-204/90, ECR [1992] Page I-00249.

532 *Alpine Investments BV v Minister van Financiën.* Case C-384/93, ECR [1995] Page I-01141.

533 See for more case law Commission Interpretative Communication – Freedom to provide services and the general good in the insurance sector, Official Journal C 043, 16/02/2000 P. 0005-0027, 13.

534 *Dieter Kraus v Land Baden-Württemberg.* Case C-19/92. ECR [1993] Page I-01663 and *Reinhard Gebhard v Consiglio dell'Ordine degli Avvocati e Procuratori di Milano.* Case C-55/94, ECR [1995] Page I-04165.

535 *Verband der Sachversicherer e.V. v Commission of the European Communities.* Case 45/85, ECR [1987] Page 00405.

536 See chapter 2.

537 In the case of:

"– any agreement or category of agreements between undertakings,
– any decision or category of decisions by associations of undertakings,
– any concerted practice or category of concerted practices,
which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:
(a) impose on the undertakings concerned restrictions which are not indispensable to the

The Council has not as such regulated competition with regard to insurance. Instead, it has granted the Commission, in its Council Regulation (EEC) No. 1534/91 dated 31 May 1991 "on the application of article 85(3)[538] of the Treaty to certain categories of agreements, decisions and concerted practices in the insurance sector"[539], the authority to adopt a block exemption for certain classes of insurance agreements. The Commission used its authority first in 1992, when it issued Commission Regulation (EEC) No. 3932/92 dated 21 December 1992 "on the application of article 85(3)[540] of the Treaty to certain categories of agreements, decisions and concerted practices in the insurance sector."[541] This as a response to the number of notifications for exemption under article 81(3) EC Treaty by insurance companies to the Commission as a result of the *Sachversicherer* case in which the ECJ made clear that the special characteristics of the insurance industry could be taken into account.

These special characteristics of the insurance industry are the reason for states to both regulate the insurance market and at the same time exempt it from competition regulation.[542] The special characteristics relate to the excess in capacity on insurance markets which could lead to low premiums and bankruptcy, insufficient information for accurate premium calculation and a tendency to underestimate risk in order to compete, the lack of transparency in offered products which leads to competition on the product level and information costs for the consumer, the lack of uniformity in both policy conditions and risk assessment which results in high transaction costs and the need for financial security, i.e., trust and confidence of the public in the insurance industry which is essential as "an instrument of planning the future".[543]

Besides the *Sachversicherer* case's effect on the number of notifications for exemption from competition law, another ECJ case also influenced the drafting of the insurance block exemption regulation. At around the same time of its judgement in *Sachversicherer* the ECJ in the *German insurance* case[544] found state regulation that conflicted with the freedom to provide services justified because of the special characteristics of the insurance industry and the lack of Community regulation.[545] The ECJ found state regulation that protected the consumer justified which, as seen in the previous section, led to the introduction of consumer protection, and later the general good exemption, in the second and third generations of insurance directives.

Despite the exemption in the generations of insurance directives however, the states are more limited in their authority to regulate the insurance industry than before the three generations insurance directives were implemented. Where state

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attainment of these objectives;
(b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question."

538 Article 81(3) EC Treaty.

539 Official Journal L 143, 07/06/1991 P. 0001-0003.

540 Article 81(3) EC Treaty.

541 Official Journal L 398, 31/12/1992 P. 0007-0014.

542 See chapter 3 for the interests on the insurance markets that state regulation aims to protect.

543 Wulf-Henning Roth, European Competition Policy for the Insurance Market, in European Common Law Review, Issue 2, Sweet & Maxwell Limited (and contributors) 2000, 108.

544 *Commission of the European Communities v Federal Republic of Germany*. Case 205/84, ECR [1986] Page 03755.

545 See chapter 4.

regulation with regard to the solvency of insurance providers is now limited to normative prudential regulation and is in principle the responsibility of the home member state of the insurance provider only, the insurance providers have been given leeway for coping with processes such as gathering statistics for premium calculation, cooperation with regard to standard policy conditions and the common coverage of certain types of risks warranting their solvency in the insurance block exemption regulation.

The principles in the 1992 block exemption were derived by the Commission from the insurance cases it had previously investigated under article 81(3)[546] of the Treaty.[547] Because collaboration between insurance companies goes beyond what the Commission permits in its notice concerning cooperation between enterprises[548] and is therefore in violation of article 81(1) EC[549], the Commission stated in the preamble to the regulation the importance of specifying the obligations for the four categories of agreements to be exempt from article 81(1).[550]

Article 1 of the Commission regulation[551] provided exemptions from article 81(1)[552] EC for:

> "agreements, decisions by associations of undertakings and concerted practices in the insurance sector which seek cooperation with respect to:
> (a) the establishment of common risk-premium tariffs based on collectively ascertained statistics or on the number of claims;
> (b) the establishment of standard policy conditions;
> (c) the common coverage of certain types of risks;
> (d) the establishment of common rules on the testing and acceptance of security devices."[553]

For the establishment of common risk-premium tariffs based on collectively ascertained statistics or on the number of claims (category a), the regulation summed up how these statistics could be collected or studied[554] as well as the

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546 Ex. article 85(3) EC Treaty.

547 84/191/EEC, Commission Decision of 30 March 1984 (IV/30.804 *Nuovo Cegam*), 85/75/EEC Commission Decision of 5 December 1984 (IV/30.307 - *Fire Insurance (D)*), 85/615/EEC Commission Decision of 16 December 1985 (IV/30.373 *P&I clubs*), 90/22/EEC Commission Decision of 20 December 1989 (IV/32.408 *TEKO*), 90/25/EEC Commission Decision of 20 December 1989 (IV/32.265 *Concordato Incendio*) See chapter 4.

548 Notice concerning agreements, decisions and concerted practices in the field of cooperation between enterprises /*unofficial translation*/ C 075 van 29/07/1968 BLZ. 0003-0006.

549 Ex. 85 (1) EC Treaty.

550 Ex. 85 (1) EC Treaty.

551 Commission Regulation (EEC) No 3932/92 of 21 December 1992 on the application of article 85 (3) of the Treaty to certain categories of agreements, decisions and concerted practices in the insurance sector, Official Journal L 398, 31/12/1992 P. 0007-0014, article 1.
Kapteyn 2003, 667.
Merkin Rodger 1997, 173.

552 Ex. 85 (1) EC Treaty.

553 As regards to the exemption of common rules on the testing and acceptance of security devices, rather than related to the special characteristics of insurance, this is a result of the 1985 European Act's new approach in accomplishing technical harmonization and standardization to improve the functioning of the internal market and to promote competition. See Roth, 2000, 112.

554 Article 2 Commission Regulation 3932/92, Official Journal L 398, 31/12/1992 P. 0007-0014.

conditions that had to be be fulfilled before the exemption could apply.[555] For the establishment of standard policy conditions, title three of the Commission Regulation ("Standard policy conditions for direct insurance") provided the requirements and conditions for the exemption to apply.[556] For the other two categories – the common coverage of certain types of risks and the establishment of common rules on the testing and acceptance of security devices – titles IV[557] and V[558] provided the requirements and conditions for exemption from article 81 EC.

All agreements that fell within the conditions of the block exemption were exempt and did not have to be reported to the Commission. All other agreements needed to be submitted for consideration for exemption from the rules of competition. With Council regulation 1/2003[559], the notification procedure for agreements that are not covered in the block exemption has been abandoned. It has been replaced with a directly applicable exception system where the competition authorities and courts of the member states have the power not only to apply article 81(1) and article 82 of the Treaty but also article 81(3) of the Treaty.

Upon its expiry on 31 March 2003 the 1992 block exemption has been replaced with Commission Regulation (EC) No 358/2003 of 27 February 2003 "on the application of article 81(3) of the Treaty to certain categories of agreements, decisions and concerted practices in the insurance sector".[560] This new insurance block exemption covers the same four categories of agreements in the previous block exemption, albeit slightly adjusted.

As regards the joint calculation and studies of risks[561] the regulation requires that the calculation of premiums must concern pure premiums – average cost of risk cover – based on statistics that are based on sufficient data and may only be illustrative and non-binding.[562] The current block exemption regulation makes one condition for exemption that was implicit in the previous regulation explicit, i.e., that statistics must be broken down in as much detail as possible[563], and introduced a new condition that requires statistics on risk premiums to be made available to any insurance undertaking on reasonable and non-discriminatory terms.[564]

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555 Article 3 Commission Regulation 3932/92, Official Journal L 398, 31/12/1992 P. 0007-0014.

556 TITLE III Standard policy conditions for direct insurance: Articles 5, 6, 7, 8, 9 Commission Regulation 3932/92, Official Journal L 398, 31/12/1992 P. 0007-0014.

557 TITLE IV Common coverage of certain types of risks: Articles 10, 11, 12, 13 Commission Regulation 3932/92, Official Journal L 398, 31/12/1992 P. 0007-0014.

558 TITLE V Security devices: Articles 14, 15 Commission Regulation 3932/92, Official Journal L 398, 31/12/1992 P. 0007-0014.

559 Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty (Text with EEA relevance) Official Journal L 001, 04/01/2003 P. 0001-0025.

560 Commission Regulation (EC) No 358/2003 of 27 February 2003 on the application of article 81(3) of the Treaty to certain categories of agreements, decisions and concerted practices in the insurance sector (Text with EEA relevance) Official Journal L 053, 28/02/2003 P. 0008-0016.

561 Chapter 2. Commission Regulation (EC) No 358/2003 Official Journal L 053, 28/02/2003 P. 0008-0016.

562 Articles 3 and 4 (ex articles 3 and 4) Commission Regulation (EC) No 358/2003 Official Journal L 053, 28/02/2003 P. 0008-0016.

563 Article 3(1)b Commission Regulation (EC) No 358/2003 Official Journal L 053, 28/02/2003 P. 0008-0016.

564 Article 3(2)c Commission Regulation (EC) No 358/2003 Official Journal L 053, 28/02/2003 P. 0008-0016.

Standard policy conditions are in principle only allowed if they are optional. The regulation however provides a list of standard conditions that, even when they are optional, are still prohibited. With regard to the common coverage of certain types of risks these are exempted if the cooperation falls below certain market share thresholds. The existing thresholds have been increased in the current block exemption[565] and a new exemption has been introduced applicable for co-insurance or co-reinsurance groups which cover new risks regardless of the market share of the group.[566]

As to the establishment of common rules on the testing and acceptance of security devices the previous as well as the current regulation granted an exemption for the joint determination of lists of approved safety equipment. However, it does not exempt agreements among insurers for the use of these lists.[567]

4 Conclusion

In this chapter I have described the limits on state authority to regulate and the limits on market participants liberty to act in secondary Community regulation and case law (ECJ and Commission decisions) and the exceptions to these limits.

The three generations of insurance directives limit state authority to regulate the authorization and supervision of insurance providers. The first generation of insurance directives facilitated establishment, the second generation the provision of services, and the third completed the framework for access to insurance markets with the introduction of a single licence, mutual recognition of supervision and home country control.

Exceptions to the prohibitions in the insurance directives have, like the justifications for the obstacles and barriers in the Treaty, followed the development of these limits. The first generation, the establishment directives, required equal treatment and provided for authorization requirements and minimum supervision standards. These directives created a framework for authorization and supervision in which states were allowed to continue to apply non-discriminatory state laws to anyone who required access to the market. The second generation of insurance directives, regarding services, introduced normative control and partly abolished the material control the first generation insurance directives had allowed. It provided all service providers access to the host states' market without the requirement of prior authorization. Although it introduced normative control, the directive also introduced an exception to the prohibition of prior authorization requirements, allowing host-state authorization measures for the protection of consumers of mass risk insurance and unsolicited life insurance. The third generation insurance directives changed the second generation consumer protection exception into a general exception. States are thus provided a justification for their non-compliance

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565 From 10% for co-insurance pools and 15% for co-reinsurance pools (ex article 11) to 20% and 25% in article 7 Commission Regulation (EC) No 358/2003 Official Journal L 053, 28/02/2003 P. 0008-0016.

566 Article 7(1) Commission Regulation (EC) No 358/2003 Official Journal L 053, 28/02/2003 P. 0008-0016.

567 Article 9 (ex article 14, 15) Commission Regulation (EC) No 358/2003 Official Journal L 053, 28/02/2003 P. 0008-0016.

with the directives if their actions comply with the conditions of the "general good" exception.

As for secondary Community competition law, the Council authorized the Commission to facilitate the exception to the prohibitions in the Treaty with a regulation that provides a block exemption for certain categories of agreements, decisions and concerted practices in the insurance sector.

Chapter 6

Legal Development of Insurance Market Integration in the United States of America

Constitution, Federal Law and Case Law

1 Introduction

In chapter 2 we have seen that one of the objectives of cooperation among the previously confederated North American states into a federation was designed to solve their economic problems through economic integration of the states' markets. This was to be accomplished by eliminating intentional barriers and minimizing obstacles to free and fair interstate trade. In the United States Constitution the authority to ensure free and fair interstate trade is laid down in the Commerce Clause. Rather than prohibitions of "state restrictions" or "concerted actions among market participants" the Commerce Clause simply grants a general authority to the Congress to regulate commerce among the states.

The judicial interpretation and legislative use of the commerce clause power determines the limits on the authority of the states to regulate and, indirectly through either federal or state regulation, the liberty of market participants to act. In chapter 2 we have seen that the Supreme Court in the case of *Paul v. Virginia* was asked to determine whether the business of insurance was "commerce" before Congress had regulated the business of insurance. This Supreme Court case determined not only the authority of the states to regulate the business of insurance, Congress' authority with regard to the insurance markets and the federal limits to the liberty of market participants to act in states' insurance markets, it determined the legal developments of insurance market integration in the United States of America.

In this chapter I describe the legal development of insurance market integration[568] that is the result of the institutional structure and grants of authority as laid down in the United States Constitution. I describe the limits to state authority to regulate, the liberty of market participants to act, and exceptions to these limits in the Constitution, federal law and case law.

In section 2 I begin with the limits to state regulatory authority and the exceptions to these limits in the Constitution and case law prior to the federal regulation of the business of insurance. I describe the legal developments of

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[568] As already mentioned in chapter 1, I do not attempt to determine the extent of insurance market integration that has been achieved in the United States (which for example for a large part has been facilitated by the NAIC, a voluntary organization of insurance regulators from the 50 states, the District of Columbia and the four U.S. territories insurance commissioners), but rather the elements of the institutional structure and the grants of authority that facilitate law making, regulations or case law, which result in insurance market integration that accommodates state insurance market interests.

insurance market integration until the enactment of the McCarran-Ferguson Act. In section 3 I describe the limits to state authority to regulate and tax the business of insurance after the enactment of the McCarran-Ferguson Act, in the Constitution and federal legislation as well as the exceptions to these limits. Section 4 concludes this chapter.

2 Limits to the Freedom of the States and the Market Participants until the McCarran-Ferguson Act

The 1869 Supreme Court case of *Paul v. Virginia*[569] is an example of the limited, dual federalist vision of the Supreme Court in its interpretation of the Commerce Clause power of Congress.[570] Federal intervention was only permitted when there was interstate commerce in the narrowest of meanings. The Supreme Court decided that issuing a policy of insurance was not interstate commerce, and because of this definition Congress was refrained from regulating the insurance business on the basis of its commerce clause powers.[571] *Paul v. Virginia* not only barred the Congress from commerce clause regulation of insurance for 75 years, the Supreme Court interpretation of the direct limits in the Commerce Clause, in the absence of Congressional legislation, did not apply to the business of insurance either. After the *Paul* decision states had the power to regulate the insurance industry free from Commerce Clause interference. Other Constitutional articles however could still limit states' freedom to regulate.

The Supreme Court in *Paul v. Virginia,* in addition to the applicability of the Commerce Clause to the business of insurance, also considered whether the Virginia statute that imposed taxes and conditions on out-of-state corporations was unconstitutional under the Constitution's Privileges and Immunities Clause of article IV, section 2 and the Equal Protection Clause of the Fourteenth Amendment.[572]

The Supreme Court viewed corporations as recipients of "special privileges,", and found that a state may apply any and all terms and conditions it found appropriate for access to their markets.[573] It found that there was no need to consider "whether the statute was arbitrary, irrational, or discriminatory."[574] It dismissed unconstitutionality under the Privileges and Immunities Clause as well as under the Equal Protection Clause of the Fourteenth Amendment and established that a state may impose taxes and conditions with unfettered discretion on foreign[575]

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569 *Paul v. State of Virginia*, 75 U.S. 168 (1868).

570 See chapter 2.

571 Banks McDowell, *The Crisis in Insurance Regulation*, Quorum books Westport, copyright 1994, 40.

572 Amendment XIV (1868): " No state shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; ... nor deny to any person within its jurisdiction the equal protection of the laws."
Article IV section 2 (1): "The citizens of each state shall be entitled to all privileges and immunities of citizens in the several states."

573 *Paul v. State of Virginia*, 75 U.S. 168 (1868), paragraphs 180-181.

574 *Western & Southern Life Ins. Co. v. state Board of Equalization of California*, 451 U.S. 648, paragraph 659.

575 Out-of-state.

corporations, in return for granting the "privilege" of doing business within the state.

The states' authority to regulate the insurance markets was not completely free from federal interference, however. Federal courts relied on the "substantive due process" doctrine to stop over-eager states from infringing on private property and the freedom of citizens. The Fifth[576] and Fourteenth[577] Amendments to the Constitution contain due process clauses that protect liberty of contract and private property against unwarranted government interference. With its interpretation of 'due process' the Supreme Court, among others, stopped the states in limiting their citizens to contract with foreign insurance companies beyond their jurisdiction.

In the 1894 case of *Hooper v. California*[578] a New York insurance company sold insurance policies in California. It used an insurance agent in California, Hooper. Hooper sold insurance to Mott in California, and the New York insurance company sent the policy to California where it was delivered and paid for. California law required a company, association, or individual that is not incorporated under the laws of California to file a bond with the insurance commissioner before transacting business. Selling insurance, directly or through an agent, without a bond was not allowed under California law.

Justice White stated that since the Supreme Courts decision in *Paul v. Virginia* it had been established that the state had the power to determine the conditions under which it allowed foreign insurance companies to enter the market within the state and to enforce any conditions imposed by her laws, to insurance companies, their agents or officers, and to prohibit citizens from contracting with a foreign insurer within her jurisdiction. This state freedom to regulate the business of insurance is subject to the "paramount authority of the Constitution of the United States".[579]

Hooper argued that the right of a citizen to contract for insurance for himself is guaranteed by the Fourteenth Amendment's Due Process Clause requiring that "no state deprives any person of life, liberty, or property without due process of law". The state could therefore not prohibit a citizen from contracting through an agent. The Court did not agree: "The Fourteenth Amendment does not guarantee the citizen the right to make within his state, either directly or indirectly, a contract, the making whereof is constitutionally forbidden by the state."[580]

Three years later in *Allgeyer v. Louisiana* [581] (1897), the New York based Atlantic Mutual Insurance Company made a contract with E. Allgeyer & Co., a New Orleans based company, for an open policy of marine insurance. The Louisiana statute stated: "... Any person, firm or corporation who shall fill up, sign or issue in this

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576 "... nor be deprived of life, liberty, or property, without due process of law; ..."

577 Section 1: "nor shall any state deprive any person of life, liberty, or property, without due process of law; ..."

578 *Hooper v. People of State of California*, 155 U.S. 648 (1895).

579 *Hooper v. People of State of California*, 155 U.S. 648 (1895), paragraph 653.

580 *Hooper v. People of State of California*, 155 U.S. 648 (1895), paragraph 658.
Hooper argued that this California state statute violated his right "to transact any business in the state of California which is not opposed to good morals or health of the community", which is in violation of the Fourteenth Amendment to the Constitution. Hooper refers to the police powers of the state that justify violation of the Fourteenth Amendment if the state law relates to "safety, health, morals and the general welfare of the public".

581 *Allgeyer v. State of Louisiana*, 165 U.S. 578 (1897).

state any certificate of insurance under an open marine policy, or who in any manner whatever does any act in this state to effect, for himself or for another, insurance on property, then in this state, in any marine insurance company that has not complied in all respects with the laws of this state, shall be subject to a fine."[582] The Atlantic Mutual Insurance Company had not complied with the conditions required by the laws of Louisiana for doing business in the state.

In this case the insurance company had not appointed an agent in the State of Louisiana. All that was required from the policyholders was to mail a letter or send a telegram to the insurance company in New York in which the cotton to be covered was described.[583] In *Allgeyer v. Louisiana*, the Supreme Court for the first time applied the Fourteenth Amendment, substantive due process, in an insurance case. The Court limited states from applying legislation that prevented its citizens from contracting with foreign insurance companies beyond their jurisdiction.[584] The Court referred to *Hooper v. California* and stated that states power to prohibit foreign insurance companies from doing business within its limits[585] is not in question, but that the state power does not extend beyond state borders.

Justice Peckham delivered the opinion of the Court and found that "the statute is a violation of the Fourteenth Amendment of the federal Constitution, in that it deprives the defendants Allgeyer & Co. of their liberty without due process of law." The statute that forbade Allgeyers' actions did not provide due process of law because it was inconsistent with the Fourteenth Amendment. The right granted in the Fourteenth Amendment meant:

> "not only the right of the citizen to be free from the mere physical restraint of his person, as by incarceration, but the term is deemed to embrace the right of the citizen to be free in the enjoyment of all his faculties; to be free to use them in all lawful ways; to live and work where he will; to earn his livelihood by any lawful calling; to pursue any livelihood or avocation, and for the purpose to enter into all contracts which may be proper, necessary and essential to his carrying out to a successful conclusion of the purposes above mentioned."[586]

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582 *Allgeyer v. State of Louisiana*, 165 U.S. 578 (1897), paragraph 578.

583 *Allgeyer v. State of Louisiana*, 165 U.S. 578 (1897), paragraph 586.

584 In the European Community the second generation insurance directives facilitated the provision of services among the member states. It prohibited member states to require compliance with the laws of the host state regarding authorization and supervision unless it regarded mass insurance (non-life insurance) or unsolicited life insurance by out of state insurance providers. Where in *Allgeyer v. State of Louisiana* the Supreme Court limited the states' powers to regulate within the states' borders, i.e., if no agent was appointed there was no activity in the state and therefor it could not regulate, in the second generation insurance directives the distinction whether states are allowed to regulate was not based on presence in the state but rather on the perceived need of certain consumers to be protected. In case of the provision of large risk insurance or solicited life insurance with an out of state insurer, whether through an agent in the host state or directly from the insurers home state, the second generation insurance directives did not allow the host member state to require compliance with its rules on authorization and supervision. In case of the provision of mass insurance or unsolicited life insurance, whether through an agent in the host state or directly from the insurers home state, the insurance directive allowed the host member state to require compliance with authorization and supervision regulation. See chapter 5.

585 *Allgeyer v. State of Louisiana*, 165 U.S. 578 (1897), paragraph 583.

586 *Allgeyer v. State of Louisiana*, 165 U.S. 578 (1897), paragraph 587.

Allgeyer established that although the Supreme Court in *Paul v. Virginia* had found that the states retained the power to regulate the insurance industry, it had not granted them unlimited freedom to regulate. In *Hooper* the Court confirmed the states' right to make rules with which foreign insurance companies had to comply in order to do business within the state. In *Allgeyer* the Court made it clear that the (broad) power of the states to regulate the business of insurance did not extend beyond their borders. The Constitutional due process principle dictated that state powers remain within state borders.

Where the Supreme Court decisions in the beginning of the twentieth century recognized the "mutually exclusive spheres of autonomy for the states governments, the federal government and the individual"[587], with the 1930s New Deal this changed. When Franklin D. Roosevelt took office as President of the United States in 1933 he immediately proposed a series of radical statutes intended to stimulate the economy; they also changed the interpretation of Congressional and state authority to regulate. The New Deal focused not on overall individual freedom but rather on increasing government interference at both the state as well as the federal level.

Many of New Deal statutes interfered with what had been regarded as the proper domain of the states. As a result, these New Deal statutes were challenged with regard to their Constitutionality. Both supporters and opponents of New Deal legislation relied on the Supreme Court case law that had defined Congress's power under the Commerce Clause.[588] The Supreme Court broadened the interpretation of the Congressional commerce clause power in 1940 in *United States v. Darby*.[589]

In *United States v. Darby* a federal law prohibited the shipment of goods produced for interstate commerce by employees whose wages and hours of employment did not conform to federal law. The Court found that although manufacturing of goods is not in itself interstate commerce, the interstate shipment thereof is and it can thus be regulated by Congress under the Commerce Clause.[590] The Court refers to *Gibbons v. Ogden* where Marshall stated: "The power of Congress over interstate commerce is complete in itself, may be exercised to its utmost extend, and acknowledges no limitations other than are prescribed in the Constitution."[591]

This decision overruled the dual federalism interpretation which had viewed the Tenth Amendment[592] as a positive grant of power to the states.[593] The Court interpreted the Tenth Amendment not as a positive grant of power to the states but rather as a declaration of the relationship between the federal government and the states "to allay fears that the new national government might seek to exercise

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587 Charles M. Freeland, *The Political Process as Final Solution*, 68 Indiana law journal 525, 537. See also Laurence H. Tribe, *American Constitutional Law*, 2d ed. 1988.

588 Geoffrey R. Stone et al, *Constitutional Law*, 1986, Little Brown and Company, 155.

589 *U.S. v. Darby*, 312 U.S. 100 (1941).

590 *U.S. v. Darby*, 312 U.S. 100 (1941), paragraph 113: "While manufacture is not of itself interstate commerce the shipment of manufactured goods interstate is such commerce and the prohibition of such shipment by Congress is indubitably a regulation of the commerce."

591 *Gibbons v. Ogden*, 22 US 1 (1824), at 196.

592 "The powers not delegated to the United States by the Constitution, nor prohibited by it to the states, are reserved to the states respectively, or to the people."

593 *Paul v. State of Virginia*, 75 U.S. 168 (1868), paragraph 183: "The defect of the argument lies in the character of their business. Issuing a policy of insurance is not a transaction of commerce."

powers not granted, and that the states might not be able to exercise fully their reserved powers."[594] The Court found that:

> "The power of Congress over interstate commerce is not confined to the regulation of commerce among the states. It extends to those activities intrastate which so affect interstate commerce or the exercise of the power of Congress over it as to make regulation of them appropriate means as to the attainment of a legitimate end, the exercise of the granted power of Congress to regulate interstate commerce ..."[595]

This return by the Supreme Court to an expansive interpretation of the commerce power effected not only Congress' powers under the Commerce Clause, but also the freedom of states to regulate and act as well as the freedom of market participants to act. *Darby*, as soon would be confirmed in the case of *South Eastern Underwriters Association*[596], had expanded the commerce clause interpretation to include the business of insurance.

When the insurance industry was charged with anti-trust violations under the federal Sherman Act[597] (based on the Constitutions commerce clause) in 1943, the Supreme Court revised the interpretation of "commerce among the states" in relation to the business of insurance. The Supreme Court answered two questions affirmatively. Whether fire insurance transactions which move across state lines constitute "commerce among the several states" so as to make them subject to regulation by Congress under the Commerce Clause, and whether the Sherman Act

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[594] *U.S. v. Darby*, 312 U.S. 100 (1941), paragraph 124: "Our conclusion is unaffected by the Tenth Amendment which provides: 'The powers not delegated to the United States by the Constitution, nor prohibited by it to the [312 U.S. 100, 124] states, are reserved to the states respectively, or to the people'. The amendment states but a truism that all is retained which has not been surrendered. There is nothing in the history of its adoption to suggest that it was more than declaratory of the relationship between the national and state governments as it had been established by the Constitution before the amendment or that its purpose was other than to allay fears that the new national government might seek to exercise powers not granted, and that the states might not be able to exercise fully their reserved powers. See e.g., II Elliot's Debates, 123, 131; III id. 450, 464, 600; IV id. 140, 149; I Annals of Congress, 432, 761, 767-768; Story, Commentaries on the Constitution, secs. 1907, 1908."

[595] *U.S. v. Darby*, 312 U.S. 100 (1941), paragraph 118.

[596] *U.S. v. South-Eastern Underwriters Association*, 322 U.S. 533 (1944).

[597] Harry A. Toulmin, jr., *A Treatise on the Anti-Trust Laws of the United States and including all related trade regulatory laws*, Cincinnati Anderson, 1949-1952, 99: "In 1890, the Sherman Act had been enacted as the first in a series of general federal antitrust laws. The reason for implementation of federal antitrust legislation was the economic situation of the time. There was 'a vast accumulation of wealth in the hands of corporations and individuals, an enormous development of corporate organizations, ... and combinations known as trusts were being multiplied.'(*Standard oil v. United States*, 221 U.S. 1 (1911)). There was a 'widespread impression that their powers had been and would be exerted to oppress individuals and injure the public generally.'(*Standard oil v. United States*, 221 U.S. 1 (1911)). The trusts and combinations of businesses hindered competition and became a matter of great public concern. The Sherman Act was to prevent restraints of free competition."
Toulmin 1949, 107: "The main concern in enacting the Sherman Act was preservation of the competitive system and protection against wealth transfers from consumers to monopolists."
The Supreme Court in *Appalachian Coals, inc. v. United States* (288 U.S. 344) said that "The purpose of the Sherman Anti-Trust Act is to prevent undue restraints of interstate commerce, to maintain its appropriate freedom in the public interest, to afford protection from the subversive or coercive influences of monopolistic endeavor."

intended to prohibit conduct of fire insurance companies which restrain or monopolize the interstate fire insurance trade.[598]

With regard to the first question that the Supreme Court found that: "The power granted to Congress is a positive power. It is the power to legislate concerning transactions which, reaching across state boundaries, affect the people of more states than one; to govern affairs which the individual states, with their limited territorial jurisdictions, are not fully capable of governing."[599] With regard to the second question it stated that: "From the beginning, Congress used language broad enough to include all businesses, and never has amended the [Sherman] Act to define these businesses with particularity." The Supreme Court found that the fact that Congress has not legislated insurance did not mean that "Congress has held the view that insurance alone, of all businesses, should be permitted to enter into combinations for the purpose of destroying competition by coercive and intimidatory practices."[600]

In the cases prior to *South Eastern Underwriters Association* the Supreme Court had been asked to determine the validity of state statutes, never the applicability of Congressional Acts. In those cases the Supreme Court interpreted the extent to which the Commerce Clause deprived states of the power to regulate the insurance business in the absence of Congressional action, the so-called "negative" or "dormant" commerce clause.[601] In the *South-Eastern Underwriters Association* case it answered a different question: "Today however we are asked ... not to uphold another state law, but to strike down an Act of Congress which was intended to regulate certain aspects of the methods by which interstate insurance companies do business: and in so doing, to narrow the scope of the federal power to regulate the activities of a great business carried on back and forth across state lines."[602]

The Supreme Court concluded that the Sherman Act, based on the Commerce Clause, applied to the business of insurance. An extensive interpretation of the Commerce Clause, the economic impact of trade, rather than the limited definitions of "interstate" and "commerce", determined the reach of the commerce clause power after 75 years. This meant that all commerce clause limits, constitutional as well as legislation enacted on the basis of the Commerce Clause, could suddenly apply to the business of insurance, immediately effecting states' authority to regulate as well as the liberty of market participants to act.

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598 *U.S. v. South-Eastern Underwriters Association*, 322 U.S. 533 (1944), paragraph 538.

599 *U.S. v. South-Eastern Underwriters Association*, 322 U.S. 533 (1944), paragraph 552: Justice Black in South-Eastern Underwriters Association quoting Justice Marshall in *Gibbons v. Ogden*.

600 *U.S. v. South-Eastern Underwriters Association*, 322 U.S. 533 (1944), paragraphs 560-561.

601 The Commerce Clause does not only affect states when Congress uses its authority to regulate, it can affect the states without congressional regulation as well. The Supreme Court has derived a negative implication on the power of the states from the express grant to Congress to regulate commerce among the states. This so called dormant commerce clause power allows the Supreme Court to interpret the silence of the Congress over matters of commerce, and interpret the authority of the states regarding matters of interstate commerce. Gerald Gunther and Kathleen M. Sullivan 1997, 258.
Lenaerts 1988, 16.
See chapter 2.

602 *U.S. v. South-Eastern Underwriters Association*, 322 U.S. 533 (1944), paragraph 545.

After the decision of the Supreme Court in *South Eastern Underwriters Association* both the insurance industry (which had previously called for federal legislation)[603] and the states were troubled by the effect that *South Eastern Underwriters Association* might have on their liberty to act as well as, their authority to regulate and tax.[604]

The insurance industry proposed a total exemption from federal regulation which was rejected by Congress. The National Association of Insurance Commissioners (NAIC)[605] established a committee to study federal legislation. Its subcommittee suggested the enactment of legislation by Congress to grant the states the power to regulate insurance. It also suggested a partial exemption from the Sherman and Clayton Anti-Trust Acts.[606] This NAIC proposal resulted in the McCarran-Ferguson Act.

With the adoption and enactment of the McCarran-Ferguson Act the NAIC achieved the preservation of state commissioners' power to regulate and state power to tax the insurance industry. The purpose of bill S.340[607], proposed in 1945, was: "to declare that the continued regulation and taxation by the several states of the business of insurance is in the public interest".[608] The McCarran-Ferguson Act was made law on March 9, 1945.[609]

The 1945 McCarran-Ferguson Act grants states the authority to regulate commerce among and tax the business of insurance.[610] It restored the status quo that existed before the *South Eastern Underwriters Association* decision, preserving state

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603 See Kenneth J. Meier, *The Political Economy of Regulation, The Case of Insurance*, State University of New York Press, 1988, 53. "Paul v. State of Virginia, 75 U.S. 168 (1868), was the result of the insurance industry's favor for federal regulation. Federal regulation was not so much preferred, but rather it was perceived that the federal government would be a weaker regulator than the states."

604 Alan M. Anderson, *Insurance and Antitrust Law: The McCarran-Ferguson Act and Beyond*, 25 William & Mary Law Review 81, 85.

605 The National Association of Insurance Commissioners, or NAIC, is the voluntary organization of insurance regulators from, today, the 50 states, the District of Columbia and the four US territories.

606 Claude C. Lilly, *A History of Insurance Regulation in the United States*, 29 CPCU Annals 99 (1976), 107.

607 Public Law 15, 79th Congress.

608 To assure a more adequate regulation of this business in the states it suggested suspending the application of the Sherman and Clayton Acts for approximately two sessions of the state legislatures, so that the states and the Congress may consider legislation during that period. House Committee on the Judiciary, house report no. 143, February 13, 1945.

609 This insurance moratorium act or McCarran-Ferguson act, made the federal anti-trust laws inapplicable to the business of insurance (after an extension) until June 30, 1948. Public Law 238, 80th Congress.

610 Before *Paul v. State of Virginia*, 75 U.S. 168 (1868), the states each regulated the insurance industry in their jurisdiction. This regulation ensured the solvency of the insurance companies while avoiding unnecessary restraints placed on competition by the insurance industry. The regulation of the insurance industry was often accompanied by taxation, which in many states was an important source of income.
Earl W. Kintner and Joseph P. Bauer, *Federal Antitrust Law*, volume IX antitrust exemptions specific industries and activities, Anderson Pub. Co, Cincinnati 1989, 181-183.

regulation and taxation of the insurance industry[611], and partially exempting the business of insurance from application of federal anti-trust laws.[612]

By enacting the McCarran-Ferguson Act Congress decided not to exercise its power to regulate the states and, in the process, barred the Supreme Court from interpreting the compatibility of states' regulations with the Constitutional Commerce Clause. Limits to state authority to regulate are determined by the McCarran-Ferguson Act and the Constitution, excluding however the Constitutional Commerce Clause. Limits to the liberty of market participants are determined by the McCarran-Ferguson Act and state regulation. The Supreme Court determines the compatibility of state actions and market participants' actions with federal Acts, including the McCarran-Ferguson Act, and is also empowered to determine the compatibility of state regulations to Constitutional articles other than the Commerce Clause. The Supreme Court, though not through Commerce Clause interpretations, continued, and still continues today, to shape the economic integration of the insurance market in the United States of America.

3 Limits to the Freedom of the States and the Market Participants after the McCarran-Ferguson Act

Sections 1012b and 1013b of the McCarran-Ferguson Act define the limits to state authority to regulate (and tax)[613] and the limits to the liberty of market participants to act in federal (insurance market) regulation.[614] Section 1012b of the McCarran-

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611 William Cohen, 1985, *Federalism in Equality Clothing: A Comment on Metropolitan Life Insurance Company v. Ward*, 38 Stanford L. Rev. 1, 4.

612 Kintner Bauer 1989, 179.

613 Section 2.2.2.

614 Ch. 20, 59 Stat. 33., 15 U.S.C. Sections 1011-1015.

Section 1011. Declaration of policy

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

Section 1012. Regulation by state law; federal law relating specifically to insurance; applicability of certain federal laws after June 30, 1948

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

(b) federal regulation. No act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any state for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: Provided that after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by state law.

Section 1013. Suspension until June 30, 1948, of application of certain federal laws; Sherman Act applicable to agreements to, or acts of, boycott, coercion, or intimidation

(a) Until June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, and the Act of June 19, 1936, known as the Robinson-Patman Anti-discrimination Act, shall not

Ferguson Act operates as a reverse supremacy clause.[615] It determines that state insurance regulation supersedes federal law unless the federal Act "specifically relates to the business of insurance."[616] The second part of section 1012b and section 1013b relate to the liberty of market participants to act, determining the (limited) applicability of federal anti-trust regulation to the business of insurance.

The McCarran-Ferguson Act leaves the regulation and taxation to the states and excludes the applicability of all federal law that does not "specifically relates to the business of insurance". It does, however, make general federal anti-trust regulation applicable in two situations. The second part of section 1012b of the McCarran-Ferguson Act makes federal anti-trust regulation applicable to the business of insurance only if the states have not regulated it.[617] Where the applicability of federal anti-trust law is made dependent on state regulation in section 1012b, section 1013b makes the Sherman Act applicable to "any agreement to boycott, coerce, or intimidate, or act of boycott, coercion, or intimidation" regardless whether the states have regulated anti-trust.

The McCarran-Ferguson Act refers to three federal anti-trust acts, the Sherman Act, the Clayton act and the federal Trade Commission act. The Sherman Act was enacted in July 1890. It was designed to prevent or suppress devices or practices which create monopolies or restrain trade or commerce. "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states, or with foreign nations, is declared to be illegal."[618] It was designed to protect the public against the failure of the market by protecting competition and competitive processes.[619] The Clayton Act and federal Trade Commission Act were passed in 1914. The Clayton Act, unlike the general prohibitions in the Sherman Act, specifically names and sums up those activities

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apply to the business of insurance or to acts in the conduct thereof.
(b) Nothing contained in this Act shall render the said Sherman Act inapplicable to any agreement to boycott, coerce, or intimidate, or act of boycott, coercion, or intimidation.

615 Article VI United States Constitution: "This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every state shall be bound thereby, any Thing in the Constitution or Laws of any state to the Contrary Withstanding."
Charles D. Weller, *The McCarran-Ferguson Act's Antitrust Exemption for Insurance: Language, History and Policy*, 1978 Duke Law Journal, 605.

616 John A. Appleman and Jean Appleman, *Appleman, Insurance Law and Practice*, West Publ. Co., 1982, at 31. *Hamilton Life Ins. Co. of New York v. Republic Nat'l Life Ins. Co.*, 291 F.Supp. 225 (NY App. 1969), aff'd 408 F.2d 606 (1969).
Where in the European Community the three generations of insurance directives state both limitations to the states regulatory freedom as well as the exemptions to the directives and its limitations, in the United States the McCarran-Ferguson Act grants the states exclusive authority to regulate and tax the business of insurance, unless a federal Act is enacted that specifically relates to the business of insurance.

617 The article reads: "Provided that after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by state law."

618 15 U.S.C. Section 1.

619 54 Am. Jur. 2d Monopolies and restraints of trade, §1.

that are illegal, with the condition that these activities are illegal only when their effect is to lessen or prevent competition or create a monopoly. The federal Trade Commission Act established the federal Trade Commission. This Commission's task is to prevent "unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce."[620]

The McCarran-Ferguson Act not only makes federal anti-trust regulation applicable, it also provides for exceptions to anti-trust regulations for the insurance industry, in order to avoid economic damage to the industry.[621] The objective of the Act was not only "to declare that the continued regulation and taxation by the several states of the business of insurance is in the public interest"[622] but also to create a legal environment for the insurance industry to self-organize and cooperate in order to maintain competition in a safe and responsible manner.[623]

The Supreme Court has interpreted[624] the meaning of several McCarran-Ferguson Act terms[625] to determine the limits to state authority to regulate an tax, and the liberty of market participants to act, as well as the exceptions to these limits.

3.1 1012b Invalidate, Impair and Supersede

Section 1012b of the McCarran-Ferguson Act states: "No act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any state for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance." In 1999, in *Humana Inc., et al., petitioners v. Mary Forsyth et al.*[626] the Supreme Court affirmed that the McCarran-Ferguson Act's section 1012b does not automatically prevent all federal law that does not specifically relate to the business of insurance from applying to business of insurance regulated by state law.

Humana Insurance paid 80% of the policy beneficiaries' hospital charges while the beneficiaries themselves were responsible for the other 20% of the hospital charges. Humana Insurance had also agreed with the hospital, Humana Hospital-Sunrise, that the hospital would give Humana Insurance large discounts on their portion of the charges without disclosing the agreement to the policy holders. The result was that Humana Insurance paid much less than 80% of what the hospital claimed they charged, and consequently policy holders paid much more than 20% of the actual charges.

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620 §5: the purpose of the Act.

621 Exchange of data for the purpose of accurate risk assessment. See chapter 3.

622 House Committee on the Judiciary, house report no. 143, February 13, 1945.

623 "to assure a more adequate regulation of this business in the states by suspending the application of the Sherman and Clayton Acts for approximately two sessions of the state legislatures, so that the states and the Congress may consider legislation during that period".House Committee on the Judiciary, house report no. 143, February 13, 1945.

624 Authority established in the case of *SEC v. Variable Annuity Life Insurance Company of America* 359 U.S. 65, (1959).

625 "invalidate"," impair", and "supersede", "specifically relates to", "business of insurance", "regulated", and "agreement to boycott, coerce, or intimidate, or act of boycott, coercion, or intimidation".

626 *Humana Inc. et al. v. Forsyth et al.* 525 U.S. 299 (1999).

Humana was charged by the beneficiaries with having violated the federal Racketeer Influenced and Corrupt Organizations Act[627] (RICO). Humana Insurance however argued that this federal Act did not apply. McCarran-Ferguson specifically states that "no Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any state for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance."[628] Because the federal RICO act did not specifically relate to the business of insurance and Nevada state law was enacted for the purpose of regulating the business of insurance, the federal RICO act could only apply if it did not invalidate, impair or supersede state law.

The Supreme Court found that the actions prohibited by the federal RICO act were the same as those prohibited by Nevada state regulation. The only difference between state and federal regulations are their remedial regimes. While they both provide a private right of action, the federal RICO act authorizes treble damages, where state law permits compensatory and punitive damages only.

In the 1993 case of the *Department of Treasury v. Fabe*[629], the Supreme Court emphasized that the McCarran-Ferguson Act precludes the application of a federal statute unless the federal law is "enacted ... for the purpose of regulating the business of insurance". It added that the McCarran-Ferguson act precludes the application of a federal statute if it not "specifically relate to the business of insurance" when it "invalidates, impairs, or supersedes the state's law ".

In *Humana* the federal law at issue, RICO, was not enacted for the sole purpose of regulating the business of insurance. This meant that the McCarran-Ferguson Act precluded its application if it were found to invalidate, impair or supersede Nevada state law. The Supreme Court cited *Carter v. Virginia*[630] for a definition of invalidate, "to render ineffective, generally without providing a replacement rule of law", and to *Illinois Commerce Commission v. Thomson*[631], for a definition of supersede, "to displace (and this render ineffective) while providing a substitute rule." Because RICO neither invalidated nor superseded state law, the Court was left to decide whether RICO impaired Nevada's state law.

For a definition of impair the Supreme Court referred to its standard developed in 1969, in *SEC v. National Securities, Inc.*[632], where federal law was upheld because it did not "directly conflict with state regulation" and where federal law did not "frustrate any declared state policy" or "interfered with a state's administrative regime", and *Shaw v. Delta Air Lines, Inc.*[633] where "impair" was defined as to frustrate a goal of the state law. Applying this standard to RICO the Supreme Court concluded that the federal RICO act did not impair the Nevada law and that therefor the McCarran-Ferguson Act did not preclude applicability in this case.

In *Humana* the Supreme Court found that "when federal law is applied in aid or enhancement of state regulation, and does not frustrate any declared state policy or disturb the state's administrative regime, the McCarran-Ferguson Act does not bar

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627 18 USC 1961 et seq.

628 Section 1012 b McCarran-Ferguson Act.

629 *United States Department of Treasury v. Fabe*, 508 U.S. 491, 501 (1993).

630 *Carter v. Commonwealth of Virginia*, 321 U.S. 131 (1944).

631 *Illinois Commerce Commission v. Thomson*, 318 U.S. 675 (1943).

632 *SEC v. National Securities, Inc*, 393 U.S. 453 (1969).

633 *Shaw v. Delta Air Lines, Inc*, 463 U.S. 85 (1983).

federal action." Although section 1012b prevents federal Acts that do not relate to the business of insurance to interfere with state regulation, it does not prevent the application of federal Acts that aid and enhance state regulation, in the case of *Humana* to protect the interests of the consumers.

3.2 1012b Specifically relates to the Business of Insurance

An act of Congress that "specifically relates to the business of insurance" can invalidate, impair, or supersede any law enacted by any state for the purpose of regulating the business of insurance or which imposes a fee or tax upon such business. The Supreme Court defined "specifically relates to the business of insurance" in the case of *Barnett Bank of Marion County v. Nelson.*[634]

This case raised the question whether a federal statute that allows national banks to sell insurance in small towns pre-empts a state statute that forbids banks to sell insurance. The 1916 federal statute[635] allowed national banks, organized under the laws of the United States, located and doing business in a place with less than 5000 people, to act as agent for an insurance company. The State of Florida in 1974 enacted a statute prohibiting banks affiliated with a bank holding company to sell (most kinds of) insurance. The state statute does allow small town banks not affiliated with a bank holding company to sell insurance in a small town (less than 5000 people).

A branch of the national Barnett bank was ordered by Florida's State Insurance Commissioner to stop selling insurance. Barnett bank argued that the federal statute allowing its branch to sell insurance pre-empted the state statute that forbade it to sell insurance.

The Supreme Court interpreted the phrase "specifically relates to the business of insurance" to determine whether the federal Statute pre-empted the state statute. The Supreme Court held that "a statute that says that banks may act as insurance agents, and that the Comptroller of the Currency may regulate their insurance related activities, 'relates' to the insurance business". With regard to "specifically", it referred to Black's Law Dictionary which defines specifically as "explicitly, particularly, (or) definitely". The Supreme Court held that the "particular words 'finance, banking, and insurance'" was sufficient to constitute a specific reference, fulfilling the meaning of "specifically".[636] Because the statute focuses directly on industry-specific selling practices, the relation of the insured to the insurer and the spreading of risk, it relates to the business of insurance, fulfilling all requirements for the federal statute to supercede the state statute.

3.3 1012b Business of Insurance

The "business of insurance" in the McCarran-Ferguson Act is clearly and restrictively defined by the Supreme Court. In its case law the Supreme Court developed a three-part test that aids in determining whether particular conduct constitutes the business of insurance. If it is, the conduct is covered by the

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634 *Barnett Bank of Marion County v. Nelson.* 517 U.S. 25 (1996).
635 Act of September 7, 1916, 39 Stat. 753, 12 U.S.C 92.
636 *Barnett Bank of Marion County v. Nelson.* 517 U.S. 25 (1996), paragraph 12.

McCarran-Ferguson Act and can be exempt from federal (anti-trust) regulation. Although the Court does not use the three-part test as a checklist, it is used as "a vehicle for effectuating its goal of construing exemptions from the [anti-trust] laws in a limited fashion."[637]

The first part of the test was developed in *SEC v. Variable Annuity Life Insurance Company of America*.[638] Before it interpreted "business of insurance" the Supreme Court determined that the question whether conduct is "business of insurance" is a federal question, not one for the states, establishing its authority to interpret the McCarran-Ferguson Act.[639]

In *SEC v. Variable Annuity Life Insurance Company of America* a life insurance company offered variable annuity contracts. It failed to register these contracts with the Securities and Exchange Commission under the Securities Act of 1933 and the Investment Company Act of 1940. Variable Annuity, the life insurance company, argued that the McCarran-Ferguson Act rendered these federal laws inapplicable to its activities. The Court however emphasized that the McCarran-Ferguson Act exemption only applies when there is business of insurance. A central element of the "business of insurance" is the underwriting of risk.[640] Because the offered annuities did not involve some form of risk, the issuance of the annuities by the defendant did not constitute the "business of insurance."[641]

The "underwriting of risk" as defined in 1959 in *SEC v. Variable Annuity Life Insurance Company of America*, is only the first element of the three-part test that the Supreme Court developed to determine whether conduct is the "business of insurance."[642] The second part of the test was developed ten years later in 1969 in *SEC v National Securities*.[643] In this case the Supreme Court emphasized that the section 1012b rule[644] in the McCarran-Ferguson Act does not apply to all insurance companies activities.[645]

One insurance company had acquired the stock of another. Because material facts had not been disclosed to the stockholders, the Securities Exchange

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637 Kintner Bauer 1989, at 197.

638 *S. E. C. v. Variable Annuity Co*, 359 U.S. 65 (1959).

639 S. E. C. *v. Variable Annuity Co*, 359 U.S. 65 (1959), paragraph 69.

640 *S. E. C. v. Variable Annuity Co*, 359 U.S. 65 (1959), paragraph 73.

641 *S. E. C. v. Variable Annuity Co*, 359 U.S. 65 (1959), paragraph 69: "While all the states regulate "annuities" under their "insurance" laws, traditionally and customarily they have been fixed annuities, offering the annuitant specified and definite amounts beginning with a certain year of his or her life. The standards for investment of funds underlying these annuities have been conservative. The variable annuity introduced two new features. First, premiums collected are invested to a greater degree in common stocks and other equities. Second, benefit payments vary with the success of the investment policy. "
S. E. C. v. Variable Annuity Co, 359 U.S. 65 (1959), paragraph 71: " In hard reality the issuer of a variable annuity that has no element of a fixed return assumes no true risk in the insurance sense."
See Kintner Bauer 1989, 191.

642 William R. Andersen and C. Paul Rogers III, *Antitrust Law: Policy and Practice*, Matthew Bender, 1992, 903.

643 *SEC v National Securities*, 393 U.S. 453 (1969).

644 "No Acts of Congress shall be construed to invalidate, impair, or supersede any law enacted by any state for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance."

645 Andersen Rogers 1992, 903.

Commission challenged the acquisition as violating the federal Securities Exchange Act. The State Director of Insurance had approved the acquisition because it fulfilled state insurance statute requirements. The trial court and appeals court both found that the McCarran-Ferguson Act shielded the actions (of non-disclosure) of the insurance company. The Supreme Court however reversed and clearly stated that the McCarran-Ferguson Act exemption was not intended for all the actions of the insurance companies regulated by state law, but only for state regulations covering the relationship between the insurer and the insured, or rather, the "business of insurance."[646]

The third part of the "business of insurance" test was developed in two Supreme Court cases: *Group Life & Health Insurance Co. v. Royal Drug Co.*[647] in 1979, and *Union Labor Life Insurance Co. v. Pireno*[648] in 1982. In *Group Life & Health Insurance Co. v. Royal Drug Co.* an insurance company offering health care insurance had made provider agreements with pharmacies. These agreements reduced the cost of prescription drugs and had been offered to all pharmacies. Insured were encouraged by the insurer to buy their prescription drugs with participating pharmacies. This was done by reimbursing less when the insured bought their prescription with non-participating pharmacies.

The Supreme Court clearly stated that the scope of the McCarran-Ferguson Act exemption is limited to the "business of insurance" and not, as in this case, to the business of insurers.[649] The Supreme Court held that "when the activities of the insurer are mere agreements to purchase goods or services and do not constitute underwriting or spreading of risk, these activities or agreements are not the "business of insurance" and therefore not exempt from federal anti-trust regulation."[650]

In *Union Labor Life Insurance Co. v. Pireno*, the Supreme Court clearly summed up all three factors that determine whether conduct is *business of insurance* for the purpose of the McCarran-Ferguson Act exemption to anti-trust regulation. In *Union Labor Life Insurance Co. v. Pireno* an insurance company relied on a medical peer review committee in deciding whether claims submitted by insured should be reimbursed. The committee had to decide whether the charge was reasonable and the treatment necessary. A chiropractor, the plaintiff, brought an action under the Sherman Act. He asserted that the arrangements between the insurance company and the members of the committee constituted price fixing agreements and a boycott. The district Court had dismissed the claim on the exemption clause of the McCarran-Ferguson Act. The Supreme Court however in *Pireno* summarized the three-part test.[651] The Supreme Court ruled:

> *Royal Drug* identified three criteria relevant in determining whether a particular practice is part of the "business of insurance" exempted from the anti-trust laws by §2 (b) [1012b]: first, whether the practice has the effect of transferring or

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646 *SEC v. National Securities*, 393 U.S. 453 (1969), paragraphs 457, 459, 460.

647 *Group Life & Health Insurance Co. v. Royal Drug Co*, 440 U.S. 205 (1979).

648 *Union Labor Life Insurance Co. v. Pireno*, 458 U.S. 119 (1982).

649 *Group Life & Health Insurance Co. v. Royal Drug Co Id.*, 440 U.S. 205 (1979), paragraph 211.

650 Andersen Rogers 1992, 904.

651 The three-part test is not to be used as a checklist. The test should be part of a thorough consideration and balancing of all factors in the judgment of the activity.
See Kintner Bauer 1989, 193-194.

spreading a policyholder's risk; second, whether the practice is an integral part of the policy relationship between the insurer and the insured; and third, whether the practice is limited to entities within the insurance industry.[652]

The Court repeated what it already had said in *Royal Drug*, that Congress did not intend to include within the business of insurance, agreements or practices that involve parties outside the insurance industry.[653]

In the 1993 *United States Department of Treasury v. Fabe*[654] case, the Supreme Court found that a federal Act does not pre-empt rights granted to one group of creditors (policyholders) in a state statute that regulates the business of insurance, while the interests of other groups of creditors protected in the same state statute are pre-empted by federal law. In *United States Department of Treasury v. Fabe* the Supreme Court held that the Ohio State statute granting priority to certain categories of creditors in liquidation procedures of an insolvent insurance company, is a law enacted 'for the purpose of regulating the business of insurance' but only to the extent that it regulates policyholders, and not other protected creditors in the state law.

3.4 1012b Regulated by State Law

The federal anti-trust Acts: the Sherman, Clayton and federal Trade Commission Act, apply to the business of insurance to the extent that anti-trust has not been regulated by state law. The McCarran-Ferguson Act is not the only federal Act that exempts state regulated anti-competitive activities from the applicability of federal anti-trust regulation. The 1943 Parker doctrine[655] exempts from federal anti-trust regulation state action or state regulation that imposes restraints on competition. However, where the general Parker doctrine requires the restraint on competition to be a "clearly articulated and affirmatively expressed state policy that must be actively supervised by the state itself"[656], the McCarran-Ferguson Act requires much less scrutiny for the exemption to apply.

The Supreme Court addressed the meaning of the requirement "regulated by state law" in the McCarran-Ferguson Act for the first time in *federal Trade*

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652 *Union Labor Life Insurance Co. v. Pireno*, 458 U.S. 119 (1982), paragraph 129.

653 Andersen Rogers 1992, 905.

654 *United States Department of Treasury v. Fabe*, 508 US 491 (1993).

655 Julia M. Melendez, *The McCarran-Ferguson Act: Has It Outlived Its Intend*, 1992 FICC Quarterly 283, 294-295.
"The Parker doctrine or state action doctrine was created by the Supreme Court in 1943 in *Parker v. Brown*, 317 U.S. 341 (1943). The Court decided that the Sherman Act was not intended to restrain state action that imposed restraints on competition. The doctrine was further developed in *Goldfarb v. Virginia state Bar*, 421 U.S. 773 (1975) where the Supreme Court narrowed the doctrine in stating that:"It is not enough that, ..., anticompetitive conduct is 'prompted' by state action; rather, anticompetitive activities must be compelled by direction of the state acting as the sovereign." In *California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97 (1980) the Supreme Court developed two standards. The exemption to the Sherman Act applies when the challenged (state) restraint is clearly articulated and affirmatively expressed as state policy's and the policy must be actively supervised by the state itself."

656 *California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97 (1980), paragraph 105.

Commission v. National Casualty Co.[657] In this case the Supreme Court found that the mere existence of state legislation was sufficient to apply the exemption.[658] The federal Trade Commission (FTC) prohibited the National Casualty Company and the American Hospital and Life Insurance Company from carrying on certain advertising practices. The FTC found the activities to be false, misleading and deceptive and thus in violation of the federal Trade Commission Act.[659] The states however had their own statutes prohibiting unfair and deceptive insurance practices. The FTC argued that the McCarran-Ferguson Act should be interpreted to authorize federal regulation. The Supreme Court found for the states and concluded that "the McCarran-Ferguson Act withdrew from the federal Trade Commission the authority to regulate respondent's advertising practices in those states which are regulating those practices under their own laws."[660]

The FTC stressed that even when the McCarran-Ferguson Act bars federal regulation where the states have regulated, the federal Act should still apply when "the states have not regulated within the meaning of the section 2(b)[661] provision."[662] It urged that a general prohibition cannot be regulation under section 2(b) unless and until it has been crystallized into "administrative elaboration of these standards and application in individual cases."[663] The Supreme Court however concluded that the mere enactment of prohibitory legislation by each state was enough to satisfy section 1012(b), and the McCarran-Ferguson Act exemption applied. Once a statute is enacted that regulates the insurance practices, it is sufficient for McCarran-Ferguson Act purposes; the effectiveness of state regulation is irrelevant.[664]

3.5 1013 Boycott

When "business of insurance is regulated by state law" the McCarran-Ferguson Act pre-empts the applicability of all federal laws that invalidate, impair or supersede the state law, unless these have been enacted specifically to relate to the business of insurance. This pre-emption includes federal anti-trust laws. The McCarran-Ferguson Act however provides an exception to that rule in section 1013. The federal anti-trust Sherman Act applies to "an agreement to boycott, coerce, intimidate, or act of boycott, coercion, or intimidation"[665] irrespective of state regulation.[666]

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657 *Federal Trade Commission v. National Casualty Co.*, 357 U.S. 560 (1958).

658 Kintner Bauer 1989, 230.

659 15 U.S.C. Section 45.

660 *Federal Trade Commission v. National Casualty Co.*, 357 U.S. 560 (1958), paragraph 563.

661 Section 1012b.

662 *Federal Trade Commission v. National Casualty Co.*, 357 U.S. 560 (1958), paragraph 564.
No act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any state for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance.

663 *Federal Trade Commission v. National Casualty Co.*, 357 U.S. 560 (1958), paragraph 565.

664 *St. Paul Fire & Marine Ins. Co. v. Barry*, 438 U.S. 531 (1978), *Federal Trade Commission v. National Casualty Co.*, 357 U.S. 560,/ *Hartford Fire Ins. Co. v. California*, 509 U.S. 764 (1993).
Andersen Rogers 1992, 906.

665 The Supreme Court has so far in insurance cases regarding the exception of section 1013 of the McCarran-Ferguson Act only defined "boycott".

666 Section 1013.
"(b) Nothing contained in this Act shall render the said Sherman Act inapplicable to any

The Supreme Court in *St. Paul Fire & Marine Ins. Co. v. Barry*[667] held that the boycott exclusion to the McCarran-Ferguson Act exemption not only protects insurance companies or agents but other parties as well, such as the policyholders. Physicians had refused to accept an unfavorable change in their malpractice insurance policies. This change reduced the protection from liability from any act done while the policy was in effect, to only the claims made while the policy was in effect.[668] The other malpractice insurers in the state were not willing to insure the physicians. The physicians filed suit against four insurers for agreeing among themselves not to insure the physicians that did not agree to buy insurance from one particular insurer. The Court held the language of section 1013b to be broad and unqualified, covering any act or agreement that boycotts, coerces or intimidates. The Court held that "boycott" included "concerted refusals to deal with parties who were not competitors"[669] and defined it as "a withholding, or enlisting others to withhold, patronage or services from the target."[670]

Fifteen years later, in the 1993 case of *Hartford Fire Insurance Co. V. California*[671], the Supreme Court again addressed the definition of boycott in the McCarran-Ferguson Act. The action in *Hartford Fire Insurance Co. V. California* was brought by 19 states and numerous private plaintiffs, against a group of domestic and international insurance companies, reinsurance companies, underwriters, brokers, and individuals. The Supreme Court in this case was asked to resolve two issues: 1) whether insurers lose their McCarran-Ferguson exemption by acting in concert with foreign (non-exempt) parties[672], and 2) to precisely define the types of actions that constitute an unlawful "boycott" as defined in the McCarran-Ferguson Act.

In *Hartford Fire Insurance* it was alleged that domestic and foreign insurers and reinsurers had boycotted various insurance policies in violation of the McCarran-Ferguson Act. The Insurance Services Office, Inc. (ISO) is an association of approximately 1,400 domestic property and casualty insurers. It develops standard policy forms and files them with each state's insurance regulators. In 1983 ISO proposed two standard policy forms, one the traditional "occurrence" type, the other with a new "claims-made" trigger.

Hartford Fire Insurance Company and Allstate insurance objected to these proposed forms. Majorities in the relevant ISO committees, however, supported the proposed so-called 1984 CGL[673] forms and rejected the changes proposed by Hartford and Allstate. In December 1983, the ISO Board of Directors approved the proposed 1984 forms, and ISO filed the forms with state regulators in March 1984. Hartford took steps to force a change in the terms of coverage of CGL insurance generally available. Steps that, the plaintiffs alleged, implemented a series of conspiracies in violation of section 1 of the Sherman Act. These steps consisted of

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agreement to boycott, coerce, or intimidate, or act of boycott, coercion, or intimidation."

667 *St. Paul Fire & Marine Ins. Co. v. Barry*, 438 U.S. 531 (1978).

668 From coverage on "occurrence" basis while the policy is in effect to a "claims made" basis while the policy is in effect.

669 Andersen Rogers 1992, 906.

670 *St. Paul Fire & Marine Ins. Co. v. Barry*, 438 U.S. 531 (1978), paragraph 541.

671 *Hartford Fire Ins. Co. v. California*, 509 U.S. 764 (1993).

672 See Penny Zagalis, *Hartford Fire Insurance Co. v. California: Reassessing the Application of the McCarran-Ferguson Act to Foreign Reinsurers*, 27 Cornell Int. L. J. 241 (1994), 242.

673 Comprehensive general liability.

conspiracies between the four domestic primary insurer defendants (Hartford, Aetna, CIGNA, and Allstate) and domestic and foreign (international) reinsurers, brokers, and associations to manipulate the ISO CGL forms. According to the complaints, the object of the conspiracies was to force certain primary insurers (insurers who sell insurance directly to consumers) to change the terms of their standard CGL insurance policies to conform with the policies the defendant insurers wanted to sell.

The Supreme Court first answered the question whether insurers lose their McCarran-Ferguson exemption by acting in concert with non-exempt parties (in this particular case foreign, as in international, insurance companies). The Supreme Court made clear that the "business of insurance" of the McCarran-Ferguson Act exempts *activities* inherent in the business of insurance, and that the entities with which business of insurance is conducted are irrelevant. That the international parties dealt with are not exempt from the anti-trust legislation by the McCarran-Ferguson Act was irrelevant. The Court noted that agreements made with entities that are non-exempt *and* that are entities outside the insurance industry are not about "the business of insurance" and therefore not exempt. In *Hartford Fire Insurance* however the entities dealt with were foreign (international) insurance companies which, in fact, were in the "business of insurance."[6-4]

As for the definition of boycott in the McCarran-Ferguson Act, the Supreme Court had the opportunity to broaden the meaning of "boycott" to further limit the states' regulatory authority with regard to the insurance industry. Instead, it narrowly interpreted "boycott." It held, by a five to four vote, that there is a clear distinction between a true boycott and a concerted agreement to terms. Justice Scalia, writing the majority opinion for the Court, defined "the term 'concerted agreement' as one that seeks particular terms in particular transactions [as] ... a way of obtaining and exercising market power by concertedly exacting terms." A concerted agreement becomes a boycott only when the parties refuse to deal beyond the given transaction, thereby using "unrelated transactions as leverage to achieve the terms desired."[6-5]

The Supreme Court did not find that the actions taken by the insurers constituted a boycott but rather concerted agreements to seek particular terms in particular situations, the change of the ISO forms. Because the actions were not boycotts, the McCarran-Ferguson exemption from anti-trust legislation applied to the actions of the insurers and the Sherman act did not apply.

While the more realistic "activities" standard in the "business of insurance" interpretation looks to the particular activity rather then the entity and therefore provides the courts with the option of applying the original and essential purposes of the McCarran-Ferguson Act[6-6], this definition of "boycott" makes the applicability of the exemption more likely. Rather than further limiting the anti-trust exemption in the McCarran-Ferguson Act, the Supreme Court respected the Congressional intent of exempting the business of insurance (which it clearly

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[6-4] Charles R. McGuire, *Regulation of the Insurance Industry After Hartford Fire Insurance v. California: The McCarran-Ferguson Act and Anti-trust Policies*, 25 Loyola University Chicago Law Journal 303 (1994), 338-339.

[6-5] *Hartford Fire Ins. Co. v. California*, 509 U.S. 764 (1993), paragraph 4. See also Zagalis 1994, at 258.

[6-6] McGuire 1994, 351-352.

defined in earlier case law) from federal anti-trust regulation with its limited definition of boycott.

3.6 Taxation

Section 1012b not only grants the states the authority to regulate the business of insurance, it also grants the authority to impose fees or taxes upon it. In the 1946 case of *Prudential Ins. Co. v. Benjamin*[6-7], South Carolina levied a tax on foreign[6-8] insurers only, as a condition of receiving a certificate of authority to carry on the business of insurance in the state. No similar tax was required of South Carolina corporations. The discriminatory three percent state tax was challenged as being contrary to the Commerce Clause. Prudential, a foreign insurance company, asserted that in the McCarran-Ferguson Act Congress "neither intended to, nor could, validate such taxes."[6-9]

Justice Rutledge delivered the opinion of the Court. Regarding the intention of the McCarran-Ferguson Act the Court ruled:

> "Obviously Congress' purpose was broadly to give support to the existing and future state systems for regulating and taxing the business of insurance. This was done in two ways. One was by removing obstructions (to the states' authority to regulate[680]) which might be thought to flow from its own (Congressional[681]) power, whether dormant or exercised, except as otherwise expressly provided in the Act itself or in future legislation. The other was by declaring expressly and affirmatively that continued state regulation of this business is in the public interest and that the business and all who engage in it shall be subject to the laws of the several states in these respects ..."

And,

> "It clearly put the full weight of its power behind existing and future state legislation to sustain it from any attack under the Commerce Clause to whatever extent this may be done with the force of that power behind it, subject only to the exceptions expressly provided for."[682]

The Supreme Court concluded that the McCarran-Ferguson Act provided authority to the states and therewith permitted the tax.[683] The Court also addressed the question whether Congress could validate discriminatory taxes by a federal Act. The Court stated:

> "The power of Congress over commerce ... is not restricted, except as the Constitution expressly provides ... Congress is subject only to the restrictions placed upon its authority by other constitutional provisions and the requirement that it shall not invade the domain of action reserved exclusively for the states."[684]

6-7 *Prudential Ins. Co. v. Benjamin*,328 U.S. 408 (1946).
6-8 Out-of-state.
6-9 *Prudential Ins. Co. v. Benjamin*,328 U.S. 408 (1946), 418.
680 My addition.
681 My addition.
682 *Prudential Ins. Co. v. Benjamin*,328 U.S. 408 (1946), paragraphs 430-31.
683 Cohen 1985, 5.
684 *Prudential Ins. Co. v. Benjamin*,328 U.S. 408 (1946), paragraph 434. See also *Gibbons v. Ogden*, 22 U.S. 1, (1824), paragraph 196.

The basic principle laid down in this case, that the McCarran-Ferguson Act removed any Commerce Clause restriction on California's power to tax the insurance business[685], protecting state regulation and taxation from commerce clause interference[686], was confirmed in the 1981 case of *Western & South Life Insurance Co. v. state Board of Equalization.*[68-]

Justice Brennan in *Western & South Life Insurance Co. v. state Board of Equalization* pointed out however that there are three provisions of the Constitution under which a taxpayer may challenge an allegedly discriminatory tax: the Commerce Clause, the Privileges and Immunities Clause and the Equal Protection Clause. Because the Commerce Clause is inapplicable to the insurance industry due to the McCarran-Ferguson Act[688], and the Privileges and Immunities Clause is inapplicable to corporations[689], the only provision remaining as possible grounds for invalidating a discriminatory tax is the Equal Protection Clause.[690]

The Fourteenth Amendment's Equal Protection Clause[691] prohibits states from acting arbitrarily or treating similarly situated persons differently. Fifteen months after the enactment of the Fourteenth Amendment[692] its core guarantee of equal protection was held to be inapplicable to the area of insurance regulation. In the 1868 case of *Paul v. Virginia* the doctrine was established that "a state may impose taxes and conditions at its unfettered discretion on foreign corporations, in return for granting the privilege of doing business within the state".[693] During the first quarter of the 20th century the doctrine established in *Paul v. Virginia,* was altered. The Supreme Court initially required more justification for discrimination against foreign corporations by states than the mere fact that they were granted "the privilege of doing business within the state".

In the 1910 case of *Southern Railway Co. v. Greene*[694] the Court rejected the principle that "the imposition of special taxes upon foreign corporations for the privilege of doing business within the state is sufficient to justify such different taxation."[695] After several cases[696] which followed the new doctrine enunciated by *Southern R. Co. v. Greene* the Supreme Court made a brief intermediate return to the

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685 *Western & Southern Life Ins. Co. v. state Board of Equalization of California,* 451 U.S. 648, 655.

686 Weller 1978, 599.

68- *Western & Southern Life Ins. Co v. State Board of Equalization of California.* 451 U.S. 648 (1981).

688 *Prudential Ins. Co. v. Benjamin* 328 U.S. 408 (1946).

689 See *Toomer v. Witsell,* 334 U.S. 385 (1948).

690 In *Prudential Ins. Co. v. Benjamin* 328 U.S. 408 (1946) the equal protection issue was not resolved because it had not been raised.

691 See section 2.

692 Ratified July 9, 1868.

693 *Western & Southern Life Ins. Co v. State Board of Equalization of California.* 451 U.S. 648 (1981), paragraph 658.

694 *Southern Railway Co. v. Greene,* 216 U.S. 400, 1910.

695 *Western & Southern Life Ins. Co v. State Board of Equalization of California.* 451 U.S. 648 (1981), paragraph 662.

696 *Hanover Fire Ins. Co. v. Harding,* 727 U.S. 494 (1926), *Frost & Frost Trucking Co. v. Railroad Comm'n,* 271 U.S. 593 (1926), *Power Manufacturing Co. v. Saunders,* 274 U.S. 490 (1927), *Wheeling Steel Co. v. Glander* 337 U.S. 562, *Allied Stores of Ohio Inc. v. Bowers* 358 U.S. 522, *WHYY Inc. v. Glassboro* 393 U.S. 117.

Paul v. Virginia doctrine of "unfettered discretion" to impose tax and conditions, even discriminatory ones, on the part of the states in 1945.[697]

In 1981 however, the Supreme Court in *Western & Southern Life Insurance Co. v. state Board of Equalization of California* considered it established that "whatever the extent of a state's authority to exclude foreign corporations from doing business within its boundaries, that authority does not justify imposition of more onerous taxes or other burdens on foreign corporations than those imposed on domestic corporations". In this case the court established that in principle discrimination between foreign and domestic corporations was not allowed, unless however, the court added, "the discrimination between foreign and domestic corporations bears a rational relation to a legitimate state purpose."[698]

California imposed a retaliatory tax on foreign insurers whose state of incorporation imposed higher taxes on California insurers doing business in that state. An Ohio insurer brought suit in California alleging that the retaliatory tax violates the Commerce Clause and the Equal Protection Clause. The Court had long established that McCarran-Ferguson Act removes any commerce clause restriction on states powers to regulate or tax the business of insurance, and here established that the Equal protection Clause of the Fourteenth Amendment does not prohibit retaliatory taxes if "the discrimination bears a rational relation to a legitimate state purpose."[699] The state's purpose of the retaliatory tax was to promote the interstate business of California insurers by deterring other states from imposing higher taxes than California normally imposed. The majority of the Court in *Western & Southern Life Insurance Co. v. state Board of Equalization of California* concluded that the California Legislature's rational belief that the retaliatory tax would promote its objective was sufficient to satisfy the Equal Protection Clause.[700]

The Equal Protection Clause prohibited discriminatory taxes in the 1985 Supreme Court case of *Metropolitan Life insurance Co. v. Ward.*[701] An Alabama statute imposed a substantially higher tax on out-of-state insurance companies than on domestic insurance companies. The out-of-state insurance companies could reduce their tax rate by investing in specified state assets and securities. The purpose of the Alabama statute was to promote domestic business with a substantially lower tax rate than on foreign companies.

The Supreme Court used the Equal Protection Clause of the Fourteenth Amendment to strike down the discriminatory tax. "Equal protection restraints are applicable even though the effect of the discrimination in this case is similar to the type of burden with which the Commerce Clause also would be concerned."[702] The Court stated "Although the McCarran-Ferguson Act exempts the insurance

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[697] *Lincoln National Life Ins. Co. v. Read*, 325 U.S. 673.

[698] *Western & Southern Life Ins. Co v. State Board of Equalization of California.* 451 U.S. 648 (1981), paragraphs 667-668.

[699] *Western & Southern Life Ins. Co v. State Board of Equalization of California.* 451 U.S. 648 (1981), paragraph 668.

[700] *Western & Southern Life Ins. Co v. State Board of Equalization of California.* 451 U.S. 648 (1981), paragraph 672.

[701] *Metropolitan Life insurance Co. v. Ward*, 470 U.S. 869, (1985).

[702] *Metropolitan Life insurance Co. v. Ward*, 470 U.S. 869, (1985), paragraph 881.

industry from Commerce Clause restrictions, it does not purport to limit in any way the applicability of the Equal Protection Clause."[703]

Although the Equal protection clause limits the state authority to tax the business of insurance, it also provides an exception to the limits when the discrimination between foreign and domestic corporations bears a rational relation to a legitimate state purpose.

4 Conclusion

In this chapter I have described the legal development of insurance market integration in the United States of America. Rather than limits to state regulatory authority and to the liberty of market participants to act, the Constitutional Commerce Clause grants Congress the authority to regulate commerce among the states. With the enactment of the McCarran-Ferguson Act the states retained their authority to regulate free from Commerce Clause interference and the market participants remained for a large part exempt from federal (anti-trust) laws.

I have described the Commerce Clause in the Constitution as the article that relates to free and fair interstate trade in the United States. The Constitutional Commerce Clause did not apply to the business of insurance until the *South Eastern Underwriters Association* Supreme Court case. With the almost immediate enactment of the McCarran-Ferguson Act, the limits that flow from the Commerce Clause apply neither to the states nor do federal acts based on the Commerce Clause automatically effect market participants with regard to the business of insurance.

State authority to regulate and tax is not completely unlimited, nor is the market participants liberty to act. The Constitution, federal regulation in general, and the McCarran-Ferguson Act in particular provide a few limits to the state freedom to regulate and tax the business of insurance and to market participants liberty to act free from federal anti-trust regulation. The Supreme Court has interpreted the Constitution to limit the states' regulatory authority[704] and has interpreted the McCarran-Ferguson Act's limits for the states and market participants.

The McCarran-Ferguson Act maintained the status quo of state regulation and taxation of the business of insurance. The Act mainly excludes federal interference, granting the states authority to regulate and tax the business of insurance, and the general application of federal anti-trust regulation to the business of insurance. The Act's wording however allows for interpretation.

The Supreme Court very clearly and restrictively has defined the "business of insurance", limiting the pre-emptive effect of the McCarran-Ferguson Act on federal regulation to state regulations regarding the business of insurance only, i.e., "practices that have the effect of transferring or spreading a policyholder's risk, which practices must be an integral part of the policy relationship between the

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[703] *Metropolitan Life insurance Co. v. Ward*, 470 U.S. 869, (1985), paragraph 880.

[704] Despite the fact that it prohibits state regulation with which the Commerce Clause would also be concerned in *Metropolitan Life insurance Co. v. Ward*, 470 U.S. 869, (1985), paragraph 881: "Equal protection restraints are applicable even though the effect of the discrimination in this case is similar to the type of burden with which the Commerce Clause also would be concerned."

insurer and the insured, and they must be limited to entities within the insurance industry."[105]

Where federal regulation must specifically relate to the business of insurance to invalidate, impair or supersede state law, the Supreme Court has interpreted a specific reference to insurance as being sufficient to fulfill the condition.

The blanket delegation of taxing power in the McCarran-Ferguson Act was limited by the Supreme Court in 1985, in the case of *Metropolitan Life Insurance Co. v. Ward* where it prohibited discrimination in taxation on the basis of the Equal Protection Clause of the Constitution. In the same case however the Supreme Court also introduced an exception to the equal protection limit for the states. When state regulation bears a rational relation to a legitimate state purpose, discrimination can be allowed.

Where the mere regulation of the business of insurance by the state is sufficient for pre-emption of federal anti-trust law, the liberty of the market participant to act is limited by the Sherman Act, regardless of state regulation, when there is "an agreement to boycott, coerce, intimidate, or act of boycott, coercion, or intimidation" irrespective of state regulation.[106] The actual limiting effect of this article on the liberty to act depends however on the interpretation of the terms boycott, coercion, and intimidation in an insurance case.[107] When in *Hartford Fire Insurance Co. v. California*[108], the Supreme Court was asked to interpret boycott in an insurance case, it used a narrow definition, broadening the exemption from federal anti-trust law.

However, while the Supreme Court has not been willing to narrow the scope of the McCarran-Ferguson Act pre-emptive effect on federal anti-trust legislation, in 1999 it did interpret federal anti-trust law to simultaneously apply to state anti-trust regulation in the case of *Humana Inc. et al. v. Forsyth et al.*[109] It held that federal law prohibiting anti-competitive behavior could apply to the insurance industry even when it has already been regulated by state law: "when federal law is applied in aid or enhancement of state regulation, and does not frustrate any declared state policy or disturb the state's administrative regime, the McCarran-Ferguson Act does not bar federal action."[110]

In this chapter I have found that states are limited in their authority to regulate and tax with regard to discriminatory regulation unless it bears a rational relation to a legitimate state purpose"[111], with regard to federal Acts that specifically relate to the business of insurance, and is the market participants liberty limited only by federal anti-trust regulation if the states have not regulated anti-trust, or in case of a boycott, coercion or intimidation or an agreement to boycott, coerce or intimidate.

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[105] See *Union labor life insurance co. v. Pireno* 458 US 119,(1982), paragraph 129.

[106] Section 1013.
"(b) Nothing contained in this Act shall render the said Sherman Act inapplicable to any agreement to boycott, coerce, or intimidate, or act of boycott, coercion, or intimidation."

[107] Boycott has been defined in *St. Paul Fire & Marine Ins. Co. v. Barry*, 438 U.S. 531 (1978) and in *Hartford Fire Ins. Co. v. California*, 509 U.S. 764 (1993).

[108] *Hartford Fire Ins. Co. v. California*, 509 U.S. 764 (1993).

[109] *Humana Inc. et al. v. Forsyth et al.* 525 U.S. 299 (1999).

[110] Justice Ginsberg who delivered the opinion of the Court.

[111] Discriminatory taxation allowed. *Western & Southern Life Ins. Co v. State Board of Equalization of California*. 451 U.S. 648 (1981), paragraphs 667-668.

Chapter 7

Summary and Conclusion

1 Introduction

In the first chapter I set out to answer what institutional structure and grants of authority facilitate legal developments which result in insurance market integration that accommodates state insurance market interests. Where in this study the insurance markets of the European Community and the United States are used as case study, the same questions and answers are of interest for any transboundary market within a federal context or a transnational authority-context.

In the previous three chapters I described the legal development of insurance market integration in the European Community and the United States of America. In addition to the limits on state authority to regulate and the liberty of market participants to act in the EC Treaty, secondary legislation and case law in the European Community, and the Constitution, federal legislation and case law in the United States, I found exceptions to the limits for states and market participants alike to protect their interests on the insurance markets.

In the next section I summarize the findings of the previous three chapters, in particular the extent that the legal development of insurance market integration has resulted in the accommodation of state insurance market interests in the European Community and the United States of America. Section 2.1 summarizes the findings for the European Community in chapters 4 and 5, determining the extent to which the legal development of insurance market integration has accommodated the insurance market interests in the European Community. Section 2.2 summarizes the findings for the United States of America in chapter 6 and determines the extent to which the legal development of insurance market integration has accommodated the insurance market interests in the United States of America.

In section 3 I compare and evaluate the differences in legal development between the European Community and the United States and draw conclusions with regard to the institutional structure and grants of authority that facilitate legal developments which result in insurance market integration that accommodates state insurance market interests.

2 Legal Developments of Insurance Market Integration

2.1 European Community

The limits to the state authority to regulate the insurance market and the liberty of market participants to act in the insurance markets are laid down in the Treaty and have been defined by the ECJ, the Commission, and the Council. The ECJ has interpreted the meaning of the freedom of establishment and the freedom to provide services as well as EC Treaty rules on competition with regard to insurance. The Commission has interpreted the freedoms in its proposals for secondary regulation, has issued an interpretative communication with regard to the general good, and has regulated competition. The Council has enacted directives to facilitate

the freedom of establishment for insurance providers and the freedom to provide insurance services; it has also issued regulations regarding EC Treaty rules on competition. The EC Treaty, directives, regulations, (their) interpretations and definitions determine the limits to the state authority to regulate, limits on the liberty of market participants to act, and the exceptions to these limits; the justifications for the obstacles and barriers to free and fair interstate trade.

As described in chapter 2, the economic integration of the insurance markets in the European Community is based on the concept of a common market. The common market requires the creation of an internal market that is free from all customs duties, quantitative restrictions on the import and export of goods and all other measures having equivalent effect, free from the obstacles and barriers to the freedom of movement for persons, services and capital[-12], a common customs tariff, and the institution of a system to ensure that competition in the common market is not distorted.

The EC Treaty articles on the freedom of establishment (freedom of movement for persons), the freedom of movement for services and fair competition are relevant for the economic integration of the insurance markets. In chapter 4 we have seen that in addition to limits specified in the EC Treaty text, the Council has used the authority granted to it in the EC Treaty to enact three generations of insurance directives that limit the authority of the states to regulate. These three generations of insurance directives have limited the state authority to regulate, lowering the barriers for market access with regard to the freedom of establishment for insurance providers and the freedom to provide insurance services. They coordinate the states' regulation on authorization and supervision of insurance providers in the European Community, introduced a single licence, home country control, and mutual recognition of member states' authorization and supervision laws.

Chapters 4 and 5 described not only the limits in both the Treaty and the directives for the regulatory authority of the states, but also the limits to the liberty of market participants to act. The Treaty rules on competition complement those on the freedom of establishment and the freedom to provide services.[-13] Anti-competitive behavior by market participants is prohibited in articles 81 and 82 EC Treaty.[-14] The ECJ has found the Treaty rules on competition to apply to the business of insurance, requiring insurance providers to comply with the Treaty.[-15]

[-12] Kapteyn 2003, 104-105.
Kapteyn/Gormley 1998, 122-123.

[-13] Kapteyn 2003, 647.
Kapteyn/Gormley 1998, 837.

[-14] *Verband der Sachversicherer eV v European Commission.* Case 45/85, ECR [1987] 405, paragraph 14. The European Court of Justice confirmed that the competition system of the EC Treaty applies without restriction to the insurance industry.

[-15] *Brentjens' Handelsonderneming BV v Stichting Bedrijfspensioenfonds voor de Handel in Bouwmaterialen.* Joined cases C-115/97 to C-117/97, ECR [1999] Page I-06025, paragraph 65: "Although article 85 (now 81) concerns itself only with the conduct of undertakings and not legislation or regulations that have been adopted by members states, the ECJ in the case of van Eycke v. ASPA (1988 ECR 4769, 267/86) (16), the Treaty requires that (article 85 in combination with article 5) member states do not introduce or maintain in force measures which may render ineffective the competition rules applicable to undertakings. This is the case where a member state requires or favours the adoption of agreements, decisions or concerted practices contrary to article 85 of the Treaty or reinforces their effect or deprives its own

Article 81 EC Treaty prohibits agreements, decisions and concerted practices that may effect trade between Member states and have the objective or effect of distorting competition on the market. It voids any agreements or decisions found to do so. Interpretation by the ECJ of Treaty rules in the case of *Verband der Sachversicherer eV v European Commission*[16] defined the terms used in articles 81 and 82[17] of the Treaty broadly, making the rules of competition easily applicable, limiting market participants' liberty to act, and here too, lowering barriers to free and fair interstate trade.

All state regulations and state and market participants actions that have not been regulated in secondary regulation are limited by the Treaty articles on the freedom of establishment, the freedom to provide services, and the rules regarding European competition. As previously seen, with the expiry of the transitional period in 1974, the Treaty articles on these freedoms directly limit state authority to regulate and act[18] With the freedoms having direct effect, the interpretation of these freedoms by the ECJ, beyond the prohibition of discrimination, has broadened the definition of obstacles and barriers, and further limited state authority to regulate.

The European Court of Justice's case law, interpreting the limits to state authority in the freedom of establishment and the freedom to provide services, clarifies that the states are limited in their authority to regulate with regard to discriminatory state regulation, national measures without distinction that have a discriminatory effect and state regulation that as much as hinders or makes establishment less attractive and substantially impedes the provision of services or are liable to prohibit or otherwise impede the freedom.[19]

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legislation of its official character by delegating to private trader responsibility for taking decisions affecting the economic sphere, see also case 2/91 Meng 1993 (14), Reiff 185/91 1993 par 14, Ohra 245/91 1993 par 10, Cie. V. Italy 1998 35/96 par 53/54, 266.96 Corsica ferries 1998 par. 35, 36, 49."

[16] *Verband der Sachversicherer eV v European Commission.* Case 45/85, [1987] ECR 405.

[17] See chapter 5.

[18] *Jean Reyners v Belgian State.* Case 2-74, ECR [1974] Page 00631, paragraph 30.
Johannes Henricus Maria van Binsbergen v Bestuur van de Bedrijfsvereniging voor Metaalnijverheid. Case 33/74, ECR [1974] 1299, paragraph 27.
Alexandra Prechal, *Directives in European community law: a study on EC directives and their enforcement by National Courts*, Brouwer Uithof, 1995, 276: " direct effect is the obligation of a Court or another authority to apply the relevant provisions of Community law, either as a norm which governs the case or as a standard for legal review."
Direct effect; *NV Algemene Transport- en Expeditie Onderneming van Gend & Loos v Netherlands Inland Revenue Administration.* Case 26-62, ECR English special ed. [1963] 0001 and *Flaminio Costa v E.N.E.L.* Case 6/64, ECR English special ed. [1964] 0614.
Jean Reyners v Belgian State. Case 2-74, ECR [1974] Page 00631, paragraphs 24-25: "the rule on equal treatment with nationals is one of the fundamental legal provisions of the Community" and "this rule is, by its essence, capable of being directly invoked by nationals of all the other member states."

[19] Craig de Búrca 1998, 733.
Kapteyn 2003, 526.
Kapteyn/Gormley 1998, 626.
Reinhard Gebhard v Consiglio dell'Ordine degli Avvocati e Procuratori di Milano. Case C-55/94, ECR [1995] Page I-04165, *Dieter Kraus v Land Baden-Württemberg.* Case C-19/92 ECR [1993], Page *I-01663,Manfred Säger v Dennemeyer & Co. Ltd.* Case C-76/90, ECR [1991] Page I-04221, *Alpine Investments BV v Minister van Financiën.* Case C-384/93, ECR [1995] Page I-01141, *Jessica*

The limits in the Treaty, the directives, regulations and case law, determine the economic integration potential in the European Community. I use the term potential because the Treaty and the directives, despite the prohibitions to regulate and act provide exceptions to these limits. The justifications for obstacles and barriers provided in the Treaty, in ECJ case law, and in the Commission's interpretation of "the general good"[-20], relate to state interests, consumer interests, and provider interests within the European (insurance) markets. These, in combination with the limits, determine whether the legal development of insurance market integration has resulted in an integration of the insurance markets that accommodates the insurance market interests.

The Treaty[-21] provides a definitive[-22] list of justifications for discriminatory obstacles and barriers as well as equally applicable measures liable to hinder or make the exercise of fundamental freedoms less attractive.[-23] These exempt state regulations that protect official authority, public policy, public security or public health, and that are necessary and proportionate from Treaty limits.

In addition to Treaty exceptions, the ECJ introduced the rule of reason[-24] for state regulations and acts with regard to the provision of services and the freedom of establishment.[-25] Contrary to the exceptions provided in article 55 of the EC Treaty, the rule of reason applies in principle only to non-discriminatory state rules and regulations that have not (yet) been harmonized, are justified by imperative reasons in the general interest (i.e. general good), are necessary, and proportionate.

As I have described in chapter 4, the ECJ has accepted various exceptions to the limitations placed on states in the freedom to provide services and the freedom of establishment.[-26] In the 1986 insurance cases[-27], the ECJ applied the rule of reason to

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Safir v Skattemyndigheten i Dalarnas Län, formerly Skattemyndigheten i Kopparbergs Län. Case C-118/96, ECR [1998] Page I-01897.

[-20] To help eliminate the obstacles to the freedom to provide insurance services caused by the uncertainty over the general good concept, the Commission in 1997 drafted an interpretative communication on the freedom to provide services and the general good in the insurance sector which, after a wide-ranging consultation process, resulted in 2000 in a Commission Interpretative Communication – Freedom to provide services and the general good in the insurance sector Official Journal C 043, 16/02/2000 P. 0005-0027.

[-21] Articles 45 sq. EC (ex article 55 sq). and 55 EC (ex article 66) (which makes the provisions of the articles 45 sq. EC applicable to services): Official authority, public policy, public security or public health.

[-22] *Jean Reyners v Belgian State.* Case 2-74, ECR [1974] Page 00631, paragraph 43: "having regard to the fundamental character of freedom of establishment and the rule on equal treatment with nationals in the system of the Treaty, the exceptions allowed by the first paragraph of article 55 cannot be given a scope which would exceed the objective for which this exemption clause was inserted."

[-23] Kapteyn 2003, 550.
Kapteyn/Gormley 1998, 658.

[-24] Kapteyn 2003, 560.
Kapteyn/Gormley 1998, 675.
First developed for the free movement of goods in *Cassis de Dijon* (*Rewe-Zentral AG v Bundesmonopolverwaltung für Branntwein.* 120/78, ECR [1979] Page 00649).

[-25] See chapter 4.

[-26] *Dieter Kraus v Land Baden-Württemberg.* Case C-19/92 ECR [1993], Page I-01663: establishment; prohibiting a national to use a foreign academic title prior to obtaining administrative authorization could be justified if it pursues a legitimate objective, is justified by

justify state obstacles to the freedom to provide insurance services for insurance providers. An authorization requirement by the host state for providers of insurance services for the protection of consumers, was found justified. The state measure was applied without distinction, was suitable and necessary, and not disproportional to the interests it protected.

As a result of this case law consumer protection was introduced in the second generation insurance directives. In the third generation insurance directives this was replaced with a general good exception for state regulation and acts that are necessary, proportionate and protect an interest in the general good.

As for competition, some agreements, decisions or concerted practices that, although they fall within the description of behavior that is prohibited by the Treaty rules on competition, are exempt from their application."[28] Only under strict conditions are market participants allowed to agree, make decisions or have concerted practices to protect their interests; this is permitted only when their actions "contribute to improving the production or distribution of goods or to promoting technical or economic progress" and neither "impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives" nor "afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question".[29]

The Council directives, Commission regulations and ECJ case law interpreting the Treaty and secondary law have resulted in the elimination of obstacles and barriers to interstate trade, establishment as well as the provision of services, through prohibitions in the Treaty and the coordination of state regulation in secondary regulation. They have limited state authority to regulate and the liberty of market participants to act. These limits to the states and market participants facilitate the economic integration of the insurance markets in the European Community. Limits on member states' authority to regulate and market participants liberty to act are balanced by exceptions in the Treaty, secondary regulation and case

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the public interest and is appropriate for ensuring attainment of the objective and not go beyond what is necessary; *Reinhard Gebhard v Consiglio dell'Ordine degli Avvocati e Procuratori di Milano*. Case C-55/94, ECR [1995] Page I-04165: establishment, complying with provisions relating to organization, qualifications, professional ethics, supervision and liability can be justified by the general good; *Hanns-Martin Bachmann v Belgian State*. Case C-204/90, ECR [1992] Page I-00249: the Belgian state is allowed to impose conditions for reasons of the cohesion of the Belgian tax system; *Alpine Investments BV v Minister van Financiën*. Case C-384/93, ECR [1995] Page I-01141: state can impose restrictions on cold calling to protect the integrity of the Dutch financial market; Not in *Jessica Safir v Skattemyndigheten i Dalarnas Län, formerly Skattemyndigheten i Kopparbergs Län*. Case C-118/96, ECR [1998] Page I-01897 however: restrictions on capital life insurance policies taken out with foreign insurance companies were found to be unnecessary and out of proportion.

[27] *Commission of the European Communities v Federal Republic of Germany*. Case 205/84, ECR [1986] Page 03755, *Commission of the European Communities v French Republic*. Case 220/83. ECR [1986] Page 03663, *Commission of the European Communities v Kingdom of Denmark*. Case 252/83. ECR [1986] Page 03713, *Commission of the European Communities v Ireland*. Case 206/84, ECR [1986] Page 03817.

[28] Commission Regulation (EC) No 358/2003 Official Journal L 053, 28/02/2003 P. 0008-0016. Commission Regulation (EEC) No. 3932/92 dated 21 December 1992 "on the application of article 85 (3) of the Treaty to certain categories of agreements, decisions and concerted practices in the insurance sector, Official Journal L 398, 31/12/1992 P. 0007-0014.

[29] Article 81(3) EC Treaty.

law in order to protect the interests of the insurance consumer, insurance provider, and the state.

The extent to which the legal developments in insurance market integration have accommodated the insurance market interests in the European Community is determined by the (interpretation of the) Treaty and secondary law regulating the business of insurance along with the exceptions to the limits in the Treaty and secondary law. The exceptions, respecting the interests of the insurance markets, apply only under strictly defined conditions. The (Court interpretations of the) freedoms as well as the directives allow justification of an obstacle or barrier if it protects a valid interest, whether consumer, insurance provider or state, is necessary to protect that interest, and is a proportionate means to achieve the objective. Also, the host state's interests must not (already) be protected by the home member state, and the regulation may not go further than strictly necessary to protect the interest. For exceptions with regard to the rules on competition, cooperation between market participants must necessarily contribute to competition in the insurance markets, must be in the interest of the consumer, may not impose disproportionate restrictions on the undertakings involved, nor may it eliminate competition.

I conclude that the legal development of insurance market integration in the European Community has resulted in an elimination of intentional barriers and the minimization of obstacles while accommodating the interests on the insurance markets. The Treaty, secondary regulation and case law have limited the authority of the member states to regulate but have also left possibilities to protect the interests on the insurance markets. Interstate trade in the European Community can be hindered by discriminatory state regulation only if the regulation is necessary and proportionate to protect official authority, public policy, public security or public health, and by non-discriminatory state regulation only if it is necessary and proportionate to protect a general good. The same is true with regard to the liberty of the market participants to act. The Treaty and case law have limited their liberty to act for the purpose of market integration but has provided the possibility, together with secondary law, to protect their interest on the insurance markets.

In section 3 the result is evaluated and compared with the results of the legal development of insurance market integration in the United States (see subsequent section) in order to draw a conclusion as to the role of the institutional structure and grants of authority.

2.2 United States of America

The limits to state authority to regulate are laid down in the United States Constitution and have been defined by the Supreme Court and the federal Congress. The limits on the liberty of market participants are laid down in federal and state law. Although Congress used its authority to regulate the business of insurance, it did not use its authority to economically integrate the insurance markets, but rather to allow the continued state regulation and taxation.

The Constitution, federal legislation and Court interpretations of both the Constitution and the federal regulations have resulted in a legal development of insurance market integration that differs from the legal development of insurance market integration in the European Community. Rather than limiting the state authority to regulate and act as well as market participants in their liberty to act, the federal McCarran-Ferguson Act grants individual states the freedom to regulate and

tax the business of insurance, leaving market participants the liberty to act virtually free[730] from federal interference (not however free from state regulation).

As described in chapter 6 the legal development of insurance market integration in the United States of America is based on the Constitution's Commerce Clause which was included in the Constitution to halt state erected trade barriers and obstacles between the former confederate states. The Commerce Clause grants authority to regulate interstate commerce to Congress. There are no requirements included in the Constitution's text nor the economic integration objective. In defining the Commerce Clause, and therewith the authority of the Federation to regulate, i.e. the authority of Congress, the Supreme Court initially interpreted "commerce" to not include the business of insurance and the federal Congress not to have the authority to regulate it.

When the Supreme Court redefined the reach of the Commerce Clause to include the regulation of the business of insurance in 1940, the federal Congress used its authority to issue the McCarran-Ferguson Act. As seen in chapter 6, the Act grants to the states the continued authority to regulate and tax the business of insurance. It effectively barrs all Commerce Clause limitations, whether direct or indirect in federal Acts, on states' authority to regulate and tax the business of insurance. The liberty of market participants to act is limited by federal anti-trust law only if the states have not regulated the business of insurance or in cases of agreements to, or acts of, boycott, coercion, or intimidation. (If the states have regulated[731] then market participants are limited by state legislation.)

The McCarran-Ferguson Act maintains state authority and the liberty of market participants' that had evolved prior to the reinterpretation by the Supreme Court of the Commerce Clause. The McCarran-Ferguson Act very clearly states that, in principle, Acts of Congress cannot invalidate, impair, or supersede any state law that regulates the business of insurance or imposes a fee or tax on the business of insurance. This allows the states to continue to protect the interests on their insurance markets. State authority to regulate is not completely free from Constitutional limits and federal interference, and neither is market participants liberty to act free from federal law.

Because Congress legislated the business of insurance based on the Commerce Clause, the Supreme Court is refrained from interpreting possible limits in the Commerce Clause with regard to the business of insurance. The other Constitutional articles are not off limits with regard to the business of insurance. The Equal Protection Clause of the Fourteenth Amendment, for example, has been interpreted to prohibit states from acting arbitrarily or treating similarly situated persons differently, i.e., from discrimination. Although the Equal Protection Clause of the Constitution applies to the business of insurance, the Supreme Court allows states to discriminate in their taxation of foreign insurance providers when the discrimination bears a rational relation to a legitimate state purpose.[732] When the tax

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[730] Not, however, in case of boycott, coercion and intimidation or when a federal law relates specifically to the business of insurance. See section 1013 (b) McCarran-Ferguson Act: "Nothing contained in this Act shall render the said Sherman Act inapplicable to any agreement to boycott, coerce, or intimidate, or act of boycott, coercion, or intimidation."

[731] The mere enactment of state legislation is sufficient for the exemption to apply. See chapter 6 section 3.4.

[732] *Western & Southern Life Ins. Co v. State Board of Equalization of California*. 451 U.S. 648 (1981),

bears a rational relation to a legitimate state purpose, in the particular case a retaliatory tax to promote the interstate business of the home states' insurers for the purpose of deterring other states from imposing higher taxes than the home state normally imposes, it is allowed.

The McCarran-Ferguson Act also provides exceptions to state authority to regulate and tax as well as to the liberty of market participants to act free from federal interference. Federal Acts that specifically relate to the business of insurance apply despite the McCarran-Ferguson Act, and can limit the states in their regulatory freedom. The Supreme Court in *Barnett Bank of Marion County v. Nelson*[733] defined 'specifically' in section 1012b. It held that the "particular words 'finance, banking, and insurance'" were sufficient to constitute a specific reference, fulfilling the requirement of specifically. Federal law in this particular case pre-empted the state regulation, limiting the states in their freedom to regulate.

The freedom of the states to regulate and tax in the McCarran-Ferguson Act is limited to the "business of insurance". The Supreme Court emphasized that the McCarran-Ferguson Act exemption was not intended for all the actions of the insurance companies regulated by state law, but only for state regulations covering the underwriting of risk, the relationship between the insurer and the insured, and entities within the insurance industry.[734] Not included in the definition of "business of insurance" are variable annuity contracts[735] without the underwriting of risk offered by a life insurance company, nor actions of non-disclosure of acquired stock between two insurance companies[736], nor the business of insurers.[737] With regard to these subjects the states' authority to regulate is limited by the Constitution, including the Commerce Clause, and federal laws.

The exceptions to the liberty of market participants to act free from the interference from federal anti-trust legislation apply in two situations: when the states have not regulated the business of insurance, and when there is an agreement to boycott, coerce, or intimidate, or act of boycott, coercion, or intimidation. Section 1012b states that the federal anti-trust legislation, Sherman, Clayton and federal Trade Commission Act, apply to insurance market participants if the states have not used their regulatory authority. The Supreme Court in its case law found that the mere existence of state law is sufficient to fulfill the requirement of "regulated by state law", and the McCarran-Ferguson Act to apply.[738] The effectiveness of state

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paragraph 668.
The Supreme Court in *Metropolitan Life insurance Co. v. Ward* 470 U.S. 869, (1985) did not accept a discriminatory state taxation that imposed substantially lower tax rate on domestic companies than on foreign companies. The purpose of the Alabama statute was the promotion of domestic business within the state by imposing on them a substantially lower tax rate than on foreign companies. Because the discrimination was found not to bear a rational relation to the state purpose the Court did not allow the discrimination.

[733] *Barnett Bank of Marion County v. Nelson*. 517 U.S. 25 (1996).

[734] *SEC v National Securities* 393 U.S. 453 (1969).

[735] *SEC v. Variable Annuity Life Insurance Company of America* 359 U.S. 440 (1959).

[736] *SEC v National Securities* 393 U.S. 453 (1969).

[737] *Group Life & Health Insurance Co. v. Royal Drug Co.* 440 U.S. 205 (1979) and *Union Labor Life Insurance Co. v. Pireno*. 458 U.S. 119 (1982).

[738] Kintner Bauer 1989, 230.
F. T. C. v. National Casualty Co, 357 U.S. 560 (1958).

regulation is irrelevant.[139] This definition of "regulated by state law" limits states as far as in their choice to regulate, but leaves them complete freedom with regard to the content of their insurance regulation.

Section 1013b states that the Sherman Act applies to the business of insurance irrespective whether states have regulated when there is an "agreement to boycott, coerce, or intimidate, or act of boycott, coercion, or intimidation". The Supreme Court interpreted section 1013b and found that the boycott exclusion to the McCarran-Ferguson Act exemption protects all market participants.[140] Not just insurance companies or agents but policyholders as well. With regard to defining a boycott however, the Supreme Court narrowly interpreted it. A boycott exists only when the parties refuse to deal beyond the given transaction, thereby using "unrelated transactions as leverage to achieve the terms desired".[141] Although the "boycott" exception to the McCarran-Ferguson Act exemption from federal anti-trust laws applies to all market participants, the Supreme Court's definition of boycott limits its application.

I conclude that the legal development of insurance market integration in the United States of America has not resulted in an economic integration, the elimination of intentional obstacles or the minimization of barriers, that accommodates state insurance market interests. Rather than limits to the states' authority to regulate, and limits to the liberty of market participants to act, federal legislation grants the states an almost unlimited freedom to regulate and tax the business of insurance and exempts market participants from the application of federal (anti-trust) legislation. Only the Constitution's Equal Protection clause limits the states' authority to regulate and tax and accommodates the state insurance market interests with an exception to the prohibition of discrimination.

The subsequent section evaluates this result, compares it with the results of the legal development of insurance market integration in the European Community and draws a conclusion as to the role of the institutional structure and grants of authority in these legal developments.[142]

3 Institutional Structure and Grants of Authority

In chapter 2 I described the objective of economic integration and the means, the institutional structure and grants of authority to accomplish it. Whereas in the United States of America a Federation was formed based on a Constitution, in

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[139] Andersen Rogers 1992, 906.
St. Paul Fire & marine Ins. Co. v. Barry, 438 U.S. 531 (1978), *Federal Trade Commission v. National Casualty Co.*, 357 U.S. 560 (1958).

[140] *St. Paul Fire & Marine Ins. Co. v. Barry* 438 U.S. 531 (1978).

[141] *Hartford Fire Ins. Co. v. California*, 509 U.S. 764 (1993).
Penny Zagalis, *Hartford Fire Insurance Co. v. California: Reassessing the Application of the McCarran-Ferguson Act to Foreign Reinsurers*, 27 Cornell Int. L. J. 241, 258.

[142] Although the legal development of insurance market integration in the United States has been very limited, the same cannot necessarily be said as to the integration of the United States insurance markets. Insurance market integration has been facilitated through the NAIC, a voluntary organization of insurance regulators from the 50 states, the District of Columbia and the four U.S. territories insurance commissioners through model laws, regulations and guidelines.

Europe a Treaty was drafted to create an economic community of states. Both sought to provide the means to economically integrate their respective states' markets. The choice for the institutional structure that determines the legal relationship between the Community/Federation, and their respective institutions, states and citizens, differ, as do the grants of authority that were included in the institutional documents for the purpose of economic integration.

Although the European Community is based on a international Treaty among sovereign states, the member states have permanently limited their sovereign rights and have created a new legal order that binds both themselves as well as their nationals. The objective of economic integration, the creation of a common market, is included in the EC Treaty and is to be accomplished through limited and selective attribution of powers to the Community institutions that have tasks and objectives to fulfil in combination with express prohibitions for member states and market participants.

The states that form the United States of America have limited their sovereignty and have formed a government that cannot only make, but also enforce laws. The Federation is based on a Constitution on which citizens can attach rights. The objective of economic integration, the limiting of state authority to regulate and the liberty of market participants to act in order to eliminate intentional barriers and minimize obstacles to interstate trade, has been translated into a general grant of authority to Congress to regulate commerce among the states.

Both cooperative forms, the Treaty-based European Community as well as the Constitution-based United States Federation, have limited their sovereign rights, have created a government that not only makes but also enforces laws, and grants citizens the possibility to attach rights to the EC Treaty and the US Constitution, irrespective of their state's laws. Both the EC Treaty and the United States Constitution include a grant of authority for the purpose of economic integration. Despite these commonalities, the legal development of insurance market integration in the EC and the USA differ substantially.

The next subsections examine various elements in the institutional structure and grants of authority in the Treaty and the Constitution and the effect these have had on the legal development of insurance market integration in the European Community and in the United States of America.

3.1 Sovereignty

Both the member states of the European Community and the states of the United States Federation have limited their sovereignty. What the limits to the sovereignty of the member states meant for their authority to regulate the business of insurance however was not clear until after the parameters of the new legal order were set by the several institutions.

As early as 1964 the ECJ found in the case of *Costa ENEL*[43] that: "The EEC treaty has created its own legal system which, on the entry into force of the Treaty, became an integral part of the legal systems of the member states and which their courts are bound to apply. By creating a Community of unlimited duration, having its own institutions, its own personality, its own legal capacity and capacity of

[43] *Flaminio Costa v E.N.E.L.*Case 6/64, ECR English special ed. [1964].

representation on the international plane and, more particularly, real powers stemming from a limitation of sovereignty or a transfer of powers from the states to the Community, the member states have limited their sovereign rights and have thus created a body of law which binds both their nationals and themselves.(...)" The member states of the European Community, by signing the Treaty, limited their sovereign rights with regard to the fields covered in the Treaty. The states as well as their nationals are bound by Community law, the Treaty and secondary legislation.

In the United States limits on sovereignty are expressed in the Constitution's federal structure through a division of powers between the state governments and the federal government. The states limited their sovereignty when they joined the Federation. Their intra-state powers and authority to regulate and act are limited only by the institutional document, the Constitution, and federal Acts, and only to the extend stipulated in the Constitution.

Until the European Court of Justice and the United States Supreme Court interpreted the limits to the sovereignty of the states, and the Council of the European Community and Congress started using their authority, it remained unclear to what extent the signing of the EC Treaty and the Constitution actually limited the states' authority to regulate the business of insurance and the how it effected the liberty of (insurance) market participants to act.

The limits to the sovereignty in the European Community initially did not have much effect on state authority to regulate the business of insurance and on market participants liberty to act. Once direct effect was established, citizens could attach rights to the articles on the freedom of establishment and the freedom to provide services, as well as the rules on competition without prior need for directives that, partly due to the rule on unanimity, took years to be enacted. Once unanimity decision making was effectively replaced with qualified majority voting (in combination with the simplification of harmonization, mutual recognition and home country control), the enactment of (insurance) directives became a less complicated process, resulting in the second and third generation of insurance directives within half a decade, which determined the limits to the regulatory freedom of the states and the liberty of market participants to act.

In the United States of America the division of powers between the Federation and the states is determined through an enumeration of powers to the federal government. The Commerce Clause grants Congress the authority to regulate commerce among the states. For a long time it remained unclear whether this grant is an exclusive power to Congress and how "commerce among the states" is defined. The United States Supreme Court developed two predominant doctrines in its history of interpreting the extent to which the Commerce Clause limits state authority to regulate commerce and indirectly the liberty of market participants to act. What began as selective exclusiveness, or the concurrent powers doctrine in the 1850's, changed to the exclusive power doctrine, or dual federalism in the 1860's, to return again to concurrent powers with the New Deal in the 1930's.[44]

Where the concurrent powers doctrine interprets the grant of authority to Congress as not excluding states from regulating commerce among themselves (albeit under certain circumstances)[45], the exclusive power doctrine does so. The

[44] Little, 1985, 173.
[45] See chapter 2.

exclusive power doctrine interprets the commerce clause power to necessarily exclude states' regulatory authority. Both Supreme Court doctrines have had a great impact on the sovereignty of the states, and their authority to regulate. Where the concurrent powers doctrine allows states to regulate in compliance with federal legislation, or by lack of federal legislation in the spirit of the Commerce Clause, the exclusive powers doctrine simply prohibits the states to regulate commerce among the states.

When the Supreme Court was asked to determine whether a state could regulate the business of insurance among states in 1868, it set the parameters of the states' limit of sovereignty with regard to the business of insurance under the exclusive power doctrine. It found that the business of insurance did not constitute commerce under the Commerce Clause and that therefore the United States Constitution did not grant Congress the authority to regulate the business of insurance, leaving the authority with the individual states.

With the later return to the concurrent powers doctrine and the positive answer to the question whether federal Acts based on the Commerce Clause applied to the business of insurance, the Supreme Court found that Congress has the authority to regulate. The legal development of 75 years of state insurance regulation was an important factor for Congress when it used its authority to regulate the business of insurance. Enacting a federal law that regulated the business of insurance could invalidate state insurance market regulation. Not enacting one however meant that states could only regulate "in the spirit of the Commerce Clause", which was to be determined by the Supreme Court. Congress' solution to the impasse was a federal Act that grants the states the continued authority to regulate and tax the business of insurance. This preserves state legislation and prevents the Supreme Court from interpreting the Commerce Clause (and its limits) with regard to the business of insurance.

Limits to state sovereignty are set in both the European Community and the United States of America by institutional documents. Although these documents provide limits, the parameters that define these limits with regard to the regulation of the insurance markets have been and still are determined by Community and federal institutions.

3.2 Institutions

In order to make economic integration possible institutions must be able to not only make but also interpret and enforce the law, i.e., exercise authority. The exercise of authority by the institutions has had a decisive impact on the legal development of insurance market integration in the European Community and in the United States of America by setting the parameters that define the limits to state sovereignty.

Although in the European Community the Council is granted the authority and task to make laws based on the Treaty, initially decision making in the Council was subject to a veto right held by every member state. Unanimity made lawmaking a difficult and time consuming process. The first generation insurance directives took almost twenty years to be enacted. Because of the requirement of unanimity and the requirement that the Council had set for itself in the General Programs to coordinate the member states' rules, laws and regulations, the initial lawmaking steps in the economic integration of the insurance markets were very slow. After effectively replacing unanimity with qualified majority voting and the amendments

to the Treaty by the Single European Act of the late 1980's, the insurance market integration process accelerated. With the ability to exercise regulatory authority and make laws on the basis of qualified majority voting, the second and third generation of insurance directives were enacted within 5 years, facilitating freedom to provide services and the creation of a single licence, mutual recognition and home country control.

The European Court of Justice ensures in its interpretation of the Treaty, secondary regulation, and state and market participant acts that Community law is observed by relating the Treaty articles to the general and specific objectives of Community law.[46] While the Council struggled with lawmaking to facilitate the integration process, the ECJ continued the integration process in two ways. First it interpreted the Treaty, establishing in case law that the realization of the freedoms, although the Treaty required the Council to facilitate it with the enactment of directives, did not depend on the actions of the Council. After the transitional period[47] the Treaty articles on the freedom of establishment and the freedom to provide services could be relied on by citizens before their national courts.[48] Second, after finding direct effect of the articles on the freedom of establishment and the freedom to provide services, it interpreted the meaning of "equal treatment" in these freedoms to constitute more than the prohibition of discrimination on the basis of nationality or place of establishment. It found the Treaty to prohibit national measures without distinction to nationality or place of establishment that "hinder or make the exercise of the freedom of establishment less attractive", and national measures without distinction to nationality or place of establishment that are "liable to prohibit or otherwise impede the activities of a provider of services established in another member state where he lawfully provides similar services".[49]

With its interpretation of the Treaty the ECJ not only sped up the economic integration, increasingly limiting states in their authority to regulate and act, it also aided in an economic integration process that accommodates the interests of member states' (insurance) markets: and directed the Commission in the drafting and the Council in the enactment of the insurance directives.

Where the Treaty provides a limitative list of exceptions to discrimination, the ECJ developed the "rule of reason" which complements the justifications in the Treaty with justifications for non-discriminatory state rules and regulation that form

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[46] Kapteyn 2003, 359.

[47] The transitional period had expired and the ECJ found that secondary legislation was not required for the rule of nationality to apply to the right of establishment. It stated in *Jean Reyners v Belgian State* (Case 2-74, ECR [1974] Page 00631, paragraph 26) "article 52 thus imposes an obligation to attain a precise result, the fulfilment of which had to be made easier by, not made dependent on, the implementation of a program of progressive measures." Craig de Búrca 1998, 733.

[48] Although the Community had not implemented all measures in the General Programs, the ECJ found that because "the rule on equal treatment with nationals is one of the fundamental legal provisions of the Community"it is "capable of being directly invoked by nationals of all the other member states" and "is henceforth sanctioned with direct effect." *Jean Reyners v Belgian State.* Case 2-74, ECR [1974] Page 00631, paragraphs 24-25, 30.

[49] Craig de Búrca 1998, 745.
Reinhard Gebhard v Consiglio dell'Ordine degli Avvocati e Procuratori di Milano. Case C-55/94, ECR [1995] Page I-04165, *Manfred Säger v Dennemeyer & Co. Ltd.* Case C-76/90, ECR [1991] Page I-04221.

obstacles and barriers to free interstate trade. It provides the opportunity for member states to maintain non-discriminatory state regulations that protect "pressing"[50] or "imperative reasons relating to the public interest"[51] even though these form obstacles and barriers to free interstate trade. This is permitted however, only when these regulations are objectively necessary, do not go beyond what is necessary to protect the interest[52] and have not been regulated by Community law.[53] The European Court of Justice confirmed the application of the rule of reason to the business of insurance in the "insurance cases"[54] in the 1980's, allowing non-discriminatory state regulations that although obstacles and barriers to free interstate trade, protect the general good.

The ECJ decision in the "insurance cases" made clear that the lack of harmonization by the Council (of national rules on technical reserves and assets) allowed member states to justify non-compliance with the freedoms. The ECJ found that a host state may restrict the freedom to provide services with national provisions which are justified by the general good. In this particular case the protection of consumers. This case law resulted in the inclusion of consumer protection as a valid justification for incompatible (non-discriminatory) state regulation by the Commission in its revised proposals for the second generation insurance directives.

When the Second Council Directives were enacted, discrepancies between national rules on technical reserves and assets had not as yet been harmonized. These were eliminated in Council Directive 91/674/EEC dated 19 December 1991 on the annual accounts and consolidated accounts of insurance undertakings. The protection of consumers as a justification however, was extended to "the general good" as a justification in the 1992 third generation insurance directives for state regulation that is non-compliant with the insurance directives, i.e. secondary legislation. The interpretation of justifications "in the general good" has since then followed the ECJ interpretations involving the rule of reason. The result is that the

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[50] *Claus Ramrath v Ministre de la Justice.* Case C-106/91 [1992] ECR I-3351, paragraphs 29 and 30. *Dieter Kraus v Land Baden-Württemberg.* Case C-19/92 ECR [1993], Page I-01663,paragraph 32.

[51] *Commission of the European Communities v Federal Republic of Germany.* Case 205/84, ECR [1986] Page 03755, Paragraph 33: "It therefore appears that in the field in question there are imperative reasons relating to the public interest which may justify restrictions on the freedom to provide services, provided, however, that the rules of the state of establishment are not adequate in order to achieve the necessary level of protection and that the requirements of the state in which the service is provided do not exceed what is necessary in that respect."

[52] *Thieffry v. Conseil de L'Ordre des Avocats a la Cour de Paris.* Case 71/76 [1977] ECR 765, paragraphs 12 and 15.

[53] For all practical purposes however, the general good exception in the third generation insurance directives is defined by the ECJ according to the rule of reason, applying the rule of reason to state regulations and acts that have been limited in secondary Community regulation.
Kapteyn 2003, 544.

[54] *Commission of the European Communities v Federal Republic of Germany.* Case 205/84, ECR [1986] Page 03755, *Commission of the European Communities v French Republic.* Case 220/83. ECR [1986] Page 03663, *Commission of the European Communities v Kingdom of Denmark.* Case 252/83. ECR [1986] Page 03713, *Commission of the European Communities v Ireland.* Case 206/84, ECR [1986] Page 03817.

conditions developed in the rule of reason case law apply to the general good justification in the third of the three generations of insurance directives.

Before the creation of the United States, the Articles of Confederation did not grant the Confederation and its only institution, Congress, the authority to bind the states in matters of commerce nor did it provide an institution with the means to enforce or interpret the law. The federal Constitution introduced an institutional structure that determines the legal relationship between the states, the new Federation and between the several institutions, laying down not only the law but also the authority of the federal institutions to make, enforce and interpret the law.

Article III section 2 of the United States Constitution grants the Supreme Court the authority to interpret the compatibility of state acts with the Constitution. In the case of *Marbury v. Madison*[-55] the Supreme Court however confirmed its own authority to include constitutional (judicial) review. It assumed authority to interpret the Constitution, federal laws and the compatibility of federal laws with the Constitution.

With the authority to interpret the compatibility of state acts with the Constitution, the Supreme Court exercised its authority and found the business of insurance not to regulate "commerce" in *Paul v. Virginia* in 1868. This decision not only determined the compatibility of a state act with the Constitution, it defined commerce in the Constitution's commerce clause not to include the business of insurance, effectively removing Congress' Commerce Clause authority to regulate the business of insurance. This decision determined the legal development of insurance market integration in the United States of America.

Seventy-five years after its initial interpretation of commerce, the Supreme Court again exercised its authority to interpret, reversed its interpretation, and confirmed that federal anti-trust legislation, based on the Constitutional Commerce Clause, applied to the business of insurance. The Supreme Court emphasized in its judgment[-56] that it now answered a different question: whether a Congressional Act applied to the business of insurance[-57], while earlier it had been asked to decide the extent to which the Commerce Clause deprived states of the power to regulate the insurance business in the absence of Congressional action. In both situations however it interpreted the reach of the Commerce Clause but under different doctrines.

On several occasions since the abandonment of selective exclusiveness (dual federalism doctrine) the Supreme Court interpreted Congress' silence with regard to the impact of the Commerce Clause to limit the freedom of the states and market participants to regulate and act respectively. The Supreme Court was likely to interpret the Commerce Clause to limit states' virtually unlimited freedom to regulate and tax if a case were to present itself. The enactment of the McCarran-Ferguson Act broke Congress' (short) commerce clause silence with regard to the business of insurance. It stipulates the continued regulation and taxation of the

[-55] *Marbury v. Madison*, 5 U.S. 137 (1803).

[-56] *U.S. v. South-Eastern Underwriters Association*, 322 U.S. 533 (1944).

[-57] *U.S. v. South-Eastern Underwriters Association*, 322 U.S. 533 (1944), 545: "Today however we are asked ... not to uphold another state law, but to strike down an Act of Congress which was intended to regulate certain aspects of the methods by which interstate insurance companies do business: and in so doing, to narrow the scope of the federal power to regulate the activities of a great business carried on back and forth across state lines."

business of insurance by the states, stopping the Supreme Court from interpreting the Commerce Clause and its (possible) limits to state authority to regulate and tax the business of insurance, and market participants' liberty to act.

The Supreme Court's interpretation of the Constitution's commerce clause authority is not the only influence on the legal development of insurance market integration. The Supreme Court has found the Constitutional Equal Protection clause to prohibit discrimination, limiting the states in their freedom to discriminate in taxing foreign insurance providers when discrimination between foreign and domestic corporations does not bear a rational relation to a legitimate state purpose.[758] Also, in exercising its authority to interpret the McCarran-Ferguson Act, the Supreme Court has influenced the insurance market integration in the United States of America. It narrowly defined the business of insurance in the McCarran-Ferguson Act, limiting the freedom of the states to the business of insurance only. Despite the limited application of the act to "the business of insurance", the Supreme Court's interpretations do not interfere with Congress' chosen direction in regulation. It has interpreted "regulated" in the McCarran-Ferguson Act broadly, and "boycott" narrowly, honoring Congress' decision to leave it to the states to regulate the business of insurance, and following the objective of the McCarran-Ferguson Act which is, contrary to the objective for the Constitutional Commerce Clause, included in the McCarran-Ferguson Act.

Enacting laws and interpreting the Treaty (EC) or Constitution (US) and other regulations is based on the exercise of the authority granted by the institutional documents. Both the Council (on a proposal by the Commission) and Congress are granted the authority to regulate, and both the ECJ and the Supreme Court have been granted authority to interpret the law. The exercise of their respective authorities however, as a task or an option, or to accomplish an objective, depends on the wording of the institutional documents. The authority combined with tasks and objectives to accomplish, impact the exercise of authority, and determine the legal development of insurance market integration and its accommodation of state insurance market interests.

3.3 Objective, Authority and Task

The inclusion of the objective to economically integrate the markets in the EC Treaty has provided its institutions with a clear direction in setting the parameters that define the limits to states' regulatory freedom. This, combined with the authority and the task to accomplish the objective, paved a path that the European Community, its member states and citizens, although at variable speed, could not but follow. The United States Constitution does not include the objective to economically integrate the states' markets. The limits on state sovereignty is set in the Constitution with a general grant of authority to Congress to regulate commerce among the states without an objective or a task to accomplish. The lack of both the objective and task in the institutional document has made the use of the authority for Congress optional and the interpretation of the Commerce Clause by the Supreme Court a question of authority rather than direction. The result is two

[758] *Western & Southern Life Ins. Co v. State Board of Equalization of California*. 451 U.S. 648 (1981), paragraphs 667-668.

very different Supreme Court doctrines that have variously interpreted the limits to state sovereignty, and have set the path for the legal development of insurance market integration as it exists in the United States today.

When the states created the Federation and the Community and limited their freedom to regulate and the freedom of market participants to act, they did this in order to benefit from the outcome. (One of) the objective(s) of both unions was, as seen in chapter 2, the elimination of the obstacles and barriers between the states that hindered trade among them and interfered with economic growth and interdependence.

In the Treaty establishing the European (Economic) Community the objective of cooperation was included in the preamble laying "the foundation of an ever closer union among the peoples of Europe" with the economic integration of the states' markets into one common market. Community institutions have been granted the authority and charged the task to economically integrate their markets. Based on a limited and selective attribution of powers "the Treaties set up a system for distributing powers among the different Community institutions, assigning to each institution its own role in the institutional structure of the Community and the accomplishment of the tasks entrusted to the Community in this Treaty."[59] Through executing these tasks the objectives of the European Community are realized.[60]

The combination of an objective, a grant of authority, and a task for the institutions in the EC Treaty, resulted in immediate action with regard to the economic integration of the member states' markets in general and the insurance market in particular. The Council was ordered in articles 54 and 63 [61] of the Treaty establishing the European Economic Community to formulate two general programs, one for the abolition of the restrictions to the freedom of establishment and one for the abolition of the restrictions to the freedom to provide services before 1963.

In these General Programs the Council confirmed the authority of the Community to integrate the insurance market. Where the Council established the Community's authority to limit states' sovereignty for the purpose of creating freedom of establishment for insurance providers and freedom to provide insurance services in 1962, it was only in 1987 that the European Court of Justice confirmed the Community's authority to limit the insurance market participants' freedom to act, for the creation of a system of fair competition on the insurance market. Although the Council had not executed its task in the Treaty articles on competition, the Commission executed its task to ensure the application of the principles laid down in articles 81 and 82 EC Treaty, which resulted in the appeal to the ECJ in 1987, the *Sachversicherer* case.[62] There it was asked whether the rules on competition applied to the business of insurance. Guided by the Community objectives it set the limits for market participants.

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[59] *European Parliament v Council of the European Communities.* Case C-70/88, ECR [1990] Page I-02041, paragraph 21

[60] Barents Brinkhorst 2003, 121.

[61] Amended.

[62] *Verband der Sachversicherer e.V. v Commission of the European Communities.* Case 45/85. ECR [1987] Page 00405.

The ECJ also set the parameters for the limits to state sovereignty in the Treaty articles by lack of Council action in making Community legislation. Being given the authority and the task to ensure that in the interpretation and application of the Treaty the law is observed, relating them to the general and specific objectives included in the Treaty[-63], the ECJ found direct effect of the freedom of establishment and the freedom to provide services. In the case of *Reyners v. Belgium* the ECJ found that the transitional period had expired and that secondary legislation was not required for the rule of nationality to apply to the right of establishment. It stated "article 52 (...) imposes an obligation to attain a precise result, the fulfillment of which had to be made easier by, not made dependent on, the implementation of a program of progressive measures."[-64] And in the case of *Johannes Henricus Maria van Binsbergen v Bestuur van de Bedrijfsvereniging voor Metaalnijverheid* article 59 became "unconditional on the expiry of the (transitional) period" and has "direct effect" which means that it can be relied upon before a national court as far as they seek to "abolish all discrimination against the person providing the service by reason of his nationality or the fact that he is established in a member state other than that in which the service is provided."[-65]

In the United States of America a different situation exists. In addition to the authority to regulate commerce among the states, Congress has not been given the task to regulate, nor has the economic integration objective been included in the Commerce Clause or the Constitution. Although granted the authority to regulate commerce among the states, without the task to regulate, Congress had refrained from regulating the business of insurance at the time the Supreme Court was asked whether a state could regulate it.

Where the ECJ in its decisions is guided by the objective(s) of the Treaty, to eliminate the interstate barriers and the obstacles that prevent economic integration, the Supreme Court's only Constitutional reference is the general grant of authority to Congress "to regulate commerce among the states". The objective that was pursued with the inclusion of the article in the Constitution, to halt the development towards protectionism and economic warfare among the states and to secure freedom of commerce and fair competition nationwide[-66] as well as to effectuate the economic integration of the states, an obstacle free market with "unrestrained intercourse between the states themselves", is not included in the Constitution. With only the grant of authority to regulate commerce among the states in the Constitution, the Supreme Court interpreted the Commerce Clause as a question of authority rather than one of economic integration. During the era of dual federalism it determined exclusivity of authority for the states based on the definition of

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[-63] Kapteyn 2003, 359.

[-64] *Jean Reyners v Belgian State.* Case 2-74, ECR [1974] Page 00631, paragraph 26. Craig de Búrca 1998, 733.

[-65] *Johannes Henricus Maria van Binsbergen v Bestuur van de Bedrijfsvereniging voor Metaalnijverheid.* Case 33/74, ECR [1974] 1299, paragraphs 24, 25 and 27.

[-66] Nowak Rotunda 1995, 139.
"Two general concerns for the drafting of the Constitution in general and the Commerce Clause in particular; 1) the power must have been meant to put an end, either in itself or through federal legislation, to the trade barriers and tariffs which had led to the economic problems during the preceding period; and, 2) the national power must have been intended to be broad enough to deal with the type of economic problems of the nation as a unit."

"commerce" and "among the states". It found that the business of insurance did not constitute "commerce" and determined that Congress did not have the authority to regulate the business of insurance.

When 75 years later the question arose whether Commerce Clause based federal law applied to the business of insurance, the Supreme Court reversed its earlier decision on Congressional authority. With its concurrent powers doctrine it replaced dual federalism and found that Congress does have the authority to regulate. This authority does not automatically deprive the states of authority to regulate as long as state regulation is in compliance with federal law. Should federal law be wanting however, it is left to the Supreme Court to interpret the congressional silence over matters of commerce and to interpret the extent of the states' authority to regulate and act regarding matters of interstate commerce.[-67]

Congress enacted the McCarran-Ferguson Act. This Act's purpose is the continued regulation and taxation of the business of insurance by the states. The Supreme Court has, as with its interpretation of the Commerce Clause, interpreted the McCarran-Ferguson Act as a question of authority. It has defined "business of insurance" and has set the Act's boundaries to state authority. It has interpreted its content based on the objective of the McCarran-Ferguson Act; the continued regulation and taxation of the business of insurance by the states. Defining "regulated" broadly and "boycott" narrowly has resulted in an almost unlimited freedom of the states to regulate and tax the business of insurance.

Also in its interpretations of other Constitutional articles in relation to the business of insurance, the Constitution does not provide an objective as a guide for direction. The Equal Protection Clause, prohibiting states from acting arbitrarily or treating similarly situated persons differently was initially, at the time of dual federalism, found to be inapplicable to the area of insurance regulation. In the 1868 case of *Paul v. Virginia* the doctrine was established that "a state may impose taxes and conditions at its unfettered discretion on foreign [insurance[-68]] corporations, in return for granting the privilege of doing business within the state".[-69]

In 1981 however, with the McCarran-Ferguson Act granting the states the continued regulation and taxation of the business of insurance, the Supreme Court in *Western & Southern Life Insurance Co. v. state Board of Equalization of California* considered it established that "whatever the extent of a state's authority to exclude foreign corporations from doing business within its boundaries, that authority does not justify imposition of more onerous taxes or other burdens on foreign corporations than those imposed on domestic corporations". In this case the Court established that in principle discrimination between foreign and domestic [insurance[--70]] corporations was not allowed, unless however, the court added, "the discrimination between foreign and domestic corporations bears a rational relation to a legitimate state purpose."[--71] And again, unlike the 'rule of reason' in the

[-67] Sullivan Gunther 2004, 10.
Lenaerts 1988, 16.

[-68] My addition.

[-69] *Western & Southern Life Ins. Co v. State Board of Equalization of California.* 451 U.S. 648 (1981), 658.

[--70] My addition.

[--71] *Western & Southern Life Ins. Co v. State Board of Equalization of California.* 451 U.S. 648 (1981), paragraphs 667-668.

European Community case law, just as in the interpretation of the McCarran-Ferguson Act, the Supreme Court interpreted the Constitution's articles narrowly, treating them as questions of authority rather than direction, by virtue of the lack of the objective to economically integrate the states' markets in the text of the Constitution.

4 Conclusion

With the legal developments of insurance market integration in the European Community and the United States of America and the role of the institutional structure and grant of authority in its results, I conclude that seven elements of the institutional structure and grants of authority can facilitate legal developments of insurance market integration that accommodates state insurance market interests among states.

First, states have to accept a limitation of their sovereign powers. When the member states of the European Community and the United States of America limited their sovereign powers they limited their regulatory freedom.

Second, the new cooperative union of states must create an institution that can make laws. The veto right in EC decision making granted each state the right to stop decision making, holding back market integration. Only after unanimity was effectively replaced with qualified majority voting did the integration process accelerate allowing the Council to make laws.

Third, it must include an independent Court with the authority to interpret the institutional document and the authority, either direct in the institutional document (Treaty) or by using its interpretative powers (Supreme Court), for judicial review. This way it can interpret the institutional document and judge institutional and state compliance.

Fourth, the institutional document must contain articles from which citizens can derive rights and which they can enforce irrespective of their national laws. With the limit of sovereignty in the United States the articles of the Constitution can be judicially enforced against states. With the limit of sovereignty of the member states of the European Community the ECJ has interpreted the EC Treaty to include articles from which citizens can derive rights and that can be enforced before a court, not only against the member states, but against the institutions and other citizens as well.

Fifth, the objective of economic integration must be included in the institutional document to provide direction to the institutions in the application of their authority and the interpretation of the articles of the institutional documents. The Constitution, although citizens can derive rights from it, does not include the objective for which the grant of authority to Congress was included. The Constitution does not provide guidance in its interpretation or use of the authority granted to the Federation, but is an institutional document that determines the authority of the federal government and therewith the authority of the states. The Treaty does include an economic integration objective, providing the institutions not only with guidance as to how to use their authority, but also setting the direction of the cooperative effort.

Sixth, the grant of authority to economically integrate the state markets must not only include the authority of the institutions, but also the task to integrate. Whereas Congress is granted the authority to regulate and the Supreme Court the authority

to interpret the Constitution, the Council, Commission and the ECJ are granted the authority as well as the task to accomplish the objective to economically integrate the member states' markets. When the Council executed its task to draft General Programs it became immediately clear that insurance was part of economic integration. The task of the European Court of Justice to ensure that in the interpretation and the application of the Treaty the law is observed resulted in finding direct effect of Treaty articles when the Council failed to enact directives before the end of the transitional period. The European Commission executes its task to ensure the application of the principles laid down in articles 81 and 82 EC Treaty by investigating cases of suspected infringements of the rules of competition in the Treaty. The lack of a task to economically integrate the states' markets for the federal Congress in the Commerce Clause resulted in the enactment of federal regulation only after Congress felt the necessity because of Supreme Court case law, and then only to restore the status quo of state authority to regulate and tax the business of insurance.

Finally, when all these elements are included in the institutional structure and grants of authority, to assure the accommodation of state insurance market interests in the economic integration of the insurance markets the focus of the institutions in the execution of their authority must first and foremost be on finding common interests rather than on finding the obstacles and barriers in the differences in states' rules and regulations alone. With principles such as minimum harmonization, mutual recognition, and home country control, barriers can be eliminated and obstacles minimized while interests remain protected. Rules and regulations that are not based on common interests in the markets then can be minimized through regulation or elimination which, because of the institutional structure and grants of authority, must, and will be (gradually) accomplished.

These seven elements combined can facilitate a legal development of economic market integration that is attuned to the market's interests, resulting in a proper functioning of the markets both interstate and intrastate.

Nederlandse Samenvatting

Integratie van Verzekeringsmarkten

EEN RECHTSVERGELIJKENDE STUDIE NAAR DE INSTITUTIONELE STRUCTUUR EN BEVOEGDHEIDSTOEDELING DIE JURIDISCHE ONTWIKKELINGEN BEVORDEREN, DIE LEIDEN TOT INTEGRATIE VAN VERZEKERINGSMARKTEN, TERWIJL TEGELIJKERTIJD DE BELANGEN OP DE VERZEKERINGSMARKTEN VAN DE AFZONDERLIJKE STATEN IN HET OOG WORDEN GEHOUDEN

EUROPESE GEMEENSCHAP EN VERENIGDE STATEN VAN AMERIKA

In het onderhavige onderzoek heb ik de vraag gesteld welke institutionele structuur en bevoegdheidstoedeling juridische ontwikkelingen bevorderen die leiden tot een integratie van verzekeringsmarkten terwijl tegelijkertijd de belangen op de verzekeringsmarkten van de afzonderlijke staten in het oog worden gehouden.
Ik heb de institutionele structuur en bevoegdheidstoedeling in de Verenigde Staten van Amerika en in de Europese Gemeenschap vergeleken. Beide samenwerkingsvormen zijn het gevolg van de wens en noodzaak om tot een economische integratie van de afzonderlijke staatsmarkten te komen. Hoewel de doelstelling dezelfde is: economische integratie door het beperken van de (regelgevings)bevoegdheid van de staten en het (indirect) beperken van de vrijheid van marktdeelnemers om concurrentievervalsend te werken, is de keuze van institutionele structuur en bevoegdheidstoedeling, en de juridische ontwikkeling van verzekeringsmarkt-integratie die daarvan het gevolg is, verschillend.
In de Verenigde Staten hebben de staten hun soevereiniteit beperkt door het vormen van een federatie die gebaseerd is op een grondwet. De grondwet legt vast wat de bevoegdheden van de federatie en haar instellingen zijn en in hoeverre de staten beperkt zijn in hun bevoegdheden. Om economische integratie tussen de staten te bewerkstelligen is in de grondwet de "commerce clause" opgenomen. Deze biedt het federale Congres de bevoegdheid om handel tussen staten te reguleren ("to regulate interstate commerce").
Binnen de Europese Gemeenschap hebben de lidstaten een verdrag gesloten waarin zij hun soevereiniteit beperken. Het verdrag legt niet alleen vast welke instellingen er zijn en wat hun bevoegdheden zijn, maar ook een van de doelstellingen van de Europese Gemeenschap: de economische integratie van de markten, en hoe deze te realiseren. De Raad van de Europese Gemeenschap heeft in het verdrag naast de bevoegdheid ook de taak gekregen om belemmeringen in het handelsverkeer tussen staten af te schaffen en daarmee het vrij verkeer van goederen, personen, diensten, kapitaal en betalingsverkeer te realiseren alsmede een eerlijk mededingingsbeleid te bewerkstelligen.
Omdat de verzekeringsmarkt van oudsher van belang is voor de economische ontwikkeling van de Amerikaanse en Europese markten en er vele belangen zijn die bescherming behoeven, hebben de staten de verzekeringsmarkt aan een intensieve regulering onderworpen. De verschillende belangen op een verzekeringsmarkt variëren van de belangen van de consument – die onder andere liggen in een beschikbare en betaalbare verzekering –, tot die van de verzekeraar – onder andere

liggend in toegang tot voldoende en correcte risico-informatie om tot een gedegen risicoanalyse te kunnen komen –, tot de belangen van de staat – onder andere liggend in realisatie en instandhouding van een betrouwbare en stabiele financiële markt. Een economische integratie van de verzekeringsmarkten door het afschaffen van belemmeringen resulteert in interstatelijke integratie en bevordert het functioneren van de geïntegreerde verzekeringsmarkt. Echter, wanneer het afschaffen van belemmeringen bestaat uit het afschaffen van regelgeving ter bescherming van de belangen op de individuele verzekeringsmarkten kan dit het functioneren van de financiële markt van de staat verstoren.
In hoeverre de institutionele structuur en bevoegdheidstoedeling in de grondwet van de Verenigde Staten en in het Verdrag tot oprichting van de Europese Gemeenschap hebben bijgedragen aan een juridische ontwikkeling van verzekeringsmarkt–integratie waarbij rekening is gehouden met de belangen op de individuele verzekeringsmarkt, blijkt uit de juridische ontwikkeling van verzekeringsmarktintegratie in de Verenigde Staten en de Europese Gemeenschap.
In de Verenigde Staten heeft het federale Congres gebruik gemaakt van zijn bevoegdheid om interstatelijke handel te reguleren. In de McCarran-Ferguson Act bevestigt het de tot dan geldende praktijk dat de staten de verzekeringsmarkt reguleren. Omdat de grondwet alleen de bevoegdheid tot het reguleren van handel tussen staten biedt, maar geen richtlijnen geeft voor het gebruik van deze bevoegdheid in de vorm van doelstellingen of taken, had het federale Congres in eerste instantie niets gereguleerd met betrekking tot de verzekeringsmarkten. Toen het Hooggerechtshof een vraag voorgelegd kreeg over verzekeringsregulering, te weten: of staten beperkt worden in hun regelgevende bevoegdheid door de "commerce clause" in de federale grondwet, concludeerde het Hooggerechtshof dat verzekering geen "commerce" – handel – was. De staten werden niet beperkt in hun bevoegdheid de "business of insurance" te reguleren volgens het hof.
Bijna 75 jaar lang heeft het Hooggerechtshof deze lijn gevolgd totdat het de vraag voorgelegd kreeg of federale mededingingswetgeving gebaseerd op de "commerce clause" van toepassing was op de "business of insurance". Deze vraag werd positief beantwoord. Het federale Congres bleek wel bevoegd te zijn om de verzekeringsmarkt te reguleren. Echter, omdat in de Amerikaanse grondwet de doelstelling van economische integratie niet is opgenomen, mag het Congres zijn "commerce clause" – bevoegdheid, zijn bevoegdheid tot regelgeving, gebruiken zoals hij het wil. In plaats van het beperken van de reguleringsvrijheid van de staten om economische integratie te bewerkstelligen, bevestigde het Congres de bestaande praktijk waarbij de staten de "business of insurance" reguleren in de federale McCarran-Ferguson Act.
De McCarran-Ferguson Act laat het federale mededingingsrecht buiten beschouwing onder het voorbehoud dat de staten de verzekeringsmarkt reguleren. Het federale mededingingsrecht is alleen dan automatisch van toepassing, wanneer sprake is van: "agreement to boycott, coerce or intimidate, or act of boycott, coercion or intimidation". Iedere andere federale wet is uitsluitend van toepassing op "the business of insurance" wanneer deze specifiek verwijst naar de "business of insurance".
Naast de "commerce clause" kunnen andere grondwetsartikelen resulteren in grenzen aan de bevoegdheden van staten. De "equal protection clause" bijvoorbeeld verbiedt discriminerende belastingregulering voor verzekeraars, maar, aldus het

Hooggerechtshof, discriminatie kan gerechtvaardigd zijn als het een legitiem staatsdoel dient.
In de Europese Gemeenschap heeft er een geheel andere juridische ontwikkeling van de verzekeringsmarktintegratie plaatsgevonden. Door het opnemen van de economische integratiedoelstelling in het verdrag, en door naast de bevoegdheid ook de taak aan de instellingen te geven, zijn er onder andere drie generaties verzekeringsrichtlijnen totstandgekomen. Deze vergemakkelijken de vrijheden van vestiging en dienstenverkeer door te voorzien in een enkele autorisatie van verzekeraars in het land van herkomst die functioneert als een Europees paspoort in de gehele gemeenschap. Vergunningverlening en toezicht worden uitgevoerd door het land van herkomst van de verzekeraar. Deze verzekeraar is bevoegd in alle lidstaten diensten aan te bieden zonder een hernieuwde autorisatie of toezicht in het land waarin de dienstverlening geschiedt.
Na een moeizame start in de ontwikkeling en het resultaat van de eerste generatie verzekeringsrichtlijnen veranderde eind jaren tachtig binnen de Europese Gemeenschap de besluitvorming: deze vond voortaan plaats op basis van gekwalificeerde meerderheid van stemmen, waar vroeger unanimiteit vereist of consensus gebruik was. Daarnaast werd er gestreefd naar minimum harmonisatie, harmonisatie op essentiële punten in plaats van details, en werd het beginsel van wederzijdse erkenning benut. Hierdoor kwamen de tweede en derde generatie verzekeringsrichtlijnen niet alleen sneller tot stand; zij boekten ook meer resultaat inzake de economische integratie van de verzekeringsmarkten.
Naast de integratiemaatregelen voorzien de verzekeringsrichtlijnen ook in uitzonderingen op de vastgelegde regels. In de tweede generatie verzekeringsrichtlijnen is consumentenbescherming als rechtvaardigingsgrond opgenomen voor het niet volledig vrijgeven van dienstverlening, en in de derde generatie verzekeringsrichtlijnen is een rechtvaardiging opgenomen voor staatsregulering die, hoewel in strijd met de richtlijnen, niet-discriminerend, noodzakelijk en proportioneel is voor de bescherming van een algemeen belang.
Daarnaast heeft het Hof van Justitie in zijn interpretatie van het Verdrag directe beperkingen in de regelgevingsbevoegdheden van de staten en de vrijheid van marktdeelnemers gevonden. Ook heeft het Hof van Justitie een aantal rechtvaardigingsgronden ontwikkeld in aanvulling op de rechtvaardigingsgronden die het Verdrag zelf al biedt ten aanzien van regelgeving van lidstaten die, hoewel ze belemmeringen vormen voor economische integratie, toegestaan zijn. Waar de rechtvaardigingsgronden in het Verdrag zowel voor regelgeving die discrimineert als die niet discrimineert gebruikt kunnen worden, is de "rule of reason" die door het Hof van Justitie is ontwikkeld uitsluitend toepasbaar op maatregelen waarvoor geen gemeenschappelijke regeling bestaat, die van niet-economische aard zijn en die niet discrimineren. Daarnaast moet de maatregel noodzakelijk zijn ter bescherming van een algemeen belang én proportioneel zijn in de bescherming van het belang.
De bestudering van de juridische ontwikkeling van zowel de integratie van de Europese verzekeringsmarkt als de integratie van de Amerikaanse verzekeringsmarkt heeft geleid tot een aantal conclusies ten aanzien van elementen van de institutionele structuur en bevoegdheidstoedeling die een juridische ontwikkeling in verzekeringsmarktintegratie waarbij de belangen op de verzekeringsmarkten in acht worden genomen, kunnen bevorderen.
Ten eerste moeten staten een beperking van hun soevereine macht accepteren. Zowel de Verenigde Staten als de lidstaten van de Europese Gemeenschap hebben

hun soevereiniteit beperkt ten behoeve van de integratie van hun markten. Hiermee accepteerden zij een beperking van hun regelgevingsbevoegdheden.
Ten tweede moeten de samenwerkende staten een instelling creëren die regelgeving kan maken. De besluitvormingsprocedures in de Europese Gemeenschap, die initieel unanimiteit en later consensus behoefden, belemmerden de besluitvorming en daarmee de marktintegratie. Pas nadat unanimiteit en besluitvorming op basis van consensus werd vervangen door besluitvorming op basis van gekwalificeerde meerderheid versnelde het integratieproces.
Ten derde moet er een onafhankelijke rechtbank zijn met de bevoegdheid om naast de interpretatie van het institutionele document ook de verenigbaarheid van de regelgeving van de instellingen en de staten met de naleving van het institutionele recht te beoordelen.
Ten vierde moet het institutionele document artikelen bevatten waaraan burgers rechten kunnen ontlenen die zij onafhankelijk van hun nationale wetgeving kunnen afdwingen. Met de soevereiniteitsbeperking in de Verenigde Staten kunnen de federale grondswetsartikelen ten opzichte van de staten afgedwongen worden. In de Europese Gemeenschap heeft het Hof van Justitie het Verdrag zo geïnterpreteerd dat burgers hieraan direct rechten kunnen ontlenen. Dit ten opzichte van de staten maar ook ten opzichte van elkaar.
Ten vijfde moet de doelstelling om tot economische integratie van de markten te komen, opgenomen worden in het institutionele document. Zo wordt richting gegeven aan de invulling van de bevoegdheden en de interpretatie van het institutionele document. De Amerikaanse grondwet, hoewel burgers daar rechten aan kunnen ontlenen, bevat de congressionele bevoegdheid interstatelijke handel te reguleren, maar de doelstelling voor de bevoegdheid ontbreekt. Het Verdrag tot oprichting van de Europese Gemeenschap bevat de doelstelling van economische integratie en een toedeling van de bevoegdheden om de doelstelling te bereiken. Hierdoor stuurt het de instellingen niet alleen in de interpretatie van hun bevoegdheden, maar leidt het hen ook in de uitvoering en bepaalt het de richting van het Europese samenwerkingsverband.
Ten zesde moet er niet louter een bevoegdheidstoedeling zijn, maar ook een taakstelling voor de instellingen om economische integratie te realiseren. Wanneer een taakstelling ontbreekt, komt wetgeving pas laat tot stand. Namelijk pas dan, wanneer in de praktijk de noodzaak ertoe aangetoond is. Door het ontbreken van een taak voor het federale Congres in de Amerikaanse "commerce clause" was er geen noodzaak voor het federale Congres om zijn bevoegdheid te gebruiken. Deze instelling ging pas tot actie over toen het de noodzaak voelde als gevolg van jurisprudentie van het Amerikaanse Hooggerechtshof.
Ten slotte, wanneer al deze elementen opgenomen worden in de institutionele structuur en bevoegdheidstoekenning om de belangen op de verzekeringsmarkten van de staten in acht te nemen bij de economische integratie, moet de aandacht van de instellingen in de uitvoering van hun bevoegdheden niet gericht zijn op het vinden van belemmeringen in het interstatelijke handelsverkeer, maar juist op het vinden van de gemeenschappelijke belangen die door staatsregulering beschermd worden. Met behulp van het principe van minimumharmonisatie, wederzijdse erkenning van regelgeving en toezicht op de verzekeraar door de lidstaat van herkomst kunnen de belemmeringen voor economische integratie geminimaliseerd worden terwijl de belangen van de afzonderlijke staten beschermd blijven.

Wanneer deze zeven elementen in de institutionele structuur en de bevoegdheidstoedeling verweven worden, kan een juridische ontwikkeling teweeggebracht worden die leidt tot economische integratie die rekening houdt met de belangen op de te integreren markten.

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