gave short shrift to the title insurers' argument that they should be allowed to fix jointly the rate for escrow services because in the course of performing these services the companies do some evaluation of title defects, and thus the escrow process may have the effect of reducing the risk to them as title insurers. In answer to this argument, the Ninth Circuit, again relying on *Royal Drug,* drew a distinction between risk reduction and risk spreading, and concluded that even if it can be shown that the settlement process, which includes an updated search and examination of title, helps to identify title defects and thereby reduces the risks of a title insurer, it is nevertheless not within the McCarran Act exemption because risk reduction is not synonymous with spreading risks more widely, and spreading risk, not risk reduction, is at the core of the cooperative risk allocation rationale of the McCarran Act.[284] In other words, *TIRBA* teaches that the McCarran Act should not be read broadly as exempting all rate making by insurers because such an approach not only begs the question as to whether the collective rate making relates to the "business of insurance", but it also ignores the clear admonition in *Royal Drug* that the risk spreading purpose of the exemption must be kept in the forefront in defining the "business of insurance". Certainly once this restricted purpose **[83]** of the McCarran exemption is accepted, it necessarily follows (consistent with the basic tenet of narrowly applying antitrust exemptions) that the act cannot be interpreted so as to cover insurance company joint rate making that is unrelated to a pooling of risk experience.

Risk spreading and its central importance in defining the "business of insurance" was next taken up by the Supreme Court in *Union Labor Life Ins. Co. v. Pireno,* 458 U.S. 119 (1982), which involved still another antitrust challenge to an insurer's attempt to reduce claims by a restrictive arrangement. There the insurer refused to pay substantial claims for chiropractic services unless the case had been reviewed and approved by a peer review committee. Pireno, a chiropractor, challenged the peer review requirement as a conspiracy and attempt to boycott. The Court confirmed the three-prong test suggested by *Royal Drug* in holding that the arrangement between the insurance company and the chiropractors was not part of the

[284] As in *TIRBA*, respondents have argued here that during closing insurer-related closers verify that on-record liens have been removed and exercise special diligence in spotting off-record risks such as forgery. The *TIRBA* court did not consider these functions as constituting risk spreading or the business of insurance; moreover, there is nothing in this record to indicate that the zeal with which these non-insurance ministerial functions is carried out somehow depends on whether the closer is employed by a title insurer, bank, lawyer, independent closing company, or real estate broker. See Findings 180-184.

business of insurance since this practice, like the San Antonio prescription plan in *Royal Drug,* was aimed at reducing the cost of satisfying claims rather than risk spreading. *Pireno* added a gloss to the *Royal Drug* emphasis on risk spreading by saying that the practice must be "logically and temporally" connected to the spreading of risk, 458 U.S. at 130, but the result was the same as in *Royal Drug*—the review by the chiropractor peer committee was stricken because it was simply an aid in the claims payment process, and did not actually involve the spreading of risk.

Given the emphasis in *Royal Drug* and *Pireno* on risk spreading, respondents' insistence that *Equifax Inc.*, 96 FTC 844 (1980) is dispositive is off the mark. The Commission held in *Equifax* that the McCarran Act exempts the deceptive gathering of medical histories because presumably the material was to be used in the process of spreading risk. The Commission's decision, however, has no bearing here since the record shows, as I will indicate later, that neither search and examination in general, nor the joint setting and examination fees in particular, have anything to do with spreading risk **[84]** amongst an actuarially determined class of insureds. Equally misplaced is respondents' heavy reliance on *Commander Leasing Co. v Transamerica Title Ins. Co.*, 477 F.2d 77 (10th Cir. 1973); *McIlhenny v. American Title Ins. Co.*, 418 F.Supp. 364 (E.D. Pa. 1976), and *Schwartz v. Commonwealth Land Title Insurance Co.*, 374 F.Supp. 564 (E.D. Pa. 1974) for the proposition that search and examination cannot be separated from the risk portion of title insurance. These cases, all decided before *Royal Drug,* have been distinguished as not having applied properly the crucial risk spreading test to discrete services offered by title insurers. *TIRBA*, 517 F. Supp. 1053, 1057, n. 2, *aff'd,* 700 F.2d 1247, 1251, n. 1.[285].

In focusing on risk spreading, I also necessarily reject respondents' argument that collusion by title insurers is exempt if not undertaken for the purpose of risk spreading, but rather to preserve their status as reliable insurers. The Court in *Royal Drug* specifically considered and dismissed the "reliable insurer" standard as too broad since every

[285] Post-*Royal* and *Pireno* cases which have allowed the exemption have turned on a factual determination that the questioned activity relates to risk spreading. *See Feinstein v. Nettleship Co. of Los Angeles,* 714 F.2d 928, 932 (9th Cir.), *cert. denied,* 104 S. Ct. 2346 (1984) (exemption allowed because "[t]he effect is to spread risk across a wide area, and this is precisely what the Supreme Court described when it formulated the risk spreading criterion"); *Klamath-Lake Pharm. v. Klamath Med. Serv. Bureau,* 701 F.2d 1276, 1286 (9th Cir.), *cert. denied* 464 U.S. 822 (1983) (exemption allowed because "[i]t is the actuarial uncertainty inherent in projecting risks and the insurance industry's corresponding need for cooperation that makes its exemption from antitrust laws appropriate").

business decision made by a insurance company arguably has some impact on its status as a reliable insurer. 440 U.S. at 216-17. As for the legislative history, all that it will allow on this point is that a secondary purpose behind the McCarran Act was to permit the collective sharing of risk experience in order to preserve the solvency of insurers. But this limited objective cannot be transformed into a blanket approval of all rate fixing by insurers irrespective of the connection to risk allocation.

Finally, respondents argue that even apart from any consideration of risk spreading, there should be an exception here because the states treat search and **[85]** examination and settlement as part of the "business of insurance". But what constitutes the "business of insurance" under the McCarran Act is a federal not a state question, and all cases from *Variable Annuity* to *Royal Drug* and *TIRBA* have not resolved that question on the basis of the state's definition of insurance. *See, e.g., TIRBA,* 700 F.2d 1249-50.

Turning then to the crucial risk spreading issue raised by *Royal Drug,* and putting aside for the moment the question of escrow or settlement services which was largely disposed of in *TIRBA,* I look to what the record tells us about search and examination.

To begin with, the record shows that historically search and examination were offered, and are still offered, apart from any concept of insurance or insurance risk spreading, and while the services have been engrafted onto an insurance framework as part of an overall marketing stratagem designed to win the business of assuring good title away from abstractors and conveyancers, this does not logically transform the basic nature of the services, which are still largely ministerial functions irrespective of the particular evidence of good title that is the ultimate objective of the search and examination. But having largely succeeded in winning this competitive struggle for the search and examination business, respondents would then crown their triumph with an antitrust exemption although in the past their competitors were turned down in a comparable attempt at consolidation of market power. Thus in Virginia, where examination for title insurance may only legally be performed by lawyers, the bar sought to protect its monopoly against price competition by use of a minimum fee schedule which was defended on the grounds that the services were being performed by a learned profession. After paying due deference to the practice of law as a scholarly pursuit, the lawyers who sit on the Supreme Court had no difficulty in recognizing search

and examination as integral parts of the real estate business and held, "[w]hatever else it may be, the examination of a land title is a service." *Goldfarb v. Virginia State Bar*, 421 U.S. 773, 787 (1975). This easily identifiable service does not undergo a sea change, as respondents argue, when independent attorneys, for example, who were the subject of **[86]** *Goldfarb*, don attorney-agent or approved attorney hats, and along with their other wares—abstracts, certifications, and opinions—now offer search and examination in an insurance package.

Second, the record shows that search and examination are regarded by respondents themselves as discrete services which are usually billed at a price that is entirely removed from any consideration of whatever risk element may be involved in title insurance. That is, even assuming that there is some small risk involved in title insurance (a point which will be taken up later) the risk has been isolated and assigned a dollar value for rate making purposes which is entirely apart from the non-risk part of the premium represented by the cost of conducting the search and examination. While this separation of search and examination from the risk element of a title insurance premium is most clearly shown by the existence of separate "risk" rates, it is also seen in the promulgation of inclusive rates that simply combine separate risk and search elements. The existence of this risk component—which is not challenged by complaint counsel (except in Ohio where it is alleged that the risk rate is inflated to include search and examination as well as settlement services)—is convincing evidence of a clear distinction between the search and examination function and whatever risk is assumed in the title insurance policy.

As for the joint setting of search and examination rates—the precise subject of this proceeding—this has no logical connection whatever to risk spreading since there is no evidence that joint rate making is undertaken by title insurers for the purpose of sharing their collective risk experience. To the contrary, the record evidence is overwhelming that both joint and individual rates for title insurance (*i.e.*, apart from the "risk" rate) are set by looking to the cost of performing the search and examination service rather than the claims experience of insurers. This cost is not only easily ascertainable by each insurer, but is also within the control of the individual insurer, and therefore the basic rationale of the McCarran Act—that is, the presumed need for **[87]** insurers to combine for the purpose of sharing their experience relating to an uncontrollable element (future claims)

which is then spread among a large universe of insureds—is not present.

As it happens, the connection between any aspect of title insurance and the notion of risk spreading is tenuous in the extreme. Few risks are assumed by title insurers since the very purpose of the entire title insurance process—from search and examination to binder to issuance of a final policy—is to eliminate risks by making certain that any serious defects in title are identified for the very purpose of seeing to it that they are not insured. To the limited extent that some risks are assumed by the title insurer, this, too, has nothing to do with the concept of risk spreading by a group of insurers. Disclosed risks are covered on the basis of individual company's legal analysis of the seriousness of the recorded title defect as balanced against competitive pressure to insure over the risk or lose the business to another title insurer. Again, this is contrary to the very purpose of the McCarran Act since risks are not underwritten on the basis of a collective pooling of risk experience.

As for hidden risks, this modest extension of title insurance beyond the scope of the abstract and the attorney's opinion has nothing to do with either search and examination or risk spreading since by definition the service at issue here—search and examination of public records—cannot allocate amongst a universe of insureds what it could not uncover in the first place. In any event, there is not a whit of evidence that these hidden risks are somehow spread among policyholders during the rate making process on the basis of the shared risk experience of the insurer members of rating bureaus.

In sum, since the central purpose of the McCarran Act is to allow for cooperation in the setting of rates so that insurers may take advantage of their collective experience in spreading risk, there clearly should be no exemption here because search and examination rates are not only unresponsive to collective risk experience, but do not [88] even reflect the risk experience of the individual insurer. Moreover, even apart from rates, the services themselves are not logically connected to risk assumption since the standard practice in the title insurance business is to exclude all elements of uncovered risk from the policy.[286]

[286] There is no basis on this record for concluding that respondents' joint rate fixing practices should be condemned under the remaining two *Royal Drug—Pireno* criteria, i.e., the practice must not relate to entities outside of the insurance industry, and must be part of the insurer-insured relationship. There is no allegation in this complaint that respondents have extended their price-fixing activities to approved attorneys, independent attorneys, abstractors, surveyors, or anyone else besides their own agents and employees. And while search and examination in general and joint rate making in particular have nothing to do with risk spreading, there

The State Action Defense

While I have concluded that the search and examination and closing services (see discussion herein under *Settlement Services*) are not the business of insurance under the McCarran Act, respondents' joint rate making activities through rating bureaus would still be exempt from the federal antitrust laws if they met the requirements of the *Parker* doctrine as refined by *Midcal* and *Southern Motor Carriers*.

In *Parker v. Brown*, 317 U.S. 341 (1943), the Supreme Court held that Congress did not intend to apply the antitrust laws to state action regulating economic activity within its own borders, and while some state action may be invalid, say, blanket authorization by a state that businesses may violate the federal antitrust laws without regard to state supervision, the practices involved in *Parker* (a state-sponsored but grower-administered program for limiting raisin production) were held to be a proper exercise of state discretion. In its opinion, the Court indicated that the exemption was derived from the policy favoring a spirit of accommodation within our federal system in order to avoid unnecessary conflict between the mandates of national law governing interstate commerce and state regulation of intrastate activity that may have interstate **[89]** implications. According to the Court, the exemption was also derived from the Tenth Amendment reservation of state sovereignty, as well as the belief that the states performed the useful function of serving as economic laboratories where diverse forms of regulation may be tested without interference from the federal government.

The *Parker* doctrine lay largely dormant for some 40 years until there appeared a spate of cases, both private and public, challenging under the federal antitrust laws alleged anticompetitive actions by states and municipalities as well as the practices of private persons acting under the color of state law. In response to this wave of state action cases, there eventually evolved a restatement of *Parker* which provided that before any restrictive practice departing from the competitive norm can qualify for the state action exemption, first, it must be demonstrated that the state's intention to grant federal antitrust immunity is clearly articulated and affirmatively expressed as a matter of policy, and second, that the state actively supervises the process chosen to replace the competitive market. *California Liquor*

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can be no question that these services (and the charges for these services) are part of the relationship between insurer and insured in the sense that the search and examination determines what is excluded from the policy, and the joint rate making determines how much the insured pays for the coverage received.

Dealers v. Midcal Aluminum, 445 U.S. 97 (1980). As it happens, the second prong of *Midcal* could not be met in *Midcal* itself since there was no state involvement beyond a statute requiring liquor wholesalers to charge prices posted by producers. Despite the outcome in *Midcal,* prior to 1985, enforcement actions involving the claim of a state action exemption largely concentrated on the first *Midcal* test since it was assumed that the more complex issue of state supervision presumably did not have to be faced unless the state compelled the anticompetitive conduct as proof of a clearly articulated and affirmatively expressed state policy to suspend the federal antitrust law. *See, e.g., Mass. Furniture and Piano Movers Ass'n.* ("*Mass. Movers*"), 102 FTC 1176, *rev'd and remanded,* 773 F.2d 391 (1st Cir. 1985). The *Parker* doctrine underwent a further revision, however, on the basis of the Supreme Court's opinion in *Southern Motor Carriers Rate Conference v. United States,* 105 S.Ct. 1721 (1985) in which the Court rejected the notion that the first prong of the *Midcal* test requires compulsion, and held, instead (in a case involving joint rates filed by motor carrier rating bureaus) **[90]** that a state policy to suspend competition may be made manifest by the mere authorization of joint activity to the point that even a statutory reference to just and reasonable rates may be taken as an adequate indication that the state intended that rates were not to be set by the competitive market.

Because of the dramatic impact of *Southern Motor Carriers,* even before the first witness was heard in this case, complaint counsel conceded that it would not contest certain key aspects of respondents' state action defense. Thus complaint counsel acknowledged in its pretrial brief that respondents' alleged price fixing activities in Arizona, Connecticut, Idaho, Montana, Ohio, and Wisconsin "are undertaken pursuant to a clearly articulated and affirmatively expressed state policy and satisfy the first prong of the *Midcal* test." Complaint Counsel's Trial Brief (Legal Analysis) at p. 24 (Sept. 16, 1985). As for these six states, the only aspect of the state action defense which complaint counsel challenge is whether there is active state supervision. Respecting New Jersey and Pennsylvania, complaint counsel stipulated that there was active state supervision. Stipulation dated 11-25-85. Complaint counsel also conceded that it did not intend to challenge under any theory "price fixing in New Jersey or Pennsylvania on charges for search and examination and settlement services that do not involve attorney-agents." Complaint Counsel's Trial Brief (Legal Analysis) at p. 24, n.58 (Sept. 16, 1985). Finally, with respect

to the five other states cited in the complaint (Louisiana, New Mexico, New York, Oregon, and Wyoming), these were dropped entirely from complaint counsel's case because "the quantum of proof necessary to resolve the question whether a state action defense is available appears to be greater than we originally anticipated" (Complaint Counsel's Trial Brief at p. 2 Sept. 16, 1985), an obvious concession to *Southern Motor Carriers.*

As a result of complaint counsel's stipulations and concessions, the *Midcal* issues remaining under the state action point are first, whether there had been state authorization for joint fixing of charges paid to attorney-agents in New Jersey and **[91]** Pennsylvania, and second, whether in Connecticut, Wisconsin, Arizona, Idaho, and Montana the rating bureau activities came under active state supervision. Ohio presents a special problem of determining whether search and examination rates were fixed at all.

The "authorization" issue in New Jersey and Pennsylvania is a question of statutory interpretation. Both states have authorized the joint filing of rates by the respective bureaus, and the only remaining issue is whether these states intend to include in the jointly fixed rates charges for search and examination and settlement when these services are performed by attorney-agents. While the statutes are ambiguous, New Jersey and Pennsylvania insurance regulators have clearly interpreted them to mean that the fees charged by all agents, including attorney-agents, should be regulated by the state insurance departments and may properly be fixed by the joint activity of the rating bureaus. The contrary view urged by complaint counsel may have been more creditable had it been shored up with testimony, documentary evidence, or citation to legislative history indicative of special circumstances (say, a successful campaign by the legal lobby in support of the parochial view that everything an attorney does should only be regulated by the bar or the judiciary), which might have justified an interpretation of the statute representing an extreme departure from the basic policy of these two states, *i.e.*, to regulate (and concededly to supervise actively) all aspects of the title insurance business.

The other prong of the *Midcal* test—"active supervision"—is an emerging concept that the Supreme Court has yet to flesh out. In *Midcal* itself, the only Court case to address the point directly, California required liquor wholesalers to post retail prices, which in turn had to be charged retailers. The Court observed that, "The State

neither establishes prices nor reviews the reasonableness of the price schedule; nor does it regulate the terms of fair trade contracts. The State does not monitor market conditions or engage in any 'pointed reexamination' of the program." 445 U.S. at 105-06. All that the state did in *Midcal* was simply to issue a directive that wholesalers must either file [92] fair trade contracts or if they did not have fair trade contracts, they must post a resale price schedule which the retailers had to charge. From these facts the Court concluded that California exercised only a "gauzy cloak of state involvement over what is essentially a private price-fixing arrangement." *Id.* at 106.

Southern Motor Carriers did not add significantly to *Midcal.* It only contained a passing reference to the active supervision concept since the case was disposed of on the "authorization" basis. At several points in the decision, however, the Court touched on the issue. The Court noted, "Here the Court of Appeals found, and the Government concedes, that the State Public Service Commissioners actively supervise the collective ratemaking activities of the rate bureaus", 105 S. Ct. at 1730, and in n. 23, *id.* at 1729, the Court said—

> Contrary to the Government's arguments, our holding here does not suggest that a State may "give immunity to those who violate the Sherman Act by authorizing them to violate it." *Parker v. Brown* 317 U.S. at 351, 63. S.Ct., at 313-314; see *Schwegmann Bros. v. Calvert Distillers Corp.* 341 U.S. 384, 71 S.Ct. 745, 95 L.Ed. 1035 (1951). A clearly articulated *permissive* policy will satisfy the first prong of the *Midcal* test. The second prong, however, prevents States from "casting...a gauzy cloak of state involvement over what is essentially a private price-fixing arrangement." *Midcal,* 445 U.S., at 106, 100 S.Ct. at 943. This active supervision requirement ensures that a state's actions will immunize the anticompetitive conduct of private parties only when the "state has demonstrated its commitment to a program through its exercise of regulatory oversight." See I P. Areeda & D. Turner, *Antitrust Law* ¶ 213a, p. 73 (1978).

From the fragments in *Midcal* and *Southern Motor Carriers,* and from the Supreme Court's favorable citation to Areeda and Turner, complaint counsel urge the adoption of a strict procedural test for active supervision, which they claim finds support in the following discussion in that authoritative treatise—

> ...[state] agency inaction fails to satisfy the requirement of this Paragraph that there be adequate public supervision. Such inaction evades statutory approval procedures designed (1) to accord opponents the opportunity to present facts and arguments against the challenged act, (2) to assure conscious consideration by those particular state officials charged with the power and responsibility for approval, and (3) to allow

[93] judicial review of the agency record. Therefore, the general view is correct that official inaction does not constitute sufficient "state action" to justify an antitrust exemption. I P. Areeda & D. Turner, *Antitrust Law* ¶ 213f, pp. 78-79 (1978).

These comments by Areeda and Turner cannot be fairly transformed, as complaint counsel argue, into a hard and fast rule that for each rate change there must be a notice, opportunity for comment (preferably through a hearing), and a written decision appealable to the courts. I believe that what Areeda and Turner were suggesting instead is that state inaction obviously does not show conscious review as would be evidenced, for example, by a hearing, argument, and a record. This does not mean that these procedures are the only ways of showing state review or are even the preferred way. For one thing, it could be argued that the adoption of such strict procedural requirements, which complaint counsel acknowledge are modeled on the federal Administrative Procedure Act, may be inconsistent with the *Parker* doctrine's underlying rationale of allowing the states to experiment with alternative means of regulation. Moreover, by making procedural fastidiousness the focus of the active state supervision inquiry, this may have the adverse effect of diverting public attention away from the diligence of state insurance commissioners, which in the real world may be the only effective protection for consumers whenever non-competitive pricing norms are adopted. Besides, insistence on strict procedural conformity can quickly degenerate into meaningless exercises in bureaucratic rubber-stamping of boiler-plate rulings. In some instances, of course, the diligent regulator may choose one of the procedures advocated by complaint counsel, i.e., a public hearing, as the appropriate response to a particular regulatory problem. To take one example, in *Southern Motor Carriers*, the Fifth Circuit was obviously impressed by just such a showing ("the record evidence that the commissions routinely suspend the effectiveness of proposed tariffs and conduct hearings satisfies us that the second prong of the *Midcal* test has been met." 672 F.2d at 474, n.5) but the [94] conscientious insurance commissioner might have chosen just as readily some alternative way of determining the reasonableness of rates.

That *Parker* put the state's choice of procedure beyond the scope of federal review does not translate, as respondents argue, into a requirement that there be a docile acceptance of any regime that the states may set up as long as there exists an impressive array of latent supervisory power. Rather, what *Midcal* says is that in the context of

an application for a federal antitrust exemption, the proper function of a court or administrative agency is to look at the state's regulatory machinery and make a determination as to whether there was, in fact, a review, monitoring, and an examination of critical aspects of the rate-making process. At trial what this comes down to is that since the "state action" exemption is a matter of affirmative defense, the initial burden rests with respondents to come forward with evidence showing that the state has a regulatory system that is capable, at least on its face, of examining critical aspects of the rate making process. Once this capability is demonstrated, I believe that the burden then shifts to the government which has to prove that in actual practice the regulators did not make such an examination with respect to some crucial aspect of rate making. This allocation of proof is grounded on the assumption of official regularity and the concomitant notion that respondents should have no burden of proving that state officials do what they are supposed to do under their own statutes. Or to put it somewhat differently, if the claim is made that a facially plausible supervisory regime is demonstrably inadequate then the burden to prove this should be on the party—complaint counsel here—challenging state supervision. Such a challenge, however, should not be allowed to lapse over into a qualitative evaluation of the performance of state officials—for example, whether they put enough time or effort into reviewing a particular rate submission—since an inquiry along these lines would not only be contrary to the public policy expressed in *Parker* of due deference to state sovereignty, but from a practical standpoint "[t]here simply is no way to tell if the state has 'looked' hard enough at the **[95]** data." I P. Areeda & D. Turner, *Antitrust Law,* ¶ 213c, p. 75 (1978).[287] On the other hand, *Midcal* would have no meaning at all if the exemption were granted when the regulatory machinery is patently inadequate on its face, or when the evidence is incontrovertible, say, an acknowledgment by the state itself that its latent powers are simply not being used (or cannot be used) to review, monitor, and examine crucial aspects of rate making.[288]

[287] See also *Ferguson v. Skrupa,* 372 U.S. 726 (1963) for requirement of similar federal restraint before invoking the Due Process Clause to second-guess the economic programs adopted by state legislatures.

[288] Post-*Midcal* cases have allowed the exemption when the regulatory agency had broad regulatory powers and there was evidence the powers were used. The exemption has been denied notwithstanding the presence of latent regulatory power when the record revealed that the powers were not used. *Compare Capital Telephone Co. v. N.Y. Telephone Co.,* 750 F.2d 1154 (2d Cir.), *cert. denied,* 105 S. Ct. 2325 (1985) (active supervision found where Public Service Commission not only had broad latent powers to supervise telephone companies through hearings and examination of books, but also actually used the powers to investigate rates) *with State of N.C. Ex Rel. Edmisten v. P.I.A. Ashville,* 740 F.2d 274 (4th Cir.), *cert. denied,* 105 S. Ct. 1865 (1985)

(footnote cont'd)