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Constitutional Law - Insurance Regulation - Extraterritorial Jurisdiction of States - State Board of Insurance v. Todd Shipyards Corporation, 370 U.S. 451 (1962)

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case to allow the federal judiciary in this field was that after diligent search and discussion he could find no guidelines to assist the federal district courts in determining how to reapportion a state. Yet Justice Brennan dismisses the subject without consideration, stating that

> Beyond noting that we have no cause at this stage to doubt the District Court will be able to fashion relief if violations of constitutional rights are found, it is improper now to consider what remedy would be most appropriate if appellants prevail at the trial.[20]

It will be interesting to see whether the federal district courts' experiences in solving this problem will result in a future policy reversal or a major change in the political character of a majority of the states in the union.

[20] 369 U.S. 186 (1961) at 198.

CONSTITUTIONAL LAW—INSURANCE REGULATION—EXTRATERRITORIAL JURISDICTION OF STATES

Todd Shipyards Corporation, a New York corporation not domiciled in Texas but doing business and owning property there, was taxed pursuant to Article 21.38 of the Texas Insurance Code. This article[1] requires that a five per cent tax on gross premiums be paid by resident insureds on policies of insurance purchased by them from "unauthorized insurers."[2] Todd insured its Texas property in New York City with Lloyd's of London and Institute of Lloyd's Underwriters, both unauthorized insurers within the meaning of the Code. Each of the insurance transactions involved took place entirely outside the State of Texas. The policies were negotiated, paid for, and issued outside Texas and all losses arising under the policies were adjusted and paid for outside the state. The insurers had no office or place of business in Texas, did not solicit business in Texas, had no agents in Texas, and did not investigate risks or claims in Texas.

Todd Shipyards Corporation paid the required five per cent tax under protest and brought an action against the State Board of Insurance to re-

[1] 14 VERNON'S TEX. CIV. STAT. art. 21.38, § 2(e) (Supp. 1961). Section 2(e) states: "If any person, firm, association or corporation shall purchase from an insurer not licensed in the State of Texas a policy of insurance covering risks within this State in a manner other than through an insurance agent licensed as such under the laws of the State of Texas, such person, firm, association or corporation shall pay to the Board a tax of five per cent (5%) of the amount of the gross premiums paid by such insured for such insurance. Such tax shall be paid not later than thirty (30) days from the date on which such premium is paid to the unlicensed insurer."

[2] An "unauthorized insurer" in the State of Texas is any insurance company not licensed by the State Board of Insurance to do business in that State. 14 VERNON'S TEX. CIV. STAT. art. 21.38, § 2(a) (Supp. 1961).

cover the amount paid, its contention being that Article 21.38 Section 2(e) of the Texas Insurance Code was unconstitutional. The taxpayer had judgment in the several Texas courts,[3] and the State Board of Insurance brought certiorari. The Supreme Court of the United States affirmed in favor of the taxpayer. It declared the Texas tax invalid under the due process clause of the fourteenth amendment to the United States Constitution where the only connection between Texas and the insurance transaction is the fact that the property covered by the insurance is physically located in that state. *State Board of Insurance v. Todd Shipyards Corporation* 370 U.S. 451 (1962).

The Texas Legislature, in enacting Article 21.38, relied upon, as the source of its authority, the "powers and privileges available to the state by virtue of Public Law 15" (The McCarran-Ferguson Insurance Regulation Act), which declares that the business of insurance shall be subject to the laws of the several states.[4] The Supreme Court, in declaring Article 21.38 Section 2(e) unconstitutional, relied heavily upon its interpretation of this same act.

The Court stated that in the history of the McCarran Act there was an explicit, unequivocal statement that the act was so designed as not to displace certain prior decisions. To fully understand the significance of this interpretation, it is necessary to note certain developments in the history of insurance regulation.[5]

In accord with the rule annunciated by the Supreme Court in *Paul v. Virginia*,[6] handed down in 1869 and followed in subsequent cases over a period of seventy-five years, the issuance of policies of insurance was held not to be a transaction of commerce, but a simple contract of indemnity against loss, even though the parties be domiciled in different states. This doctrine was reaffirmed and extended in *Hooper v. California* when the Court added that, "The *business* of insurance is not commerce."[7] Not being commerce, the business of insurance could not be subject to federal regulation as interstate commerce. State laws regulating insurance were accordingly upheld, despite the fact that they were applied to companies

[3] The Fifty-Third District Court, Travis County, Texas, rendered judgment for the plaintiff, Todd Shipyards, and the defendants appealed. The Austin Court of Civil Appeals of the State of Texas, Third Supreme Judicial District, affirmed. 340 S.W. 2d 339 (1960). The defendants then applied for writ of error, but the Supreme Court of Texas denied the application. 161 Tex. 637, 343 S.W. 2d 241 (1961).

[4] 14 VERNON'S TEX. CIV. STAT. art. 21.38, § 1 (1952) (Supp. 1961).

[5] For an extensive analysis of the history of insurance regulation, see 1 RICHARDS, LAW OF INSURANCE 136 (5th ed. 1952).

[6] 75 U.S. (8 Wall.) 168 (1869).

[7] 155 U.S. 648, 655 (1895) (Emphasis added).

domiciled in other states and were concerned with transactions occurring across state lines.[8]

During this same period, however, there developed a line of cases imposing an important limitation on state regulatory power over the business of insurance under the federal due process clause.

The first important case in this line was *Allgeyer v. Louisiana*.[9] In that case the controversy involved a Louisiana statute which subjected to a fine any person or firm who in "any manner whatsoever"[10] should do any act in the state to effect insurance on property, then physically located in Louisiana, in any marine insurance company which had not complied with the laws of that state. This statute was held to violate the fourteenth amendment to the federal constitution when construed to prevent an owner of property in the state from sending by mail to an unauthorized, non-resident insurance company, in another state, an order for insurance on his property, in pursuance of a valid contract for such insurance previously made, and to be performed, in the other state.

In *St. Louis Cotton Compress Co. v. Arkansas*,[11] the Court was concerned with a similar controversy. A statute imposed a five per cent tax on premiums paid for insurance on Arkansas property to an out-of-state insurer not authorized to do business in Arkansas. The contract of insurance, as in the *Allgeyer* case, was made outside the state's jurisdiction. The United States Supreme Court, in reversing the decision of the Supreme Court of Arkansas, held the statute invalid, under the fourteenth amendment, as applied to policies contracted for, delivered, and paid for outside the state.

Subsequently, in *Connecticut General Life Insurance Co. v. Johnson*,[12] the Supreme Court held invalid, under the due process clause, a California tax on the receipt of reinsurance premiums in Connecticut by a Connecticut insurance company authorized to do business in California. The reinsurance involved no transactions with the persons originally insured, and no act in the course of the contract's formation, performance, or discharge took place in California.

For the most part, however, the power and authority of the states in the area of insurance regulation were not seriously disputed. In the light of this seventy-five year history of state regulatory power over insurance, consternation and confusion were great when, in the famous 1944 case of

[8] *E.g.*, New York Life Ins. Co. v. Deer Lodge County, 231 U.S. 495 (1913); Nutting v. Massachusetts, 183 U.S. 553 (1902); New York Life Ins. Co. v. Cravens, 178 U.S. 389 (1900); Philadelphia Fire Ass'n v. New York, 119 U.S. 110 (1886); Liverpool Ins. Co. v. Massachusetts, 77 U.S. (10 Wall.) 566 (1871); Ducat v. Chicago, 77 U.S. (10 Wall.) 410 (1871).

[9] 165 U.S. 578 (1897).

[10] *Id.* at 579.

[11] 260 U.S. 346 (1922).

[12] 303 U.S. 77 (1938).

United States v. South-Eastern Underwriters Ass'n,[13] the Supreme Court reversed its previous position and decided that the business of insurance was commerce and, therefore, when conducted across state lines, subject to federal regulation as interstate commerce. In view of the exclusive power of Congress to regulate interstate commerce, the validity of existing state laws taxing insurance companies, from which large revenues were derived by the states, seemed to be in jeopardy.[14]

To clarify the uncertainties arising from the *South-Eastern Underwriters* decision, Congress promptly enacted the McCarran-Ferguson Insurance Regulation Act.[15] The McCarran Act declared in part that:

> [T]he 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 the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States. . . . 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.

The general purpose of the McCarran Act was to give support to existing and future state systems for regulating and taxing the business of insurance, and to sustain such state systems from attacks (such as that of the

13 322 U.S. 533 (1944).

14 The consequences, however, of the *South-Eastern Underwriters* decision proved not to be as far-reaching as originally feared. In *Robertson v. California* the Supreme Court affirmed the conviction of an insurance agent who had sold insurance within the State of California without a license. The agent's acts held to violate the California statutes were committed after the rendition of the *South-Eastern Underwriters* decision and before the effective date of the McCarran Act. The court rejected the agent's contention that, as a result of the *South-Eastern Underwriters* decision, California could no longer require foreign insurance corporations seeking to do business there to maintain minimum reserves for protection of policyholders in the state or to compel brokers or agents to refrain from representing them there notwithstanding such noncompliance. Robertson v. California, 328 U.S. 440 (1946).

15 15 U.S.C. §§ 1011–15 (1945). The McCarran Act, so far as is relevant to our discussion, is as follows:
"§ 1011. Declaration of policy.
"Congress 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 the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States.
"§ 1012. Regulation by State law; Federal law relating specifically to insurance. . . .
"(a) 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) 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 Sherman Act . . . the Clayton Act, and . . . the Federal Trade Commission Act . . . shall be applicable to the business of insurance to the extent that such business is not regulated by State law. . . ."

South-Eastern Underwriters decision) under the commerce clause.[16] The constitutionality of the McCarran Act was affirmed in *Prudential Insurance Co. v. Benjamin*,[17] where the Supreme Court upheld a discriminatory tax law of the State of South Carolina.[18]

This then was the general background against which the instant controversy was to be settled. In interpreting the McCarran Act as prohibiting the Texas tax on Todd Shipyards, the Supreme Court relied specifically upon the relevant House report which states:

> It is not the intention of Congress in the enactment of this legislation to clothe the States with any power to regulate or tax the business of insurance beyond that which they had been held to possess prior to the decision of the United States Supreme Court in the South-Eastern Underwriters Association case. Briefly, your committee is of the opinion that we should provide for the continued regulation and taxation of insurance by the states, subject always, however, to the limitations set out in the controlling decisions of the United States Supreme Court [*Allgeyer v. Louisiana*,[19] *St. Louis Cotton Compress Co. v. Arkansas*,[20] and *Connecticut General Life Insurance Co. v. Johnson*[21]], which hold, inter alia, that a State does not have power to tax contracts of insurance or reinsurance entered into outside its jurisdiction by individuals or corporations resident or domiciled therein covering risks within the State or to regulate such transactions in any way.[22]

The court pointed out that Senator McCarran, after reading the foregoing part of the House report during the Senate debate, stated "we give to the States no more powers than they previously had, and we take none from them."[23]

Thus the Court decided that while the McCarran Act provided that the business of insurance shall be subject to state laws relating to the regulation or taxation of such business, it indicated without ambiguity[24] that

[16] Prudential Ins. Co. v. Benjamin, 328 U.S. 408 (1946). *Accord*, Federal Trade Comm'n v. Travelers Health Ass'n, 362 U.S. 293 (1960); Maryland Cas. Co. v. Cushing, 347 U.S. 409 (1954); American Hosp. & Life Ins. Co. v. FTC, 243 F. 2d 719 (5th Cir. 1957).

[17] 328 U.S. 408 (1946).

[18] For an analysis of the decision that insurance is interstate commerce as affecting state statutes relating to foreign insurance companies, see Annot., 164 A.L.R. 500 (1946).

[19] 165 U.S. 578 (1897). [20] 260 U.S. 346 (1922). [21] 303 U.S. 77 (1938).

[22] H.R. Rep. No. 143, 79th Cong., 1st Sess. 3 (1945).

[23] 91 Cong. Rec. 1442 (1945).

[24] Mr. Justice Black, in his dissent, stated that the continued power of the states to regulate and tax the business of insurance was declared in unqualified language in the McCarran-Ferguson Act and that the decision in the instant case seriously impairs the power of the states to discharge their responsibilities under the act to provide a comprehensive, effective, well-integrated program for regulating insurance on property within their borders. State Bd. of Ins. v. Todd Shipyards Corp., 307 U.S. 451 (1962) (dissent).

such state "regulation or taxation" should be kept within the limits set by the *Allgeyer, St. Louis Cotton Compress,* and *Connecticut General Life Insurance* decisions.[25]

The noted case, then, seemingly delineates the permissible extent of state regulation of unauthorized insurance, a subject of grave and current importance. Two recent instances in which the states themselves have dealt with this very problem demonstrate its current importance. In August, 1961, Wisconsin enacted the Wisconsin Unauthorized Insurance Act,[26] and in June, 1962, the National Association of Insurance Commissioners, at its semiannual conclave in Montreal, "received"[27] the final draft of its Proposed Non-Admitted Insurance Act.[28]

The Wisconsin Unauthorized Insurance Act provides, among other things, that any one of certain acts, such as the issuance of a policy, the taking of an application, the collection of a premium, the investigation or

[25] It is important to note that the Court deemed it unnecessary to decide *de novo* whether the results (and the reasons given) in these three decisions were still sound and acceptable, but merely stated that since Congress had posited a regime of state regulation on the continuing validity of these specific prior decisions, the Court should be "loathe to change them."

This is significant in that the Court of Civil Appeals, *supra* note 3, though feeling constrained by the precedent in the *Allgeyer* and *St. Louis Cotton Compress* cases to affirm the trial court's judgment, expressed confidence that the Supreme Court of the United States, enlightened by its own criticism of the *Allgeyer* and *Cotton Compress* cases, would, upon proper application, re-examine those cases and pronounce a decision sustaining the Texas Legislature in enacting the statute in question.

[26] WISC. STAT. ANN. ch. 201, § 201.42 (Supp. 1962).

[27] It is significant to note that at least partly because of the imminence of the Supreme Court's decision in the *Todd Shipyards* case, the Fifth and Final Draft of the Non-Admitted Insurance Act, which had been designed to serve as a Model Act for states to enact in dealing with the problem of unauthorized insurers, was not adopted by the Montreal Convention—but, at the recommendation of the drafting committee, merely "received." The feeling apparently was that if the Court should rule that states may not tax insurance placed out-of-state in non-admitted companies, the model bill would have to be materially revised—or perhaps even discarded.

[28] The announced purposes of each of these two acts may be stated as follows: (a) to protect the insureds and claimants of the state in transactions involving the purchase of insurance from insurers not authorized to transact business in the state; (b) to subject certain unauthorized insurers to the jurisdiction of state courts so as to remove from the path of residents the often insurmountable obstacle of resorting to distant forums for the purpose of asserting legal rights under policies purchased from such unauthorized insurers; (c) to provide for the public, to the extent that insurance is not procurable from admitted insurers, orderly, reasonable, and regulated access to such insurance from non-admitted insurers through qualified, licensed, and supervised surplus lines agents or brokers; (d) to protect the premium tax revenues of the state; (e) to protect regulated, admitted insurers from unregulated and unfair competition by non-admitted insurers; (f) to regulate and supervise the effectuation of non-admitted insurance in accordance with the laws of the state and Public Law 15, known as the McCarran Act; and (g) to maintain reliable insurance markets. Proposed Non-Admitted Insurance Act § 2 (Final Draft—April 15, 1962); WISC. STAT. ANN. ch. 201, § 201.42 (1) (Supp. 1962).

adjustment of a claim, or the inspection of a risk, effected in the State of Wisconsin *by mail or otherwise* constitutes doing an insurance business in Wisconsin. The venue of any act committed by mail is declared to be at the point where the matter transmitted by mail is delivered and takes effect.[29]

The act goes on to prohibit any person or insurer from doing any such acts of an insurance business in the state unless authorized by statute, which simply means that the person or insurer must be licensed by the state.[30]

Upon every insured who procures, continues, or renews insurance with an unauthorized insurer, upon a subject of insurance resident, located, or to be performed within the state, the act imposes an obligation to report the same and pay a three per cent premium receipts tax.[31]

It is further provided that every unauthorized insurer who shall so effectuate, continue, or renew insurance on subjects resident, located, or to be performed in Wisconsin, shall be subject to a premium receipts tax of three per cent,[32] shall be subject to a fine of not more than $5,000,[33] and, in addition to any other penalty provided for by the law of Wisconsin, shall forfeit $500 for the first such offense and an additional $500 for each month the violation continues.[34]

Thus, with respect to unauthorized persons and insurers, the heart of the Wisconsin Act seems to be aimed at prohibiting unauthorized direct mail business in the state. As noted above, the act provides for a premium tax, a fine, and additional penalties against any unauthorized insurer who, for example, mails a contract of insurance to a Wisconsin resident insuring property physically located in Wisconsin, even though the contract itself was entered into and is to be performed outside the State of Wisconsin.

The above situation appears to fall squarely within the purview of the limitation on state regulatory power promulgated in the *Allgeyer v. Louisiana*[35] decision and renovated by reason of the Supreme Court's interpretation of the McCarran Act in the *Todd Shipyards* decision. In *Allgeyer*, the Louisiana statute was held invalid when applied to a resident insured who, in pursuance of a valid contract negotiated and entered into outside Louisiana, notified the non-resident unauthorized insurer of a pending

[29] WISC. STAT. ANN. ch. 201, § 201.42 (2) (Supp. 1962).

[30] WISC. STAT. ANN. ch. 201, § 201.42 (3) (Supp. 1962).

[31] WISC. STAT. ANN. ch. 201, § 201.42 (12) (Supp. 1962).

[32] WISC. STAT. ANN. ch. 201, § 201.42 (11) (a) (Supp. 1962).

[33] WISC. STAT. ANN. ch. 201, § 201.42 (13) (a) (Supp. 1962).

[34] WISC. STAT. ANN. ch. 201, § 201.42 (13) (b) (Supp. 1962).

[35] 165 U.S. 578 (1897).

shipment of cotton then located in Louisiana by mailing the necessary information to the insurer. That the delivery by mail of a policy to a resident insured in Wisconsin by an out-of-state party to an already existing contract would be looked upon in the same light is highly possible.

Section 201.42 (12) of the Wisconsin Act imposes upon every insured who procures, continues, or renews insurance with any unauthorized insurer upon a subject of insurance resident, located, or to be performed within the State, other than insurance procured through a surplus lines agent pursuant to the surplus lines law of the state, the duty of filing a report of the same with the Commissioner as well as paying a premium receipts tax of three per cent of the gross premiums charged for such insurance.

This section prescribes that it is applicable to any insurance procured through negotiations or an application, "in whole or in part occurring or made within or from within or outside" of the state. The quoted language, while somewhat ambiguous, appears to mean that the section applies to such insurance whether negotiated in or out of the state or partly in and partly out of the state.

This section does not require, as a condition to its applicability, that any activity, by mail or otherwise, by either an insurer or the insured, be conducted in Wisconsin. Thus, if a Wisconsin resident drives to Illinois and, while there, purchases a fire insurance policy payable only in Illinois, on his home in Wisconsin, from an Illinois insurer not authorized to do business in Wisconsin, even if the policy is personally delivered to him in Illinois he must, according to Section 201.42 (12), report the policy to the Commissioner in Wisconsin and pay the premium tax.

It is readily seen that this section of the Wisconsin Act is very similar in scope to article 21.38, section 2 (e) of the Texas Insurance Code which gave rise to the *Todd Shipyards* controversy. Whether the Wisconsin Unauthorized Insurance Act, upon judicial examination of a situation factually similar to that of *Todd Shipyards,* will feel the impact of the Supreme Court's interpretation of the McCarran Act in that case is yet to be determined.

Thus, as a result of the *Todd Shipyards* decision, it appears that the states cannot tax or regulate unauthorized insurance where negotiations and payment for the coverage are consummated outside the state. It is highly probable that if any great number of large or corporate insurance buyers follow the practice used by Todd Shipyards in this case, it could materially lessen the stature of the states as a regulatory force in insurance as well as provide an impetus to the already existing trend toward unauthorized insurance.