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The Eleventh Circuit Gives the Banking Industry a Lesson About Reverse Preemption in *Barnett Bank of Marion County, N.A. v. Gallagher*

Recently, in *Barnett Bank of Marion County, N.A. v. Gallagher*,[1] the United States Court of Appeals for the Eleventh Circuit was presented with the question of whether Florida's prohibition against affiliations between banks and insurance agents was protected from preemption by the McCarran-Ferguson Act.[2] The appellant, Barnett Marion, is a subsidiary of Barnett Banks, Inc., the largest bank holding company centered in Florida.[3] Barnett Marion maintains its principal place of business in Ocala, Florida; however, it owns and operates a branch in Belleview, Florida, a locality where the population is less than five thousand.[4] On October 18, 1993, Barnett Marion purchased Linda Clifford Insurance, Inc. from Linda K. Clifford in Belleview.[5] That same day, Barnett Marion sought a declaration asking that they be allowed to market insurance to customers throughout the State of Florida from the branch office.[6] Barnett requested the declaration due to two conflicting statutes. Florida maintains a statute which precludes bank subsidiaries from engaging in insurance activities.[7] However, 12 U.S.C. § 92 permits

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1. 43 F.3d 631 (11th Cir. 1995), *cert. granted*, 116 S. Ct. 39 (U.S. Sept. 27, 1995) (No. 94-1837).

2. McCarran-Ferguson Act, 15 U.S.C. §§ 1011-1015 (1988).

3. Barnett Banks of Marion County, N.A. v. Gallagher, 839 F. Supp. 835, 837 (M.D. Fla. 1993).

4. 43 F.3d at 632.

5. 839 F. Supp. at 837. The decision to purchase the company was founded on a recommendation by the Executive Committee of Barnett Banks, Inc. Barnett purchased the insurance company's assets including the company's name. Furthermore, Clifford's employees became employees of Barnett Banks. *Id.*

6. 43 F.3d at 633. Specifically the bank requested the following: "Barnett Bank and, specifically Barnett Bank Belleview, is authorized and empowered by federal law to act as an agent for any insurance company authorized by the state of Florida to do business in Florida." *Id.* (quoting R1-1-7).

7. FLA. STAT. ch. 626.988 (1995). The statute provides in part: "No insurance agent or solicitor . . . who is associated with, under contract with, retained by, owned or

national banks to act as insurance agents in towns having a population of fewer than five thousand people.[8] Barnett contended that the federal statute preempted the state statute, and therefore they should be allowed to act as an insurance agent for any authorized insurance company in Florida.[9] On October 22, 1993, the Florida Department of Insurance issued an Immediate Final Order mandating that Clifford and her agents discontinue all insurance activities other than selling credit disability and credit life insurance.[10] In response, Barnett Marion filed motions seeking either a temporary restraining order or a preliminary injunction.[11] The United States District Court for the Middle District of Florida denied both motions and the case went to trial.[12] The district court looked to the McCarran-Ferguson Act,[13] which was enacted in 1945 to ensure that states, and not the federal government, regulate the insurance industry.[14] The statute creates a reverse preemption doctrine in the insurance arena whereby a state law which regulates the business of insurance is presumed to invalidate a federal law "unless the federal law specifically relates to the business of insurance."[15] The district court held that the Florida anti-affiliate statute is a law regulating the business of insurance and that section 92 is not a law which specifically relates to the business of insurance, and therefore the state statute does not yield to the federal statute.[16] The United States Court of Appeals for the Eleventh Circuit affirmed the district court's decision and declared that the district court had correctly interpreted and applied the conflicting statutes.[17]

In 1869, in *Paul v. Virginia*,[18] the United States Supreme Court held that issuing an insurance policy was not a transaction which fell under Congress's Commerce Clause powers pursuant to Article I, section 8 of the United States Constitution.[19] For approximately seventy-five years following this decision, Congress believed that insurance regulation was

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controlled by, to any degree, directly or indirectly, or employed by, a financial institution, shall engage in insurance agency activities as an employee, officer, director, agent, or associate of a financial institution agency." *Id.*

8. 12 U.S.C. § 92 (1916).
9. 43 F.3d at 633.
10. *Id.*
11. *Id.*
12. *Id.*
13. 15 U.S.C. §§ 1011-1015.
14. 839 F. Supp. at 839-40.
15. 15 U.S.C. § 1012(b).
16. 839 F. Supp. at 843.
17. 43 F.3d at 637.
18. 75 U.S. (8 Wall.) 168 (1868).
19. *Id.* at 183.

beyond the scope of its power.[20] However, the Supreme Court started enlarging the powers of Congress under the Commerce Clause in response to the emergence of an interconnected national economy, and in 1944 the Supreme Court, in *United States v. South-Eastern Underwriters Ass'n*,[21] held that regulation of interstate insurance activity was not beyond Congress's Commerce Clause power.[22] Congress responded adversely to the decision in *South-Eastern Underwriters* and within a year passed the McCarran-Ferguson Act to return the supremacy of insurance regulation to the states.[23] The Act's policy statement provided that "Congress hereby declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest."[24] Section 1012 of the Act proclaimed that "[n]o 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 a tax upon such business, unless such Act specifically relates to the business of insurance."[25] The result was the foundation of a reverse-preemption doctrine for regulating the insurance industry.[26] A state statute regulating the business of insurance would now be deemed to presumptively preempt a conflicting federal law unless the federal statute specifically related to insurance.[27] A few years later in *Prudential Insurance Co. v. Benjamin*,[28] the Supreme Court examined the McCarran-Ferguson Act for the first time. The Court stated that "[o]bviously Congress' purpose was broadly to give support to the existing and future state systems for regulating and taxing the business of insurance."[29] Over the next twenty-three years, the states were given almost full authority to regulate and tax the insurance industry. However, in 1969 the Court began to permit greater federal regulation over the insurance industry. Most of the important

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20. John F. Wagner, Jr., Annotation, *Supreme Court's Views as to Validity, Construction, and Application of McCarran-Ferguson Act, Concerning Regulation of Business of Insurance by State or Federal Law*, 125 L. Ed. 2d 879 (1995).

21. 322 U.S. 533 (1944).

22. *Id.* at 553. The decision in this case clearly invited Congress to pass legislation specifically aimed at regulating the insurance industry. *Id.*

23. 43 F.3d at 634. In fact, at the time the court handed down its decision in *South-Eastern Underwriters*, Congress was already considering a bill exempting the insurance industry from antitrust laws. SEC v. National Secs., Inc., 393 U.S. 453, 458 (1969) (referring to 90 Cong. Rec. 6565 (1944)).

24. 15 U.S.C. § 1011.

25. *Id.* § 1012(b).

26. 43 F.3d at 634.

27. *Id.*

28. 328 U.S. 408 (1946).

29. *Id.* at 429.

cases focused on the language in section 1012(b) of the Act—the debates centered on determining what constitutes the "business of insurance." In *SEC v. National Securities, Inc.*,[30] the Court dealt with the issue of whether the SEC was prohibited by the McCarran-Ferguson Act from bringing an action under the Securities Exchange Act against a shareholder of an insurance company.[31] The Court held that the McCarran-Ferguson Act did not prevent the SEC from bringing the action because the state statute that was involved actually dealt with securities regulation and not insurance regulation.[32] In reaching this decision, the Court observed that statutes which were directed at protecting the relationship between the insurance company and the policyholder were laws regulating the business of insurance.[33] Later, in *Group Life & Health Insurance Co. v. Royal Drug Co.*,[34] the Court attempted to clarify the meaning of the phrase business of insurance. The Supreme Court stated that one of the main factors to consider is the risk to the policyholders.[35] In *United Labor Life Insurance Co. v. Pireno*,[36] the Supreme Court actually established specific elements to consider when construing the phrase "business of insurance."[37] The case dealt with whether the use of a peer review committee by a chiropractic association to advise insurers as to whether charges for chiropractic services were necessary and reasonable constituted the business of insurance.[38] In reaching its decision that this practice was not part of the business of insurance, the Court set out three basic criteria: "[F]irst, whether the practice has the effect of transferring or 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."[39] More recently, the Supreme Court in *United States Department of Treasury v. Fabe*,[40] explained the relationship of these criteria to the McCarran-Ferguson Act. In *Fabe*, the Court was asked to determine whether the federal priority statute, 31 U.S.C.

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30. 393 U.S. 453 (1969).
31. *Id.* at 455-57.
32. *Id.* at 460.
33. *Id.*
34. 440 U.S. 205 (1979).
35. *Id.* at 211-12. The Court stressed that the "spreading and underwriting of a policyholder's risk" are the foundations of an insurance contract. *Id.* at 211.
36. 458 U.S. 119 (1982).
37. *Id.* at 129.
38. *Id.* at 122-23.
39. *Id.* at 129.
40. 113 S. Ct. 2202 (1993).

§ 3713, which establishes priority concerning bankrupt debtors' obligations, preempted an inconsistent Ohio priority statute that dealt with insolvent insurance companies.[41] In analyzing the issue, the Court noted an important distinction between the first and second clauses of section 1012(b) of the McCarran-Ferguson Act.[42] According to the Court, the first clause "is not so narrowly circumscribed" as the second clause.[43] As a result, a less stringent standard must be applied when determining whether the state statute regulates the business of insurance. The Court went on to hold that the Ohio statute was protected from preemption due to the fact that it regulated the relationship between policyholders and the insurance company.[44] In a 1995 Supreme Court case, the banking industry won an important battle in its war against the insurance industry. In *NationsBank of North Carolina, N.A. v. Variable Annuity Life Insurance Co.*,[45] the question presented was whether national banks may act as agents for the sale of variable and fixed rate annuities.[46] The Supreme Court ruled that annuities are not insurance products; instead, they are investment products, and therefore banks are entitled to market and sell them under the incidental powers clause of the National Banking Act.[47] The holding was a major setback for the insurance industry. Recently, the Sixth Circuit also rendered a decision which pleased proponents of the banking industry. In *Owensboro National Bank v. Stephens*,[48] decided just one month prior to the decision in *Barnett*, the Sixth Circuit addressed whether a Kentucky statute which prohibited banks from selling insurance other than credit-related insurance was preempted by section 92.[49] In a split decision, the court held that section 92, which permits banks to act as insurance agents in towns of fewer than five thousand people, preempted the Kentucky statute.[50] The court in *Owensboro* reached its conclusion by determining that the Kentucky

41. *Id.* at 2204. The Ohio statute involved priority upon claims in actions to liquidate insolvent insurance companies. *Id.*

42. *Id.* at 2210.

43. *Id.* at 2209.

44. *Id.* at 2212. The Court emphasized the rule that state laws that were created for the purpose of regulating insurance "do not yield to conflicting federal statutes unless a federal statute specifically requires otherwise." *Id.* at 2211.

45. 115 S. Ct. 810 (1995).

46. *Id.* at 811.

47. *Id.* at 817.

48. 44 F.3d 388 (6th Cir. 1994).

49. *Id.* at 389.

50. *Id.* at 392.

statute did not meet the criteria set forth in *Pireno*.[51] The majority argued that a statute which excludes a person or entity from engaging in an activity is a regulation of the person.[52] In comparison, a statute which regulates the manner in which an activity is conducted is a statute regulating the activity.[53] The court found that the Kentucky statute fell into the former category, and therefore it did not regulate the business of insurance.[54] As a result, the McCarran-Ferguson Act did not rescue the Kentucky statute from preemption.[55] This decision is in direct conflict with the Eleventh Circuit's decision in *Barnett*.[56]

The McCarran-Ferguson Act provides that "[n]o 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."[57] In *Barnett,* the court proceeded through a two step analysis in reaching its conclusion that the McCarran-Ferguson Act required that section 92 yield to the Florida statute.[58] First, the court had to determine whether the Florida statute regulates insurance. Second, a determination of whether section 92 specifically relates to insurance was required.[59] The Eleventh Circuit applied the criteria espoused in *Fabe*[60] in an attempt to establish whether the Florida statute regulated the business of insurance.[61] The Florida statute prohibited insurance agents associated with financial institutions from selling insurance products.[62] The court focused on the relationship between the insurance company and the policyholder.[63] Particular

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51. *Id.*
52. *Id.*
53. *Id.*
54. *Id.*
55. *Id.* In a well-reasoned dissent, Judge Batchelder argued that the majority had misapplied *Pireno*. The dissent determined that the *Pireno* factors were only relevant to the first clause of the McCarran-Ferguson Act. Furthermore, the dissent applied the more recent decision in *Fabe* which distinguished the first and second clauses of the McCarran-Ferguson Act. Under this analysis, the dissent found that the Kentucky statute's aim was to protect policy holders and was therefore a statute which regulated the business of insurance. Moreover, the dissent determined that section 92 did not specifically relate to the business of insurance, and therefore the Kentucky statute was saved from preemption by the McCarran-Ferguson Act. *Id.* at 394-98 (Batchelder, J., dissenting).
56. 43 F.3d at 637.
57. 15 U.S.C. § 1012(b).
58. 43 F.3d at 634.
59. *Id.*
60. 113 S. Ct. at 2210.
61. 43 F.3d at 634.
62. *Id.* at 634-35.
63. *Id.* at 635.

emphasis was placed on state court interpretations of the statute and on testimony from the Director of Legal Services for the Florida Department of Insurance in determining that the purpose of the statute involved was to regulate "the insurance-purchasing public at large."[64] Furthermore, the court looked at the abuses that the statute was trying to prevent—coercion, undue concentration of economic resources, and unfair trade practices.[65] Barnett, however, argued that the statute was enacted merely in an attempt to isolate the "independent insurance agents from competition by financial institutions."[66] The court strongly disagreed with this position, maintaining instead that the statute protects policyholders by ensuring that banks remain at arms length and remain objective when conducting transactions with the insurer and the insured.[67] Therefore, the court held that the Florida statute did in fact regulate the business of insurance.[68] Applying *Fabe*, the court opined that state laws which regulate the business of insurance "do not yield to conflicting federal laws unless the federal statute specifically requires otherwise."[69] At this point, the inquiry centered on whether section 92 specifically required otherwise.[70] In looking at the legislative history, the Eleventh Circuit noted that Congress enacted section 92 in 1916.[71] At that time, and for approximately thirty years thereafter, Congress believed that it did not possess the power to regulate the insurance industry. It was not until 1944, in *South-Eastern Underwriters*, that Congress realized that it had the authority to regulate insurance under the Commerce Clause.[72] Therefore, when Congress enacted section 92, it could not have intended to regulate the insurance industry because it believed that it lacked the power to do so.[73] The court concluded that the statute was aimed at the banking industry and not the insurance industry.[74] As a result, the court held that section 92 does not specifi-

64. *Id.* (citing testimony of the Director of Legal Services for the Florida Department of Insurance (R3-69-16)).

65. *Id.* (construing Glendale Fed. Sav. & Loan Ass'n v. Florida Dep't of Ins., 587 So. 2d 534 (Fla. 1st Dist. Ct. App. 1991)).

66. *Id.* at 636 (quoting Appellant's Brief at 35).

67. *Id.*

68. *Id.*

69. *Id.* (quoting *Fabe*, 113 S. Ct. at 2211).

70. *Id.*

71. *Id.*

72. *Id.* at 637.

73. *Id.*

74. *Id.*

cally relate to the business of insurance and therefore it is preempted by the Florida statute by way of the McCarran-Ferguson Act.[75]

The decision in *Barnett* represents a major victory for the insurance industry and appears to lay the foundation enabling a state to prohibit banks from selling insurance even in towns with fewer than five thousand residents. The decision suggests that states still possess extensive authority over the regulation of the insurance industry and may completely prohibit banks from engaging in general insurance activities in their states. However, just one month before the Eleventh Circuit decided *Barnett,* the Sixth Circuit in *Owensboro National Bank v. Stephens,*[76] rendered a decision in direct conflict with *Barnett.* This conflict between the circuits led to the Supreme Court granting certiorari on September 27, 1995.[77] The Supreme Court's decision will have far reaching ramifications on two of the nations largest and most powerful industries. The banking industry maintains that statutes such as Florida's do not fall within the confines of the McCarran-Ferguson Act.[78] Their argument is that the McCarran-Ferguson Act was designed to regulate how the insurance industry is conducted.[79] They contend that statutes such as Florida's, however, completely bar entrance into the business of insurance and are not regulating but are merely prohibiting competition.[80] The insurance industry, however, believes that statutes such as Florida's are necessary for the protection of policyholders.[81] The fear is that there will be a loss of arms-length transactions resulting in increased pressure placed on the policyholders, which could lead to improper insurance decisions.[82] If the Supreme Court sides with the insurance companies, the result will be that states will maintain significant flexibility in regulating the insurance industry in their states thereby protecting insurance companies from intrusion into this lucrative arena. However, if the Supreme Court decision favors Barnett, the banking industry will have a firm backing for encroaching even further into the insurance industry. In either situation, the time

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75. *Id.*

76. 44 F.3d at 388.

77. 116 S. Ct. at 39.

78. Jaret Seiberg, *High Court to Rule on Bank Sales of Insurance*, AMERICAN BANKER, Sept. 28, 1995, at 2 (referring to comments made by Julia Williams, chief counsel at the Office of the Comptroller of the Currency).

79. *Id.*

80. *Id.*

81. 43 F.3d at 635 (referring to testimony of Mr. Shropshire, Director of Legal Services for the Florida Department of Insurance).

82. *Id.*

might be ripe for Congress to step in and clarify exactly what authority it wishes for states to have over the insurance industry.

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