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In the

# Supreme Court of the United States

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| GROUP LIFE AND HEALTH INSURANCE COMPANY, ALSO KNOWN AS BLUE SHIELD OF TEXAS, ET AL., | ) | |
| Petitioners, | ) | |
| v. | ) | No. 77-952 |
| ROYAL DRUG COMPANY, INC., DOING BUSINESS AS ROYAL PHARMACY OF CASTLE HILLS AND DISCO PRESCRIPTION PHARMACY, ET AL., | ) | |
| Respondents. | ) | |

Washington, D. C.
October 11, 1978

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GROUP LIFE AND HEALTH INSURANCE COMPANY, ALSO KNOWN AS BLUE SHIELD OF TEXAS, ET AL.,

Petitioners

v. : No. 77-952

ROYAL DRUG COMPANY, INC., DOING BUSINESS AS ROYAL PHARMACY OF CASTLE HILLS AND DISCO PRESCRIPTION PHARMACY, ET AL.,

Respondents

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Washington, D. C.

Wednesday, October 11, 1978

The above-entitled matter came on for argument at 11:10 o'clock a.m.

BEFORE:

WARREN E. BURGER, Chief Justice of the Supreme Court
WILLIAM J. BRENNAN, JR., Associate Justice
POTTER STEWART, Associate Justice
THURGOOD MARSHALL, Associate Justice
BYRON R. WHITE, Associate Justice
HARRY A. BLACKMUN, Associate Justice
LEWIS F. POWELL, JR., Associate Justice
WILLIAM H. REHNQUIST, Associate Justice
JOHN PAUL STEVENS, Associate Justice

APPEARANCES:

KEITH E. KAISER, ESQ., Cox, Smith, Smith, Hale and Guenther Incorporated, 500 National Bank of Commerce Building, San Antonio, Texas 78205; on behalf of the Petitioners

APPEARANCES:

JOEL H. PULLEN, ESQ., Tinsman and Houser, Inc., 1900 National Bank of Commerce Building, San Antonio, Texas 78205; on behalf of the Respondents

RICHARD A. ALLEN, ESQ., Assistant to the Solicitor General, Department of Justice, Washington, D. C. 20530; amicus curiae

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# C O N T E N T S



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P R O C E E D I N G S

MR. CHIEF JUSTICE BURGER: We will hear arguments next in 77-952, Group Life and Health Insurance Company, etc., et al., versus Royal Drug Company, et al.

Mr. Kaiser, you may proceed whenever you are ready.

ORAL ARGUMENT OF KEITHER E. KAISER, ESQ.

ON BEHALF OF THE PETITIONERS

MR. KAISER: Mr. Chief Justice and may it please the court:

I represent Group Life and Health Insurance Company also known as Blue Shield of Texas. This case involves the construction of the exemption to the Antitrust Laws established under the McCarran-Ferguson Act.

There is only one issue before the Court in this case, and that issue is whether the statutory term, "business of insurance", as contained in the McCarran-Ferguson Act includes the contract between an insurer and a health care provider to furnish benefits owed to the policyholders under the insurer's health care service benefit policies. We talk only about one issue.

Blue Shield's health care service benefit policies, and in particular the prescription drug pharmacy policy which we talk about today, are a tripartite service benefit agreement. The tripartite service benefit agreement is composed of a policy between an insurer and an insured obligating the insurer to

furnish benefits to the insured in the form of goods and services as opposed to cash reimbursement.

A second feature of the tripartite service benefit agreement is that it expressly obligates the insurer to enter into a provider agreement, in this instance, Your Honors, a Pharmacy Agreement, to provide the goods and services which are the risk underwritten or the risk assumed in the policy.

QUESTION: I want to be sure I understood you, Mr. Kaiser. You began by saying it is a tripartite situation. And did you say that the contract between your client, Blue Cross, and --

MR. KAISER: Blue Shield, Your Honor.

QUESTION: Blue Shield and the insured expressly provides that Blue Shield shall enter into a contract with the suppliers?

MR. KAISER: It expressly provides that the benefits will be provided to the insured through a participating provider and it obligates the insurer to enter into participating agreements with providers.

QUESTION: In other words, it would be inconsistent with the insurance contract if Blue Shield itself were to go into the business of being a pharmacist and itself provided the in-kind --

MR. KAISER: With this policy, it certainly would, Your Honor.

This policy only provides that Blue Shield will contract with the provider to provides goods and services or needed goods and services in the form of prescription drugs.

QUESTION: And Blue Shield could not have its own drugstores under this insurance policy?

MR. KAISER: No, sir, not under this policy.

QUESTION: Mr. Kaiser, what is the business reason either from the point of the view of the insured or the insurer for requiring in the policy between those two that Blue Shield enter into an agreement with providers?

MR. KAISER: Your Honor, that involves a little bit of history. The business reason in this particular instance was that the insureds and the beneficiaries insisted on that type of policy.

The insureds under the policy that we are -- or under the forerunners of our policy were the domestic automobile manufacturers. During a rather prolonged strike in 1967, one of the major issues between the unions and the manufacturers was additional fringe benefits, specifically health insurance benefits.

Out of that collective bargaining agreement between the unions and the domestic automobile manufacturers arose an agreement that the domestic automobile manufacturers would in fact provide health insurance benefits in the form of full coverage service benefit provider agreements.

Our tripartite agreement here is the end result of that collective bargaining agreement. Now we are not saying that we are connected with the unions or the auto manufacturers. We are saying though, Your Honor, that the insureds and their beneficiaries -- the insureds being the automobile manufacturers and the beneficiaries being their employees and the employees' families -- insisted on this type of arrangement.

QUESTION: Why did they insist on it?

MR. KAISER: They wanted full benefits coverage, Your Honor.

QUESTION: But could they not get that sort of coverage and leave it up to the insurer to decide how he was going to go about procuring the benefits?

MR. KAISER: That could have been done, Your Honor. However, it was insisted that provider agreements be included in this type of policy. This entire tripartite agreement was not conceived or instigated by Blue Shield. It was conceived and instigated by the insureds and beneficiaries from the very beginning.

QUESTION: In other words, the reason that the insurance contract contains the provisions that it does is largely a historic reason. It is not essential that the contract be that way, I mean if you were doing it now from scratch, but there are historic reasons why the contract is as it is?

MR. KAISER: The essential provisions in the policy

dealing with benefits and coverage were all insisted and, in fact, demanded by the insureds and the beneficiaries.

QUESTION: As a matter of historic fact.

MR. KAISER: Yes, sir.

QUESTION: Would it be fair to say in broader terms than you have cast it that this was a response to the demand of consumers?

MR. KAISER: No doubt about it, Your Honor.

QUESTION: It would not just be limited to the automobile people?

MR. KAISER: No, sir, and it has not been limited to the automobile people. In fact, tripartite service benefit arrangements, not only by Blue Shield, but by many other insurance companies throughout the country are in effect operating today. They are in widespread use.

QUESTION: But there is no real reason why this be tripartite, is there? No reason and rationality? Normally, when the insurance benefits are in terms of money, it is just a bipartite agreement, a bilateral agreement.

MR. KAISER: Yes, sir.

QUESTION: The beneficiary receives money directly from the insurance company. There is no reason why it should not receive benefits in kind directly from the insurance company -- directly or through a subsidiary, is there?

MR. KAISER: There is really no distinction -- no

practical distinction to be drawn here with the way benefits are provided under our policy and the way benefits may be provided under another traditional form of insurance.

QUESTION: This is not inexorably a tripartite situation? The logic does not inexorably require that it be a tripartite agreement?

MR. KAISER: I might add, Your Honor, that tripartite service benefits agreements are a distinctive feature of the health insurance industry. That is for a number of reasons:

One, the insured or the policyholder wants full coverage. He does not want to worry about being reimbursed later. When he is ill or a member of his family are ill, they want --

QUESTION: Well, he wants full coverage and he wants money too. When he has liability or accident insurance, he wants full coverage.

MR. KAISER: That's right.

QUESTION: But that is not necessarily tripartite. He just gets the money from the insurance company.

MR. KAISER: There is another distinctive feature of this particular type of arrangement and that is that under a full coverage -- and when I say full coverage, Your Honor, I am talking about no matter what it takes to make this person well, the insurance company will furnish those goods and services.

QUESTION: It is not a full coverage, is it? There is a $2.00 deductible.

MR. KAISER: There is a $2.00 deductible here with each prescription.

QUESTION: So that is not full coverage then, is it?

MR. KAISER: No, Your Honor.

Over and above the $2.00 deductible, there is full coverage.

QUESTION: Well, how is this any different than the old-fashioned automobile policy or liability policy in which the insurance company agrees to provide the defense the the insured gets sued, and the company then hires lawyers to represent the policyholder and provides, in effect, the benefit in kind through the services of the lawyer and, therefore, enters into agreements with the lawyers to work at such and such a rate and be available and so forth. Is that not just like this?

MR. KAISER: Your Honor, I cannot agree that the health insurance industry is anything at all like the casualty insurance industry because of the very peculiar nature.

QUESTION: I am talking about the contractual arrangement between the liability insurance carrier and the lawyer who defends cases from time to time for the benefit of the policyholder. Why is that any different or is it any different

from agreements between the health insurance carrier and the drug company that will provide drugs?

MR. KAISER: Inasmuch as you are talking about that being a part of the benefits and coverage of the policy --

QUESTION: Correct.

MR. KAISER: -- there is really no difference.

QUESTION: So if you are correct and you may well be that this is the business of insurance, then lawyers when they represent insureds under liability policies are equally engaged in the business of insurance?

MR. KAISER: No, Your Honor, I do not think so. I cannot say that because for a very simple reason. We say that there is a bright line standard to be drawn here and what is included in the business of insurance in the context of our case -- and we are talking about a provider agreement -- does not encompass everything that an insurance company can do.

It does not encompass every contract that an insurance could enter into.

QUESTION: But it might well encompass a provider agreement when the agreement involves the probation of legal services to somebody who is sued as a result of an automobile accident. I do not see why you would run away from that. That helps you; it does not hurt you.

MR. KAISER: Your Honor, I am not arguing the court, but --

QUESTION: I would not if I were you. You can argue all you want, but not on this basis because that is in your favor.

You cannot distinguish between the variance in the case Justice Stevens posed was services; here it is goods.

MR. KAISER: Goods and services, Your Honor.

QUESTION: And unless someone can distinguish between those two variances from the normal concept of insurance, that is very strongly in your favor.

MR. KAISER: No. I think that that is the normal concept of insurance as understood. I just do not want the Court to think that I am coming in here arguing for the automobile casualty insurance industry when I am not.

We believe that the health insurance industry is somewhat different.

QUESTION: Well, I happen to disagree with my brother Stewart's comment that your answer to Justice Stevens' question helps you rather than hurts you. And I do not see the bright line that you are talking about between an agreement on the part of a casualty insurance company with a law firm to defend its policyholders in lawsuits which -- in which they are sued, and an agreement with drugstores or pharmaceutical houses to provide drugs where the casualty insured against is in need of drugs.

MR. KAISER: Your Honor, we think that the proper line

is that an agreement -- a third party agreement which relates directly to the provision of benefits, those benefits which are underwritten in the policy, and anything in that agreement which directly relates to the cost of those benefits to be delivered and which are underwritten in the policy would constitute a part of the business of insurance for McCarran-Ferguson, for instance.

QUESTION: But Justice Stevens' question meets every one of the criteria you just set forth; the covenant on the part of casualty insured to defend the insured if he is sued as a result of an accident.

If I am wrong in thinking so, tell me why I am wrong.

MR. KAISER: Your Honor, there is no service benefit policy there. I mean, there is no tripartite agreement there. There is no tripartite agreement that has been established by the insured.

QUESTION: So if the insured simply went ahead and as a part of the policy with the -- if the insurer went ahead and as a part of the policy with the insured said, "We are also going to draw up an agreement with the law firm to provide services to you" and that is part of this policy, then the two would be the same?

MR. KAISER: Your Honor, I think we are getting very close to prepaid legal services in many states, which have been

proposed to be operated in just that fashion.

QUESTION: Is it not true that some firms, some policies with insurance besides replacing the casualty loss, fire or whatever, also provide a fixed amount for the loss of profits during the period when the building or the plant or the factory is being rehabilitated, and you certainly would not say that that takes it out of the business of insurance because it goes that far, would you?

MR. KAISER: Without knowing the full terms of the policy and the requirements of the insurer -- the contractual obligations of the insurer, I am not really sure that I can comment on that.

The Pharmacy Agreement in this particular instance though is the integral and indispensable part of the tripartite agreement. Without it, neither the policy -- the policy is not effective and without the policy then the Pharmacy Agreement is not effective.

QUESTION: I would like to go back because I am not at all clear in light of the way you started out your argument. You emphasized the fact that historically this arrangement was a result of collective bargaining and you seem to think that that was important to your case.

As I understood the briefs that have been filed in this case, the arrangement is supposed to be beneficial to the consumer and also to Blue Shield, your client -- financially

beneficial in terms of lower rates to the consumer, the public, the insured. Am I correct in understanding that is your position?

MR. KAISER: Your Honor, first of all, let me -- maybe I misunderstood you, but we are not hinging our case upon the fact that this arose out of a collective bargaining agreement.

The essential fact there though is that this type of policy was demanded by the insureds and the beneficiaries. That is how we got into --

QUESTION: Demanded because it offered this coverage at lower rates?

MR. KAISER: Precisely, Your Honor.

QUESTION: Well, I hadn't heard you say that.

MR. KAISER: It offers full coverage and at lower rates and it guarantees the provision of benefits.

QUESTION: And it in a sense protects, I understood from your argument and your brief, the Blue Shield Company and similar insurers from the hazard of perhaps higher charges by pharmaceutical retail outlets around the state.

MR. KAISER: One of the principal policies behind the enactment of the McCarran-Ferguson Act was that insurance companies be able to maintain themselves, manage their own business subject to regulation by the states, and that they be able to, in managing their business, more fully assess their risks and provide solvency for their policyholders.

This provides the reliability that an insurance company must have. That is one of the reasons for the Pharmacy Agreement because it does in fact assist Blue Shield in controlling the cost of the risk that it has assumed. It controls the magnitude of the risk so to speak.

And in such a situation as here, where we have a full benefits coverage policy open-ended, there is no limit to this policy.

QUESTION: For all of these reasons I would have thought Blue Shield would have wanted this without regard to any pressure from the labor unions.

MR. KAISER: I am sorry, Your Honor, I did not understand.

QUESTION: I said for all of these economic reasons I would have thought Blue Shield, as a business operation serving the public, would have wanted this sort of contract without regard to any pressure from a labor union.

MR. KAISER: Your Honor, these tripartite benefit arrangement policies have been in effect since the early 1930s. They were an outgrowth of the depression when people could not get adequate health care service at a reasonable cost.

It initially started out with a three-party arrangement between the insurer and hospitals and the insured. By 1940 these three-party arrangements had increased to where they had 4 million subscribers across the United States.

This is not something new. Subsequent to that, insurers began to enter into three-party arrangements for the precise reasons that we have for -- with physicians to provide physician services to the insureds.

In 1944 during the Joint Senate/House debates on the passage of the McCarran-Ferguson exemption, Attorney General Biddle made an express comment referring to the tripartite nature of these service benefit policies. And in his comment he said that the insurance -- or the policy that they were talking about -- the arrangements that they were talking about during the discussions fits but one word and that perfectly. He said that word is the "business" or is "insurance".

Attorney General Biddle was referring there to a company called Group Health who had physicians on its staff and it agreed with its policyholders to provide hospital services.

So this is nothing new, Your Honor, just as you said, but the pharmacy arrangement portion of it is relatively new. It became effective in 1969. Tripartite arrangements though have been around since the early 1930s.

Your Honor, as we believe that under the plain meaning of the statute, the statutory construction in this court's two prior decisions, that clearly Pharmacy Agreements come within the business of insurance.

QUESTION: Does last term's St. Paul case, have any

bearing on this?

MR. KAISER: Your Honor, the St. Paul versus Barry case dealt with the 3(b) portion of the statute, the boycott exception.

QUESTION: So it really does not have any bearing, does it -- any direct bearing?

MR. KAISER: It has no direct bearing, but it has some bearing that I think is very beneficial and that this Court said in St. Paul versus Barry that there is no indication in the legislative history of the Act that Congress intended to define the business of insurance in a manner inconsistent with its ordinary meaning or customary understanding, that being the state of the industry at the time of the Act's passage.

And as I just related, the state of the industry at the time of the Act's passage. And as I just related, the state of the industry at the time of the Act's passage was that tripartite health service benefit arrangements were flourishing. They were well known to the public; they were known to Congress and in fact brought to Congress' attention by Attorney General Biddle.

With respect to the meaning of the statute, we see some very broad words: "business of insurance" and "every person engaged therein". There is no indication in the statute that Congress intended to limit the meaning of the term "business of insurance" even though during the Senate/House

debates in the Subcommittee meeting there were numerous suggestions that the McCarran-Ferguson Act be limited severely.

QUESTION: I have a question about the words "every person engaged therein". Is it your position that those words grant an exemption to the pharmacies?

MR. KAISER: No, Your Honor, we are not saying that the pharmacies are exempt. It is our position that the Pharmacy Agreement constitutes a part of the business of insurance and is exempt; therefore, both signatories to that agreement must be exempt or we eviscerate the purpose of the Act.

QUESTION: Does that mean that if the pharmacies hold a trade association or similar meeting and say we would like to increase by 15 percent the price of drugs on our schedule under these Blue Shield policies, that that meeting would be exempt and they implement it by then going around to the insurance companies and say we want 15 percent more and you renegotiate the agreement with the group as a whole and come out with a higher drug price. Is that exempt or is it not?

MR. KAISER: As I understand your question, if there was collaboration among the pharmacies and then they went --

QUESTION: If there are persons engaged in the business of insurance is my question. You are saying they are not persons engaged in the business of insurance though.

MR. KAISER: We are saying that the Pharmacy Agreement

constitutes the business of insurance and in order to effectuate the purpose of the Act, both signatories to the Agreement must be exempt.

QUESTION: Well then, are the signatories exempt insofar as they collaborate with one another in determining how to negotiate with Blue Shield about the price schedule?

MR. KAISER: Your Honor, it would be our position that if the signatories collaborated among themselves, went to the insurer and said we want a 25 percent increase in the dispensing fee which you are prepared to offer --

QUESTION: Not the dispensing fee. I am not talking about the dispensing fee. I am talking about the drug price. You have a price schedule, I take it, with --

MR. KAISER: No, Your Honor. There is a formula -- a reimbursement formula for the pharmacist. The pharmacist receives $2.00 from the insured. We pay him a dispensing fee, plus the acquisition cost of the drug. That is the formula on which he is reimbursed.

However, back to your question, Your Honor, if the pharmacist went to Blue Shield and said we want to readjust the formula and we want more money, and if that was ultimately agreed upon and incorporated into the Pharmacy Agreement, which is a part of the business of insurance and therefore exempt, we do not believe that that would be an actionable collaboration between the pharmacists.

QUESTION: What about the action of the pharmacy trade association that Justice Stevens' postulated? Their own action, independent of whatever success -- whatever agreements they had with the insurance company?

MR. KAISER: Your Honor, we believe that if --

QUESTION: You do not mean that their action in agreeing to fixed prices would be completely immuned when you are just talking about all the drug companies?

MR. KAISER: I am not really sure that I understand your question now.

QUESTION: Well, you postulated that a group of the drug suppliers got together and entered into what amounted, I took it, to be a price fixing agreement. Now if it stopped right there, is not that a violation?

MR. KAISER: If it stopped right there before they got to Blue Cross, it probably would, Your Honor -- I mean, Blue Shield. I'm sorry.

QUESTION: Blue Shield is not a part of that consortium at that stage. Now Blue Shield might conceivably have to yield to it ultimately, but they are not part of any agreement.

MR. KAISER: Well, Your Honor, most times these prices or the established reimbursement formula would be established in a competitive atmosphere.

If the pharmacists want to charge more money than Blue

Shield can afford to pay in order to issue its policies at a reasonable level, well then there may be some negotiation. And it will come down to what each party can afford to pay or accept, but the reimbursement formula or reimbursement fee would therefore be established in a competitive atmosphere and if incorporated into the Pharmacy Agreement which is a part of the business of insurance, then --

QUESTION: But Blue Shield itself might be a victim of that price fixing agreement, if they could not buy anywhere else, but suppose that it was so pervasive that it covered the whole realm of suppliers?

MR. KAISER: Well, Your Honor, I guess that that is always a possibility to do that.

QUESTION: You would have an antitrust violation then, would you not, conceivably?

MR. KAISER: Quite possibly you would, Your Honor. I might mention -- and I apologize for not doing it -- those are not the facts of our case. And in fact the facts of our case are quite to the contrary.

In our case it is undisputed and uncontroverted that there was no collaboration, no conspiracy among the pharmacy defendants who are involved. It was a take it or leave it offer offered by Blue Shield. They accepted unilaterally; we entered into a bilateral contract.

In fact, the government agrees that that does not

constitute a violation of the antitrust laws, but that is really beside the point when we are talking about an exemption. We do not need to get to the merits of --

QUESTION: No. The reason it is beside the point is because the exemption, if it applies, would cover the conduct even you did have an antitrust violation. So we really have to consider whether or not the exemption covers the illegal conduct as well as the conduct which does not appear to be illegal in this --

MR. KAISER: That is what I understand.

QUESTION: And you mentioned it would be set in a competitive atmosphere, but you are talking about competition between Blue Shield and the drug companies, rather than competition among the drug companies.

And here, I gather, some drug companies accepted your offer and others turned it down. So that some think that maybe if they could agree on a higher price that they might have come into the program.

MR. KAISER: I think that is right, Your Honor. But as the government said in its brief that the antitrust laws are -- or the purpose of the antitrust laws are to protect competition and not competitors. We have some that felt that they could accept what was offered by Blue Shield and we have some that felt they could not. Therefore, they did not enter into the Pharmacy Agreement.

QUESTION: And the purpose of the exemption is to protect the competitors even though there is no competition at all, even if there is collaboration.

And your point, as I understand it, is -- and I think you were forthright on it -- that even if the drug companies all -- the whole market -- got together and agreed to try and change the economic arrangements so that they get 15 percent more out of these sales than they do now that that would be exempt, and if Blue Shield ultimately signed up with them, then it would be exempt.

MR. KAISER: Yes, sir. If it was incorporated in the Pharmacy Agreement, it is our position that, the Pharmacy Agreement constituting a part of the business of insurance, that would be exempt.

QUESTION: So Blue Shield would in effect have the power to grant the exemption if it were ultimately approved by the --

MR. KAISER: Well, no, Your Honor. We are talking about an exemption which -- we are talking about the term "business of insurance".

QUESTION: But it becomes a "business of insurance" as soon as Blue Shield signs the contract.

MR. KAISER: Your Honor, the Pharmacy Agreement --

QUESTION: I am talking about if they raise the price by the drug companies which ultimately Blue Shield could take or

leave, but ultimately if it takes it -- if I understand your position -- as soon as the insurance company signs up, then that has the effect of conferring exemption on what would otherwise have been an illegal price fixing conspiracy. That is your position. It is a perfectly legitimate position, but I am just trying to make sure I understand it.

MR. KAISER: Well, I do not like the way it sounds.

QUESTION: Well, you are asking for an exemption from the antitrust laws. If there is true or free competition, you do not need an exemption. You do not have to come in and ask for an exemption if you are just talking about having nobody reliable for competing with one another. You do not need an exemption on that hypothesis.

You just need it when you have conduct which would otherwise violate the statute. Otherwise, there is no point in this litigation.

MR. KAISER: That is really --

QUESTION: Mr. Kaiser, suppose you have five drug manufacturers who deliberately conspire in violation of every antitrust principle in the world to run up the price of a lease law, and that is put in, the insurance contract is protected?

MR. KAISER: Would we claim that to be the "business of insurance"? Is that your question, Your Honor?

QUESTION: Would that be protected?

MR. KAISER: No, Your Honor.

It is our position that the "business of insurance" with respect to a provider agreement encompasses only those provisions which directly relate to the delivery of the goods and services underwritten in the contract and only those provisions which directly relate to the cost of those goods and services delivered to the insured.

As I said earlier, an insurance company might put a number of non-cost related items into any of its contracts, whether they were --

QUESTION: Well, I am talking about drugs.

MR. KAISER: No, sir, I think that would be too far removed. If you took the manufacturer --

QUESTION: They deliberately got together and jacked up the price of one drug, five companies, in deliberate violation of the antitrust laws, and the insurance company took that price.

MR. KAISER: Your Honor, I am not sure I am totally understanding -- are you talking about a manufacturer or a pharmacist?

QUESTION: I said manufacturer.

MR. KAISER: Manufacturer; Your Honor, I think a manufacturer would be too far removed to come within the scope of the exemption of the "business of insurance" under the situation that we have here.

QUESTION: Mr. Kaiser, your time may be running a bit

short. I am interested in knowing precisely what the Insurance Commission of Texas did with respect to these agreements. I understood that initially it exempted them from approval, but thereafter regarded the agreement as subject to all other laws applicable to the insurance business in Texas.

MR. KAISER: Your Honor, initially the State Board of Insurance in Texas absolutely disapproved the issuance and the use of the policy.

Then it issued an order to prevent a competitive disadvantage with a foreign insurance carrier who was carrying on the same business in Texas, and permitted -- authorized Blue Shield to issue and use this policy in the State of Texas, specifically referring to the Pharmacy Agreement, and the fact that Blue Shield would enter into participating providers to provide dispensed drugs to the policyholders under the terms of the contract.

Later on in 1974, another policy form was submitted to the State Board of Insurance identical in content to the one that was submitted in 1969, and the State Board unequivocally approved that policy for issuance and use in the State.

Now with respect to your question -- or the inference of exemption, Your Honor, from the Texas antitrust law there is a provision in the approval statutes of Texas and we do require that all new policy forms be filed for approval prior to issuance or use.

But if the Commissioner of Insurance determines that a policy should be -- for reasons that are totally discretionary with him and within his regulatory capacity, if the Commissioner determines that a policy may be issued or should be issued and used within the State, then he may exempt that policy only from the approval requirement, a very limited exemption.

Thereafter, the policy is subject to all of the regulatory authority, all of the regulatory statutes and other provisions within the State of Texas. So there was no exemption from regulation.

QUESTION: Well, I understood you to say initially that the policy had been approved, and now you say that it was exempted, and I so understood the opinion of the Court of Appeals to say -- and I have it before me -- that in September 1969 the Texas Commission of Insurance issued another written order exempting the policy from the approval requirement of the Texas Code.

MR. KAISER: Yes, sir.

QUESTION: Is that correct?

MR. KAISER: Yes, sir, that is exactly correct. We are talking about two separate policies that were submitted to the State Board of Insurance.

QUESTION: Yes, but what is the current status? Is it approved or exempted?

MR. KAISER: We have one policy that is being issued

under an exemption order, and one policy that is being issued under a flat approval order by the Commissioner.

QUESTION: Which is the more recent?

MR. KAISER: The 1974 policy is the more recent and it is being issued under an approval order by the Commissioner.

QUESTION: An approval order?

MR. KAISER: Yes, sir.

QUESTION: And all other laws with respect to insurance remain applicable even with respect to an exempted policy, I understand, from what CA-5 said?

MR. KAISER: Yes, sir. The Deputy Commissioner of Insurance testified that with respect to -- there is no difference between an exempted policy and an approved policy as it applies to the State regulation. They are regulated in identically the same manner.

QUESTION: What does that regulation consist of so far as this type of insurance --

MR. KAISER: Your Honor, it consists of the traditional forms of prior approval policies. The traditional forms of supervisory regulations such as continuous financial filings, regulation of the internal organization of the company, but more importantly in Texas, we have an Unfair Trade Practices Act which is very broad and prohibits virtually every type of unfair trade practice that is imaginable. It is a part of our insurance code.

In addition, the Texas antitrust laws are specifically made applicable to the business of insurance. With the Court's permission, I would like to reserve the remainder of my time for rebuttal.

MR. CHIEF JUSTICE BURGER: Very well, Mr. Kaiser.

Mr. Pullen?

ORAL ARGUMENT OF JOEL H. PULLEN, ESQ.

ON BEHALF OF THE RESPONDENTS

MR. PULLEN: Mr. Chief Justice and may it please the court:

First of all, I would like to set this case in the proper path. We do not here have a policy of insurance which in any way mentions the price fixing aspects about which we complain.

All the policy provides with respect to who is a participating pharmacist is that he is someone who has agreed to furnish covered drugs to Blue Shield's insured. There is nothing said about the agreement with the pharmacy beyond that language. And this is the policy that was exempted and this is the policy that was subsequently approved.

At nowhere in the process, however, was the Pharmacy Agreement considered or approved or anything done to it, other than the fact that it was mailed to Austin to the State Board of Insurance. They took it and they did not send it back. It is not marked filed; it is marked "for information purposes

only".

When we took depositions of the people at the State Board, I asked them specifically, "Do you claim any jurisdiction over pharmacies?" Their answer was no. I said, "Do you regulate this Pharmacy Agreement in any manner?" And they said no. And I said, "Why not?" And they said, "Because it is not part of the business of insurance in Texas."

So we have today presented to the Court a question which is basically not the situation that the McCarran Act was designed to reach.

QUESTION: Is that the testimony referred to on page 28 of your brief?

MR. PULLEN: I believe that it is, Your Honor.

QUESTION: Where does he say it is not part of insurance?

MR. PULLEN: I asked: "Question: So that the record will be clear, is it your understanding that the State Board of Insurance under the regulatory authority granted it under the Texas Insurance Code has authority to regulate contracts between a company such as Blue Shield and an independent Pharmacy?"

"Answer: My personal opinion is that this particular contract that you showed me" -- then I said, "You are talking about Deposition Exhibit 6, the Pharmacy Agreement?" He said "Right. Would be a contract between an entity and a provider

which would not be part of the original or full contract of insurance. The contract would be filed with us for informational purposes which would be part of a plan for operations, but when we get an entire plan of operations in, there are certain aspects of it that we file, such as the Pharmacy Agreement, certain aspects of it that we approve."

QUESTION: I am reading that, but why did the Commission report to approve a contract in 1974?

MR. PULLEN: I believe if you will look at the contract, Your Honor, we covered this in our brief. The contract again there refers to an agreement to supply covered drugs. It does not say anything about the price fixing agreement of what we are talking about here. We are talking about two things.

Texas law has no provision which provides for approval of the Pharmacy Agreement. It provides for approval of policy forms. And the policy form here which the State has permitted to be used does not include the price fixing aspect of the Pharmacy Agreement.

If all we had here was an agreement that was consistent with the policy, we would not be here because the issue would not have come up because all they would have asked the pharmacy, "Will you furnish covered drugs to our insured?" Well, obviously, they will.

What is bad about it is it goes beyond the policy terms. And they knew it. In fact --

QUESTION: What if the State had chosen to regulate this contrary to your contention? Would you say that you should lose your case?

MR. PULLEN: No, Your Honor. I still think that that would be a situation where this court could determine under the McCarran Act which is a Federal statute what for McCarran Act purposes under Federal law constitutes the "business of insurance".

QUESTION: But you say even if it constitutes the "business of insurance", if the State is not regulating it, then -- and who was this person that you had on the witness stand that you were asking these legal questions to?

MR. PULLEN: That was Mr. Pogue who was, I believe, the Assistant Manager of the Department of Policy Regulation.

QUESTION: Was he a lawyer?

MR. PULLEN: No, Your Honor, but he is the man who regulates the policy. He is the man who actually determines what policies are approved and which are disapproved.

QUESTION: Was that deposition or that testimony given prior to the 1974 approval of this policy?

MR. PULLEN: No, Your Honor. It was given after the approval.

QUESTION: How did he reconcile that action of the Commission if indeed the Commission did act that way with his testimony?

MR. PULLEN: Well, the Commission only approves policy forms. It does not approve or disapprove the Pharmacy Agreement.

QUESTION: But I understood that the policy called for this agreement that we are talking about here, this Pharmacy Agreement --

MR. PULLEN: No, Your Honor. Apparently, I did not make myself clear. The only agreement to which the policy form refers is an agreement with the pharmacy that it will furnish covered drugs. It says nothing about the price at which they will be furnished. And that is our argument.

QUESTION: It does say something about the price at which they will be furnished to the beneficiaries -- the drugs will be furnished to the beneficiaries.

MR. PULLEN: Yes, in other words -- but the only thing there, Your Honor, again nothing in the policy itself refers to a price fixing agreement. It refers --

QUESTION: It does not say anything about the cost to the insurance company.

MR. PULLEN: That is correct.

QUESTION: Which in terms of the seller is the price to the insurance company.

The policyholders are simply in the open market. They want drugs and pay the first $2.00, as I understand it, on each prescription. Then whatever the price was, they pay the

differential.

MR. PULLEN: No, Your Honor. And that is an important part of this case. The policy provides that if an insured patronizes a participating pharmacist, which is defined as someone who has agreed to furnish covered drugs, the policyholder pays the deductible and Blue Shield pays the rest.

Now, that is not how it operates in practice. But, first of all, to stay on your question, Your Honor, if he goes to a non-participating pharmacist who is defined as someone who has not agreed to furnish covered drugs -- that is the only test; price is not the thing -- then the policyholder still pays his $2.00 but it is done in a different manner. He pays the cost to the pharmacist. He then sends his claim to Blue Shield. Blue Shield then deducts the $2.00 deductible, but penalizes the pharmacy, and only reimburses him 75 percent of a reasonable charge as determined by Blue Shield.

QUESTION: You say it penalizes the pharmacy?

MR. PULLEN: Yes, sir. Well, it penalizes the insured who in turn learned very quickly that he had better go to a Blue Shield pharmacy who signed this agreement.

I think it is extremely significant in this case that in 1975 when we took the depositions in October, over 98 percent of the 31,000 claims a month which were filled in Texas under this type of coverage went to participating pharmacists.

And I think the significance of that is it shows the

coercive effect; it certainly shows a boycott. And I think the question that was raised earlier:Does the boycott exception have anything to do with this case? I think it does very strongly because what this Court --

QUESTION: How does it show a boycott? I do not understand that.

MR. PULLEN: Because, Your Honor, the effect of the policy is to allocate the business of Blue Shield's insureds to those pharmacies who have agreed to fix prices with Blue Shields.

QUESTION: Who agreed to accept the price Blue Shield is willing to pay is what you are saying, which has to be a lower price than the others want for their drugs. I do not understand that to be a boycott.

Anybody can get in that participation, can they not?

MR. PULLEN: Yes, Your Honor, but that is not the problem. The problem is if you do not get in, if you try and have a free market transaction with your customer, Blue Shield then exerts this effort on his customer.

QUESTION: Well, we are talking now about the merits I suppose than about the "business of insurance"?

MR. PULLEN: Well, we are talking about the boycott provision of the exemption, Your Honor, which I say is a matter that this Court should consider.

QUESTION: Would a retail drugstore have an action

against the Bank of America because the Bankamericard kind of coerces people to go to drugstores that will accept the Bankamericard and even take five percent off their gross as a result of it?

MR. PULLEN: I am not familiar with how the Bankamericard works.

QUESTION: Well, any kind of a credit card is going to have a certain coercive effect.

MR. PULLEN: I think that is true, Your Honor. But let us look at this transaction -- and I think it will be very quickly demonstrated.

A pharmacist is in business to sell drugs and pharmaceuticals. A customers comes in; he has a prescription from his doctor that the pharmacist wants to fill and the customer wants filled. The pharmacist fills that prescription. He gives him the bill for his normal charge part. Blue Shield says that we have some particular interest in that transaction, even though it is a transaction in the ordinary course of the pharmacy business which occurs everyday.

They say you are dealing with our insured. And apparently their feeling is that they have some sort of vested interest in that insured, and that, therefore, they can determine at what price the pharmacy will sell the drug to his customer.

And I do not think the Court should be misled that this case and the Court's decision is going to be limited to

pharmacists. If this action is the "business of insurance", it is going to be the business of insurance or similar actions in every aspect of our society where insurance is written. Home fire insurance companies can have participating construction agreements; automobile --

QUESTION: Getting back to the drugs, what other interest does Blue Shield have other than to get for its customers the lowest priced drugs they can get?

MR. PULLEN: I do not know that that is their interest, Your Honor.

QUESTION: Well, give me what other interests they have.

MR. PULLEN: I think their interest basically is to increase the amount of money which they will retain out of the transaction.

QUESTION: And in the meantime they get drugs cheaper?

MR. PULLEN: That is questionable.

QUESTION: You just said so, sir. You said that when they go to another place and they charge more -- is not that what you said?

MR. PULLEN: I did use that, Your Honor, but --

QUESTION: Well, more means more, does it not?

MR. PULLEN: Yes, sir.

QUESTION: So the other place is cheaper, is it not?

MR. PULLEN: It may be as to a Blue Shield customer,

and the way it operates I would say, yes, it is cheaper.

QUESTION: It is cheaper?

MR. PULLEN: Yes, sir.

QUESTION: So the person who is buying the drugs -- or the person who is buying the insurance is getting cheaper drugs at a cheaper price. And that is a crime?

MR. PULLEN: No, Your Honor, I do not say that is a crime at all. What I say is that it takes the transaction out of the competitive process and it allows the insurance company, rather than the free market price, which this Court has been very eager to protect and rightfully so -- it takes that transaction out of the marketplace transaction.

Now, following along -- and this was the question that in my analysis of this case I became concerned about this -- I said: Is the insurance company -- let us reverse it. Are they debating, so to speak, a target for whatever the druggists want to charge? Well clearly not. They have a way to protect themselves and they can protect themselves within what has traditionally been recognized as the insurance relationship in their contract with their insured.

QUESTION: Is not there a factor of the predictability of prices that goes into the actuarial activities of the insurance company as volunteer?

MR. PULLEN: Yes, Your Honor.

QUESTION: They must know reasonably what the exposure

of risk amounts to?

MR. PULLEN: Yes, Your Honor. I agree with that.

QUESTION: If they are at the mercy of anyone who wants to charge a higher price, they cannot predict the prices, can they?

MR. PULLEN: No, they cannot predict the price, but they can by specifying in their contract what they are going to pay; predict their exposure on which their premium was based. And they could do it much better if they did it that way because in that manner they could also cover the cost of drugs.

We have cited statistics which show that drug costs -- and all we get from Blue Shield is our acquisition cost of the drug -- we have shown statistics that those costs have gone up 59 percent. Yet the pharmacists' total cost for furnishing service is only up 28 percent. If they were truly concerned with maximum control, they would regulate the drug cost.

QUESTION: But the participating druggists manage to accommodate themselves to the economics, do they not?

MR. PULLEN: That is the question, Your Honor. Many tell me they cannot continue to function and furnish competition and services.

QUESTION: Well, is there anything in the record here that would indicate that?

MR. PULLEN: In some of the deposition testimony of

some of the plaintiffs in my case, I believe you will find that, Your Honor, because there was inquiry about what is wrong with what you are getting and they say it is too low. There is also a letter in the record that says the price is too low.

QUESTION: On your approach to this thing, although it is obviously not involved in this case, if you carried it to its logical conclusion, you would undermine the whole cooperative movement in the United States, would you not?

MR. PULLEN: I do not think so, Your Honor.

QUESTION: Part of it is bargain for the lowest prices and limit the areas of their purchase, do they not?

MR. PULLEN: Yes, Your Honor, but I think here we are looking at something to determine not the cooperative movement, but the business of insurance.

QUESTION: Well, they have coupled the cooperative concept with the business of insurance here.

MR. CHIEF JUSTICE BURGER: We will resume here at 1:00 o'clock, counsel.

(Whereupon, a recess was taken.)

MR. CHIEF JUSTICE BURGER: Counsel, you may resume.

MR. PULLEN: Thank you, Your Honor.

QUESTION: Could I ask you if in the approvals or exemptions of the policy forms that you were speaking about in 1974 and was it in 1969?

MR. PULLEN: Yes, sir.

QUESTION: And were not the provider agreements attached to those forms?

MR. PULLEN: As I recall, Your Honor, they were submitted with one of them and I may be in error on this. I think with regard to the first exemption that the Pharmacy Agreement was submitted.

QUESTION: It was attached to the form, was it not?

MR. PULLEN: Yes, sir.

QUESTION: And how about in 1974?

MR. PULLEN: In 1974 I do not recall. I recall a letter in the record which --

QUESTION: Well, what if it was attached and the policy was approved?

MR. PULLEN: I would still say, Your Honor, that all that would be approved would be the policy because that is all the State has authority to approve specifically under the statute.

QUESTION: Was the deposition of Paul Connor introduced into evidence?

MR. PULLEN: Your Honor, this was on a motion to dismiss. The deposition was before the --

QUESTION: It is reported?

MR. PULLEN: Yes, sir.

QUESTION: And did not Mr. Connor testify that this provider agreement was part of insurance, subject to the

jurisdiction of the Commission?

MR. PULLEN: I do not think he did so too clearly and there is some debate about --

QUESTION: Perhaps we will have to decide that when we examine it again. But you do recognize that he was looking in a little bit different direction than Mr. Pogue?

MR. PULLEN: Yes, sir.

QUESTION: Now you suggest that they approved only the terms of the policy?

MR. PULLEN: Yes, sir.

QUESTION: But the Commission had before it exactly the interpretation of the insurer as to the scope of that policy and the meaning of the language of the policy, did they not?

MR. PULLEN: Your Honor, my reading of Mr. Pogue's testimony was that this came in; they did put it in the file, although they did not stamp it "filed", but it was just a matter which they received for informational purposes.

As I read his testimony it is -- even though I may read this and examine it, I have no jurisdiction over it. And that, I believe, is what he said as the record will reflect.

QUESTION: Well, is this a question which was ultimately decided by the Supreme Court of Texas?

MR. PULLEN: Was it ultimately decided --

QUESTION: Is this the kind of question that would

ultimately be decided by the Supreme Court of Texas, whether the Texas Insurance Commissioner has what you refer to as jurisdiction over this matter?

MR. PULLEN: It could be, Your Honor. I do not think for the purpose of this case it has to be because the statute is clear.

QUESTION: Well then, you are not relying on the deposition?

MR. PULLEN: No, I am relying on Mr. Pogue's deposition very much so.

QUESTION: Well, do you really think that is the way you establish what might be a fairly important question of State law to have conflicting depositions of two agency's subordinates as to what they think the State law provides?

MR. PULLEN: No, Your Honor. I think you have to look at the State statute. And when you look at the Texas State statute, when it talks about what will be filed, it is insurance policy forms. And this is the point I tried to make when I first opened my argument, that that is all the statute provides Texas has regulatory authority over. There is nothing in the Texas statute and there is nothing that has been cited to this Court that shows any authority of the State to approve the Pharmacy Agreement.

QUESTION: Then you do not need the depositions?

MR. PULLEN: No, sir. I think it helps considerably

because he is the man who is enforcing the Texas law and this is how it does operate.

I would point out to the Court in answer to Justice Marshall's question before lunch about whether prices would increase. The pharmacy dispensing fee of $2.00 was fixed in 1969. There were no studies at that time to determine whether that was adequate. There have been no studies since to determine whether it is adequate.

Our position is that we wish to compete; we wish to have our prices set subject to the competitive forces. They may increase if this agreement is held subject to the antitrust laws, our competition may keep them from increasing, but it would be the competitive factor in our society which would determine that.

I would like to also spend a little time talking about the type of policy we have here. Despite the terms that counsel for Blue Shield has used, it is purely and simply an indemnity type of policy.

Page 255a in the Appendix which is the Michigan contract, they say Blue Shield is not a party to this drug sale. The Walgreen contract in Texas which is at 203 of the Appendix says Blue Shield is the underwriter of insurance protection only.

On page 182a of the Appendix which is a form letter for Blue Shield it talks about how they will make payments. And

that basically is what we have here.

The compensation to the pharmacy is fixed at one level for all pharmacies. The net result of this -- and particularly since it stayed the same since 1969 except -- and this is not in the record -- I think it did go up to 2.25 after the Fifth Circuit's decision. It is our position that this eliminates competition in the retail sales of drugs and pharmaceuticals, not only price competition but service competition.

Our clients say that we cannot operate and compete fully. We cannot compete in the area of services; we cannot compete in the area of hours, and that this is also a significant factor. But it also shows in my opinion that the transaction in question is purely and simply a business transaction between a pharmacist and his customer.

Blue Shield goes further and says that customer happens to be an insured of ours. So, therefore, Mr. Pharmacist, we can tell you what to charge him and we can make it stick and they cannot, and they have.

They have entered into a conspiracy.

QUESTION: I am not sure what you mean. Are you talking about the participating pharmacy?

MR. PULLEN: Yes, sir.

QUESTION: Well, the participating pharmacy does not have to participate.

MR. PULLEN: No, Your Honor, but this is where the percentage comes in because what they do -- the way the program is set up with the non-participating pharmacist and the penalty that an insured suffers if he deals with the non-participating pharmacist, it teaches that insured very quickly that if he wants to get the maximum reimbursement he has to go where the price --

QUESTION: Now tell me specifically what is wrong with that in your view in antitrust terms?

MR. PULLEN: Your Honor, in my opinion, that is a price-fixing conspiracy and it is a boycott and it is a conspiracy to boycott and it has been very successful. The figures show -- Blue Shield's own figures show that 98 percent of their customer's business goes to the participating pharmacist.

QUESTION: It is price fixing to take your terms in the sense that the participating druggists agree to sell at a lower price?

MR. PULLEN: At one fixed price, Your Honor.

QUESTION: At a lower price or you would not be here, I assume?

MR. PULLEN: What I was trying to say again and apparently for the second time I have not articulated it very well is that the ultimate price which their customers will find acceptable will be a price fixed by competition. We could very

well be successful in this case and then find that our customers will not pay any more than the $2.00 and, in fact, they will pay less, but nevertheless it is the competition that is important under the Sherman Act, and that that is where the price fixing should be determined, not by this type of agreement.

We have here an agreement. It has not been approved by any one State regulatory authority. In Michigan Blue Shield is not an insurance company. In fact, in the Demlow case which we are citing in Michigan the Commissioner of Insurance who, while he had regulatory powers, it is not insurance regulatory power -- tried to regulate their rates to help them on hospital utilization. They have fought it all the way up to the Supreme Court of Michigan and they are still fighting it.

And they say to him that that is not your business; that is our business. That is not anything that you have regulatory authority over.

In Texas it is even clearer because the statute says what the State reviews and it does not list Pharmacy Agreements of this type.

QUESTION: Well, we are not at all concerned here with the merits of the antitrust claim, but merely whether or not the defendant is under the statutory exemption, and to be under the statutory exemptions the defendants have to be first in the business of insurance and, second, not regulated by State law, and third, we are interested in the merits to this

extent, whether or not you have alleged a boycott. And that is all.

MR. PULLEN: I understand that, Your Honor.

QUESTION: Could I ask you: Assuming you are right that these provider agreements are not regulated by the State, does not Section 2 of the McCarran-Ferguson Act say that the Sherman Act does apply to the extent the State does not regulate a certain phase of the insurance business?

MR. PULLEN: That is my understanding, Your Honor.

QUESTION: So that even if you might consider for purposes of the McCarran-Ferguson Act these provider agreements to be within the contemplation of the words "insurance business", the Sherman Act would nevertheless apply in Texas if Texas did not regulate those agreements?

MR. PULLEN: That would be certainly my understanding.

QUESTION: But it does not have to regulate them under its Insurance Commissioner. It can regulate them through its antitrust laws or any other way. But it does not purport to regulate them at all, I gather.

MR. PULLEN: Sir --

QUESTION: I wonder if Mr. Justice Stewart is right because Section B says it will supersede any law enacted by any state for the purpose of regulating the business of insurance. I do not think that language covers state antitrust laws, does it?

MR. PULLEN: I have had some question about it, Your Honor. In looking at the McCarran Act legislative history, the court in my opinion was talking about affirmative acts of state regulation because they talked about agreements which the public authority has approved.

On this point, Mr. Kaiser mentioned the Texas Article XXI of the Unfair Labor Practices, we have shown in our brief and cited a Texas case that that would not apply to us because we have no insurance policy. We are just selling to someone who has. And I do not think that that would apply to us.

Obviously, Blue Shield if they are going to be in court would rather be under the Texas Antitrust Act. And we do have one and there is no question about it, but it has not been one that has been used for damage suits, and it is considerably less severe in the recovery to a plaintiff.

I have some question about whether an antitrust statute, which would apply on an after the fact basis and perhaps never be invoked by a private plaintiff, is the type of regulation that the McCarran Act --

QUESTION: Well, the question is not whether it is applied after the fact. The question is whether it is a law enacted by the state for the purpose of regulating the "business of insurance".

MR. PULLEN: As compared to just regulation of

business in general.

QUESTION: Yes.

MR. PULLEN: Yes, sir.

QUESTION: Well, Section 2(b) has no such limiting language, and I thought that was the exemptive section that was in issue of this case.

MR. PULLEN: I have been quoting from Section 2(b).

To continue, Your Honor, the matter is not one-sided. If contracts for the sale of merchandise -- the people who have insurance coverage -- do broadly constitute the business of insurance, the situation may turn to a horrible type of thing. For example, if one of these contracts automatically is within the business of insurance and exempts any trust violations, could the pharmacist get together with the small insurance company, acquire control over it and then say to Blue Shield, "Well, we are sorry, gentlemen, we are dealing with this insurance company and we are not going to deal with you. And we do not have a boycott because there are other people and they may deal with you, but we are going to service only the customers of this other insurance company, and we are not going to give any service to your insureds and we are not going to reimburse our insureds for dealing with other people."

I believe my time has expired. Thank you.

MR. CHIEF JUSTICE BURGER: Very well, Mr. Pullen. Mr. Allen?

ORAL ARGUMENT OF RICHARD A. ALLEND, ESQ.

AMICUS CURIAE

MR. ALLEN: Mr. Chief Justice and may it please the court:

The issue in this case is whether Blue Shield's agreements with various pharmacies constitute the "business of insurance" within the meaning of Section 2(b) of the McCarran-Ferguson Act. The issue does not concern the merits of Respondents' antitrust allegations.

There has been no ruling on the merits of the antitrust issues and there have been no facts developed with respect to it, but I would stress -- simply stress at the outset the point that Mr. Justice Stevens made which was that the consequence of petitioner's position would be that even if the facts showed a conspiracy between a group of pharmacies to fix the price of prescription drugs and the use of a Pharmacy Agreement with an insurance company to implement that conspiracy, the consequence of petitioner's position would be that it would be the business of insurance and, therefore, exempt from antitrust laws.

But the issue presented --

QUESTION: Mr. Allen, I just want to be sure about this. I know I put that example forward. But is that true if the State of Texas has not specifically approved that particular arrangement?

In other words, does not the exemption only come into play as part of 2(b) which says no Act of Congress shall invalidate the State law for the purpose of regulating insurance, and unless you have State approval, you do not have the State law?

MR. ALLEN: Well, Mr. Justice Stevens, there are two portions of Section 2(b) which may be a source of some of your confusion, but under either portion if an activity is not the business of insurance, it makes no difference whether the state law regulates it or does not. Our position is that the Pharmacy Agreements are not the business of insurance.

QUESTION: Well, let me be sure that I get my confusion cleared up because I am confused. What part of 2(b) would grant an exemption if you had no state regulation? You just told me that there were two parts to 2(b), one of which was --

MR. ALLEN: Excuse me. No part to 2(b) would grant an exemption from the antitrust laws if there was no state regulation. Does that answer your question?

QUESTION: Right. So that then in my hypothetical there is no exception unless there is state regulation which authorized that particular arrangement?

MR. ALLEN: That is true, even if the activity is not the business of insurance.

QUESTION: State regulation does not have to authorize

it. It just has to be state regulation.

MR. ALLEN: That is correct.

QUESTION: It is the language to which my brother Stevens adverted in Section 2(b) -- at least as I understood as referring to non-preemption prior to June 30th, 1948, and the general exemptive language I thought was in the latter part of 2(b).

MR. ALLEN: That was my understanding.

QUESTION: After June 30, 1948.

MR. ALLEN: That is my understanding too.

QUESTION: Is it not true that all the state law would have to do is purport to regulate provider agreements? You would not have to have a specific action of the state authorities on a specific provider agreement.

MR. ALLEN: That is my understanding, Mr. Justice White.

QUESTION: And even if a provider agreement was in violation of state law, you would have to leave the policing up to the state authorities not to the antitrust laws.

MR. ALLEN: If the provider agreements were part of the business of insurance. But if they were not, of course --

QUESTION: Yes, I understand that.

MR. ALLEN: The issue presented by petitioner's motion to dismiss in the issue before this Court is simply whether the Pharmacy Agreements are part of the business of

insurance.

QUESTION: I hate to take up all your time on my confusion but I think it is important that I understand the statute. So I am going to ask you one more question.

What is the language in the McCarran Act which grants the exemption?

MR. ALLEN: Section 2(b).

QUESTION: Read me the words that you talk about.

MR. ALLEN: The pertinent portion, I think, is "provided that after June 30, 1948 the Act of July 1890, known as the Sherman Act and the Act known as the Clayton Act and the Act known as 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."

QUESTION: And does it anywhere say -- and you say by reverse implication?

MR. ALLEN: By reverse implication that would suggest that if it were regulated by state law, those particular acts would not apply.

The main provision of Section 2(b) provides "no Act of Congress shall" --

QUESTION: I understand that.

In other words, it is the reverse implication of the proviso is the sole source of the exemption?

MR. ALLEN: That is my understanding, although of

course under our position it would not make any difference because under our position it is not the business of insurance.

QUESTION: Well, the words "business of insurance" are found in that Section 2?

MR. ALLEN: That is correct.

QUESTION: All right. I am sorry to have taken your time.

MR. ALLEN: That is quite all right.

QUESTION: Well, I would suppose the first part of 2(b) would satisfy any state law that was in conflict with the antitrust law?

MR. ALLEN: The first part of 2(b) provides that no Act of Congress shall be construed to supersede, according to memory, any state law enacted for the purpose of regulating insurance.

QUESTION: That is right and including antitrust laws.

MR. ALLEN: Including the antitrust laws.

QUESTION: So this Act would not apply if it served to supersede a state law?

MR. ALLEN: That is correct.

QUESTION: So the first part of 2(b) would give insurance business exemption from the antitrust laws if --

MR. ALLEN: That is correct, Mr. Justice White. The first part of Section 2(b) would --

QUESTION: Well then, why do you say it is the latter part, only the latter part?

MR. ALLEN: Well, let me modify my position. It is not only the latter part. The latter part refers specifically to the Sherman Act upon which the petitioners relied for their antitrust complaint. The first part would include the Sherman Act.

QUESTION: And every other Federal law?

MR. ALLEN: That is correct.

QUESTION: It also includes the Robinson-Patman Act, the first part of 2(b), which is not referred to in the proviso.

MR. ALLEN: That is correct. But the first part would only limit the application of Federal law to the extent it happened to supersede a state law designed for the purpose of regulating the business of insurance, if I have made myself clear.

In any event, we contend that the Pharmacy Agreements are not part of the "business of insurance", and our argument may be summarized as follows:

The precise scope of the business of insurance exemption is not clearly delineated in the McCarran-Ferguson Act, and there may be areas of reasonable doubt; although this Court has frequently stated the principle that in areas of reasonable doubt antitrust exemptions are to be narrowly

construed and antitrust application to be favored.

QUESTION: That is implicit exemptions, is it not?

MR. ALLEN: No, Mr. Justice Rehnquist, this Court has applied that principle even in the case of expressed exemptions. The two cases, for example, that we cited in our brief, Abbott Laboratories and Federal Maritime Commission versus Seatrain were cases of express exemptions from the antitrust laws.

QUESTION: Do you think that one applies the principle of narrow construction equally to express exemptions as to implied exemptions?

MR. ALLEN: Yes, I do, Your Honor. When you are dealing with an express exemption such as the McCarran-Ferguson Act or the many other express exemptions, the principle applies to that exemption as to be narrowly construed.

In any event, what the legislative history of the McCarran Act does indicate, as this Court has held in SEC versus Variable Annuity Company and SEC versus National Securities is first that Congress' core concern with respect to the "business of insurance" was the underwriting risk and the relationships between insurance companies and policyholders that concern the underwriting of risk.

And the second thing the legislative history indicates is that Congress did not intend to exempt everything an insurance company does.

Those two facts support our contention that the Pharmacy Agreements are not the business of insurance. First, the Pharmacy Agreements are not the underwriting of risk. They are simply contracts for the purchase drugs and drug distribution services by Blue Shield.

QUESTION: What is your response to what was suggested this morning on the universal practice of public liability insurance, insuring not only against the risk of the ultimate judgment against the policyholder but the cost of litigation?

MR. ALLEN: My response is that that example is a good illustration of our point. We think it would be absurd to contend that an agreement between an insurance company and a law firm concerning the supplying of legal services to the insurance company is the "business of insurance" in any ordinary sense.

QUESTION: How about if it is in the policy itself?

MR. ALLEN: Even if it is in the policy itself, it is simply common ordinary understanding to say that an agreement between an insurance company and a law firm -- how much they are going to pay per hour is the "business of insurance".

QUESTION: Is it not also true that medicine is part of health?

MR. ALLEN: That is true too, Your Honor, and our argument would follow.

QUESTION: Well, is the paying of the doctor's bill

insurance?

MR. ALLEN: The paying of the claims to the insurer -- to the policyholder is the "business of insurance". An agreement between the insurance company and somebody who provides services is we contend not the "business of insurance".

QUESTION: Including the doctors?

MR. ALLEN: Including the doctors. There is no difference between pharmacies and doctors.

QUESTION: Then under the Group Health plan it would not be covered. It would not be insurance, would it, because they pay the doctors.

MR. ALLEN: I am not certain I understand your point, Mr. Justice Marshall.

QUESTION: They pay the doctors. The Group Health hires the doctors.

MR. ALLEN: That is true.

QUESTION: So that would not be insurance then, would it?

MR. ALLEN: The hiring of the doctors would not be the "business of insurance".

QUESTION: It would not be covered by this?

MR. ALLEN: It would not be part of the "business of insurance". It may be perfectly lawful. There is no reason to suppose it is not lawful, but it would not be part of the "business of insurance".

QUESTION: What if, forgetting any problems of legal ethics -- what if an insurance company just had a stable of lawyers, its employees that it furnished under its insurance contracts to beneficiaries who were sued for liability, would those contracts with the lawyers be the "business of insurance"?

MR. ALLEN: I think not, Mr. Justice Stewart. It is hard to see how those contracts would violate the antitrust laws, but the relationship between -- although the question is not so clear.

QUESTION: If not clear, then why is it clear if the insurance company does the same thing with independent contractors that it all of a sudden becomes very clear?

MR. ALLEN: Well, there seems to me a basis for distinction between one's dealings with one's own employees and one's dealing --

QUESTION: In this case the insurer is furnishing the services and what difference is it, so far as this exemption goes, whether it does so through its employees or through independent contractors?

MR. ALLEN: As I say, my first response would be that I do not think labor relation agreements between an insurance company and doctors --

QUESTION: These are not labor relation agreements, but they are employment contracts. There is no point in giving them a fancy name.

MR. ALLEN: Between an insurance company and its doctors my first reaction was I do not think that would be the "business of insurance", although I think the question there would be closer because I think there is a basis for distinction.

But the point we wish to emphasize is that at some point we have to draw the line. Insurance companies have myriad relationships with third parties, what you would call independent contractors, to furnish the insurance company with goods and services. They contract with printers; they contract with lawyers; they contract with building owners.

There is no suggestion in the legislative history the Act of Congress intended all of those kinds of relationships to be "business of insurance".

QUESTION: You do not seriously contend that the promise to defend a person in the case of an accident is not insurance?

MR. ALLEN: No. The promise is insurance.

QUESTION: I would not think that you would think that if there has been an accident and the company is called upon to furnish the legal services that were promised, you would not think furnishing the legal services was not insurance?

MR. ALLEN: No, I agree that that would be insurance.

QUESTION: And if they are going to furnish the legal services, they are going to have to pay for them?

MR. ALLEN: That is correct, but only in the same --

QUESTION: If the insurance company goes out to an independent law firm and hires them to furnish the services that were promised, the furnishing of those services is part of the insurance business?

MR. ALLEN: The furnishing of the services to the policyholders; that is right.

QUESTION: But you would not think that the negotiations of price at which they were furnished was part of the insurance?

MR. ALLEN: The negotiation between the insurance company and the lawyer we would contend is not the "business of insurance" because there is no principal basis for distinguishing that kind of agreement between the insurance company --

QUESTION: Well, why do you not draw the line and say, well, perhaps that piecemeal negotiation is one thing, but a forward contract, a sort of supply contract in the indefinite future?

MR. ALLEN: Because any distinction on that basis would break down.

QUESTION: Any distinction breaks down. What about the contract to purchase the paper on which the policy is written, now is that part of "business of insurance"?

MR. ALLEN: The contract to purchase the paper?

QUESTION: On which the policy is written.

MR. ALLEN: We would contend it would not be and that a conspiracy between printers to fix the price of printing services, which use an agreement with an insurance company to implement that conspiracy, is not what Congress intended to exempt from the antitrust law.

QUESTION: Well, the insurance company could be a plaintiff in an antitrust lawsuit against a paper manufacturer who agree to fix the prices.

MR. ALLEN: Exactly.

QUESTION: It could be a plaintiff here against any pharmacists who agreed among themselves to fix the prices.

MR. ALLEN: Under our contention, but not under the petitioners' contention.

QUESTION: No, no. But the point is that now we have an agreement with them,between the insurance company and the pharmacists to provide services. And the question is whether or not that is the "business of insurance"?

MR. ALLEN: And our response is that it is not because if it were, then everything an insurance company would do to save its own cost of services would be the "business of insurance".

QUESTION: Well, perhaps that is the answer.

MR. ALLEN: Congress did not so intend. It is clear from this Court's decision.

QUESTION: I understood Mr. Kaiser this morning

when I put the question to him to say that the action of the drug people together, independent of the agreement with Blue Shield, could be an antitrust violation, and one of the ways that could be asserted would be for Blue Shield to sue them because they were pushing the price up.

MR. ALLEN: That is correct, Mr. Chief Justice, but the distinction is important. He makes that concession and that is perfectly true. We agree with that, but what his position necessarily entails is that if that conspiracy between the pharmacists were embodied in an agreement with an insurance company, that would be the -- that agreement would make it all part of the "business of insurance".

QUESTION: No. His response to that was that would not render them. It might be part of the "business of insurance" as between Blue Shield and the druggists, but it would not render the druggists immuned from an antitrust violation for their own agreement.

MR. ALLEN: Well, I do not understand that to be their position, Your Honor. I did not hear him say that this morning.

QUESTION: I understood it very clearly.

MR. ALLEN: But if that is his position, what he is saying is that then we can violate the antitrust laws by entering into an agreement with pharmacists and then the pharmacists --

QUESTION: Well, that is exactly what an exemption means, that you can engage in conduct which would be violating the antitrust laws if you did not have an exemption. That is exactly what an exemption means.

MR. ALLEN: But what this Court has established is that the McCarran-Ferguson Act did not intend it to immunize entities. It intended to immunize conduct, agreements, practices.

QUESTION: Except at a business, the business of insurance.

MR. ALLEN: That is right, but it does not matter who is engaging in it.

MR. CHIEF JUSTICE BURGER: Very well, Mr. Allen. You have some time left, Mr. Kaiser. Do you have anything further?

REBUTTAL OF KEITHER E. KAISER, ESQ.

ON BEHALF OF THE PETITIONERS

MR. KAISER: Mr. Chief Justice, if there was any confusion with our discussion earlier today, it would be our position that in the event the pharmacies got together and conspired to enter into a Pharmacy Agreement and came to Blue Shield and told us -- held a gun to our heads, so to speak, and said we are not going to enter into this agreement with you unless you pay us a certain price.

QUESTION: Well, what if Blue Shield joined the

conspiracy?

MR. KAISER: Your Honor, if we are a victim of a conspiracy --

QUESTION: I did not say that. I said you are a party to it.

MR. KAISER: I think we have two different circumstances. Under my theory --

QUESTION: Yes, I know, but I am asking about mine now. How about if Blue Shield is a party to the conspiracy?

MR. KAISER: All right. If Blue Shield was a party to the conspiracy --

QUESTION: And remember, they are carrying out the "business of insurance".

MR. KAISER: It would be my initial impression right now that if the agreement was embodied into the Pharmacy Agreement, and it has always been our position that the Pharmacy Agreement is immuned as a part of the "business of insurance", well then there would be no violation.

QUESTION: Blue Shield would be immuned?

MR. KAISER: Yes, sir. For the separate conspiracy between the druggists there may be an actionable -- that may be an actionable conspiracy.

QUESTION: But Blue Shield is, at least in ordinary human experience, not very likely to enter into conspiracies to raise their own costs?

MR. KAISER: Not at all, Your Honor, that would be totally against our own interest and the interest of our policyholders.

QUESTION: So the hypothesis is, at least economically, not very real.

MR. KAISER: That is correct.

QUESTION: Unless they get together to keep Blue Shield from going too low and Blue Shield gets paid off in some way.

MR. KAISER: Yes, I guess that is a possibility.

QUESTION: Well, it has been true, has it not, in some places?

MR. KAISER: Not to my knowledge. I am not familiar with anything of that nature that has ever happened.

QUESTION: Does the price fixing agreement have to be to fix maximum prices to be unlawful? Supposing it is an agreement to fix prices much lower than anybody else will charge?

MR. KAISER: There is considerable dispute about that, but as I read the cases price fixing can either be to fix maximum prices or --

QUESTION: It would be illegal either way, would it not?

MR. KAISER: Strictly from an antitrust --

QUESTION: If you had a group of large druggists who

wanted to have a very low price in order to drive small companies out of business, for example, and persuaded Blue Shield to go along with it, then that would normally be an antitrust violation?

MR. KAISER: My thoughts are under the theory that Blue Shield would offer this agreement to everyone; some would possibly be able to accept and some possibly could not.

QUESTION: Is there any limitation now? Can anyone be a participant?

MR. KAISER: Any licensed pharmacy in the State of Texas has been invited and is capable of becoming a participating pharmacy.

QUESTION: Mr. Allen, to be sure that my confusion is completely cleared up, do you agree with the view that in order to qualify for the exemption under Section 2(b) of the McCarran Act, you must establish both that you are in the "business of insurance", and secondly, that that which you claim as an exemption is regulated by state law?

MR. ALLEN: Yes, Your Honor, we claim that it must constitute a part of the business of insurance and the activity regulated by state law. And we believe that it undeniably has in this case.

QUESTION: I take it that the court below did not reach the second step. They just simply said it is not the business of insurance?

MR. KAISER: The Court of Appeals for the Fifth Circuit did not reach the second step. However, the trial court found that it had been regulated in its words pervasively.

QUESTION: But the Court of Appeals did not reach that second --

MR. KAISER: No, sir. They said that in view of the fact that it was finding that the Pharmacy Agreement did not constitute the "business of insurance", it was not required to go to the second step relating to state regulation, nor was it required to go to the step relating to boycott.

The business of insurance is a federal question. There seems to have been considerable discussion today about the state's interest and whether or not the state has regulated and whether or not the state considered the matter to be the "business of insurance".

QUESTION: It is true that the exemption, however, exists -- the exemption for the "business of insurance" exists only to the extent that it is regulated by state law.

MR. KAISER: That is correct, Your Honor.

QUESTION: And your opponent in Part 2, I think it is, of his brief asserts that this is not regulated by state law.

MR. KAISER: I just wanted to make our point clear. We are not relying upon what the state did to say that this constitutes the "business of insurance". We are relying strictly

upon a federal standard.

QUESTION: But a part of that federal standard is that the "business of insurance" has to be regulated by state law?

MR. KAISER: Yes, sir.

QUESTION: Well, suppose the state says the dealing in drugs is not an insurance function and therefore we will not regulate it, then what would your position be?

MR. KAISER: My position would still be the same. The "business of insurance" is a federal question. If it happens to be the "business of insurance" but not regulated, the exemption does not attach, although we do believe that the federal court should give a certain amount of --

QUESTION: Well, if they said it was and they did regulate it, it would not be a federal consideration.

MR. KAISER: I think it would still be a federal consideration. The "business of insurance" is a federal question to be decided by the federal courts.

We do not suggest that everything an insurance company does constitutes the "business of insurance". An insurance company may do many things in the conduct of its business which are not directly related to the furnishing of specific benefits and which are not related directly to the costs of those specific benefits.

What we are saying, and our position here today is

that the Pharmacy Agreement directly relates --

QUESTION: Let us assume a company that is an insurance company and nothing else. It is not a conglomerate or anything. It is only in the insurance business. Now what those many things be?

MR. KAISER: As the Solicitor General has said: the contracts for the purchase of paper.

QUESTION: Well, why would that not be the "business of insurance"? It is in the insurance business and it has to buy paper.

MR. KAISER: Your Honor, the federal court and this Court has said that the key is not whether or not it is in the "insurance business" but the "business of insurance" and there is a difference there.

QUESTION: Well, it is in the business of insurance and in conducting that business, it has to have policies that are written and printed on paper. And why, therefore, should not this purchase of paper be the "business of insurance"?

MR. KAISER: Because there is not a relationship between the insurer and its policyholder in that situation.

QUESTION: Well, what about the paper that they send out to the policyholder to submit claims on?

MR. KAISER: That still would not really involve the claim.

QUESTION: The condition of the policy is that you

file a claim on this form.

MR. KAISER: That would be too attenuated to the "business of insurance" to become an exempt activity.

QUESTION: I want to go back to where we started on the lawyer hired by the insurance company to defend the policyholder who sued under a liability policy.

MR. KAISER: Yes, sir.

QUESTION: Would that be the "business of insurance"?

MR. KAISER: If it was an obligation contained in the policy of insurance?

QUESTION: The policy says "will defend all claims". It does not say by lawyers or how, but then they go and hire lawyers to defend the claim.

MR.KAISER: If it is a part of the coverage and benefits provided by the policy and if it is something that is intimately related to the --

QUESTION: Well, yes or no? Is it covered in your view or not? Is it part of the "business of insurnace"?

MR. KAISER: I think it might be.

QUESTION: You think it might be?

MR. KAISER: Yes, sir.

QUESTION: You are not very confident and yet I do not see any difference between that and providing drugs as I indicated earlier. I do not understand your lack of confidence on that case and your complete confidence on this

case.

MR. KAISER: Your Honor, it is the conceptual difference between the two types of cases here. I agree with Your Honor's hypothesis. I think I agree; not I think I agree but I do agree.

However, we are looking at a different type of insurance and a different type of policy here. We are looking at one where this particular --

QUESTION: Supposing you pay money and you go out and borrow money from a bank to pay off a claim in dollars, is that the "business of insurance"?

MR. KAISER: If the insured?

QUESTION: No, the company is a little short of cash. So they go to the bank; they raise the cash to pay up a very large claim of some catastrophe of some kind?

MR. KAISER: Your Honor, I do not believe that would constitute the "business of insurance".

QUESTION: How is that different?

MR. KAISER: Well, I believe that it would fall too far outside the relationship between the insurer and the insured, the assumption of risk in providing the benefit.

QUESTION: It is getting what the insurance company needs to set aside a claim that it is obligated under the policy to satisfy. It is in dollars rather than drugs. I do not see the difference.

MR. KAISER: I do not believe it would fall within the criteria established by this Court in SEC versus National Securities.

QUESTION: Well, the only criteria there is that it be the "business of insurance".

MR. KAISER: This Court set out some very broad criteria in determining what constitutes the "business of insurance" in that case, but the real nexus for what does constitute the "business of insurance" are matters that intimately relate to the insurer/insured relationship.

The Court also said that the type of policy which could be issued, its reliability, interpretation and enforcement and other activities of insurers, which relate closely to their status as reliable insurers constitute the "business of insurance" for McCarran purposes.

QUESTION: You apply all that language to making a big loan from a bank to pay off the policy obligation.

MR. KAISER: Your Honor, the preceding case in 1959 of Securities and Exchange Commission versus Variable Annuity said that the merger of two insurance companies, even though the sale of stock or the holding of stock involved the insureds to some respect, said that that was not sufficient. That did not sufficiently relate to the insurer/insured relationship.

And I think your proposition about going out and borrowing money would be more akin to the Variable Annuity case.

QUESTION: Your real answer is to my brother Stevens' question is that the further we take you away from this case and your theory of it, the less certain you get?

MR. KAISER: Yes, sir.

MR. CHIEF JUSTICE BURGER: Thank you, Mr. Kaiser. Thank you, gentlemen. The case is submitted.

(Whereupon, at 1:43 p.m., the above-entitled case was submitted.)