INSURANCE AND INTERSTATE COMMERCE*

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THE life insurance industry is the largest institutional long-term creditor in our American economy. As of December 31, 1937, the twenty-six largest companies in the field held 11.6 per cent of our entire federal debt, 6.7 per cent of the municipal and state debt of the nation, 17.4 per cent of the railway debt, 18.2 per cent of the public utility debt, 11.7 per cent of the industrial debt, 10.5 per cent of all farm mortgages, and 13 per cent of all urban mortgages.¹ Their holdings of long term indebtedness would have been even greater had not the depression brought about the foreclosure of a great volume of their mortgages, so that they now have an ownership, rather than a creditor's interest, in large amounts of farm and urban real estate.² One company, for example, the Metropolitan Life Insurance Co., is the largest farmer in the United States, owning over 7,000 separate farms located in twenty-five states and representing an investment of close to \$80,000,000.³ The

* This paper deals only with the constitutionality of federal regulation of insurance and not with its wisdom. The views herein set forth are personal, and do not reflect the views of the Securities and Exchange Commission.

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1. *Hearings before the Temporary National Economic Committee* (1940) 14718 *et seq.* (hereinafter cited as *Hearings*). This enumeration does not include policy loans, where the insurance company assumes a creditor relationship towards its own policyholders.

2. The decline in life insurance company ownership of farm mortgage debt (of which they had held 19.2 per cent in 1930) is explained by the number of mortgages that had passed into the companies' real estate account. In 1929 about 96 per cent of the total farm investment of the twenty-six leading companies was in mortgages; by 1939 this percentage had fallen to 55.8 per cent. *Hearings* (part 10A) 180-181. During the period 1932-1938 the twenty-six largest companies foreclosed \$1,229,849,000 of urban mortgages. *Hearings* (part 10A) 199. They owned about \$11,000,000 of urban real estate in 1929 and almost a billion dollars in 1938. *Hearings* (part 10A) 217-218.

3. *Hearings* 14948. One hundred eleven insurance companies had 34,243 farms under contract with the Federal Government that were eligible to receive corn-hog benefit payments in 1935, 11 of these companies having more than 1,000 farms apiece under such contracts. Illuminating data on their multiple ownership of cotton and tobacco farms can also be obtained from Payments Made under the Agricultural Adjustment Program, a letter from the Secretary of Agriculture in response to Sen. Res. No. 265, 74th Cong., 2d Sess. (1936), Document No. 274.

total assets of the life insurance companies, which have increased by \$21,000,000,000 in the past twenty years, are twice the value of the total assets of the Federal Reserve Bank and 85 per cent of the value of the assets of all national banks.⁴ Their ratio of current growth is even more striking—94.7 per cent of the total increase, from 1929 to 1938, in the assets of the principal savings institutions of this country was accounted for by augmentation of the assets of life insurance companies and life insurance fraternal associations.⁵

This growth in assets is largely the result of a phenomenal income flow. In the period from 1929 to 1938 inclusive, the twenty-five largest life insurance companies received a total income of \$42,679,883,000.⁶ Whereas in 1865 the total income of the life insurance companies had been \$25,000,000, their 1937 aggregate was \$5,257,000,000, constituting 6.7 per cent of the total national income.⁷ The premium income of the Metropolitan Life Insurance Co. for 1935, for example, was three times the entire tax collections of New York, the state of its incorporation; the Northwestern Mutual Life Co. in 1936 collected in premiums one and one-half times the taxes collected by its home state of Wisconsin.⁸

In the ten-year period, 1929 to 1938, insurance companies invested \$26,300,000,000.⁹ The rate of investment is constantly mounting; the companies had available for investment in 1937 \$4,300,000,000, as against the \$2,000,000,000 they had in 1929.¹⁰ In 1930, the ten largest life companies were estimated to have purchased 10.9 per cent of all long and short-term bonds and notes, whether of new capital or refunding issues. In 1937, the twenty-six largest companies purchased 48.9 per cent, and in 1938, 47.7 per cent of all corporate issues.¹¹ Refunding

4. *Hearings* 1190, 1643.

5. *Hearings* 14718 *et seq.* The assets of the principal savings institutions covered time deposits of commercial banks, assets of mutual savings banks, building and loan associations, government pension funds and trust funds, total savings deposits and baby bonds.

6. *Hearings* 15493.

7. The increase in the investment income of insurance companies, as distinguished from their premium income, was proportionately greater. *Hearings* 1174. In 1865 \$22,000,000 out of the \$25,000,000, or 88 per cent of the total, was premium income; premium income in 1937 amounted to \$3,762,000,000, or only 72 per cent of the total. This large investment income was far in excess of that required to meet interest on the reserves which the companies are required by law to keep to protect their policyholders; in 1906 the excess was 30 per cent and in 1938 18.26 per cent. *Hearings* 1227. Despite the fact that premium receipts failed to meet total expenditures in 1918, 1932, 1933, and 1934, the assets of insurance companies kept on increasing in those years, solely because of their investment income.

8. *Hearings* 1179-1180.

9. TNEC Release, Feb. 10, 1940, p. 4.

10. *Hearings* 14716. During this period, the long-term debt available for investment shrank by 14 billion dollars.

11. *Hearings* 1217-1218.

issues, particularly in the public utility field, have more and more been absorbed by the same insurance colossi that floated the original issue.

Furthermore, so extensive has been their occupation of the investment field, and so enlarged the scope and competence of their investment organizations, that the life companies have largely dispensed with the machinery of investment bankers and public flotations, particularly in connection with railroad and public utility bonds. The percentage of private placements (involving neither offerings to the general public nor the intervention of the normal machinery for public flotation of securities) acquired by the insurance companies ranged from 70 per cent in 1936 to 94.6 per cent in 1937 and 91 per cent in 1938.¹² The commanding position which insurance companies are assuming in the national economy and their increasing ownership of national assets evoke once more the fears attendant upon mortmain, *i.e.*, the surrendering of capital, which should be alive and functioning at the hands of individuals, to artificial corporate hands.¹³

Life insurance embraces the security needs and the savings outlets of 64,000,000 policyholders scattered all over the United States.¹⁴ However, while the people's savings flow into the coffers of the insurance companies from every community in the land, control over these assets is concentrated in New York and the New England states.¹⁵ We have, therefore, a concentration of the control of wealth that is somewhat alien to the purposes of our Federal Reserve system.¹⁶ The concentration of insurance company influence in New York has led many other insurance companies to accept the hegemony of the New York State Department

12. *Hearings* 1520; Pike, Address before Maine Investment Dealers Ass'n, Sept. 20, 1940.

13. See Mr. Justice Brandeis, dissenting, in *Liggett v. Lee*, 288 U. S. 517, 548 (1933); *BRANDEIS, BUSINESS—A PROFESSION* (1914) 118. A direct analogue to the medieval policy against mortmain is to be found in the common state statutory provision that insurance companies must dispose of those real estate holdings not required for the conduct of their business within a fixed period of time, usually five years. See McAndless, *Report of Joint Meeting*, American Institute of Actuaries, Oct., 1938, p. 75. Cf. Hazeltine, *Mortmain* (1933) 11 *ENCYC. SOC. SCI.* 40, 43.

14. Of the five largest life insurance companies, controlling 54.4% of the total assets of all life insurance companies, *Hearings* 1191, three were authorized to do business in every state in the Union and two in every state except Texas. *Hearings* 1170.

15. Six of the largest companies, controlling 56.9% of all life insurance companies, are located in the New York City area. Ten companies in this group, controlling an additional 17.2% of the total assets of the life insurance industry, are located in New England, leaving the New York and New England companies with 74.1% of the total assets of the 308 life insurance companies in the United States. *Hearings* 1193-1194.

16. It may be noted that the total sum subject to immediate withdrawal in cash in twenty of the principal companies is almost \$8,000,000,000. These companies do not include the Metropolitan, New York Life, Equitable, Mutual Benefit, Massachusetts Mutual and Pacific Mutual. *Hearings* (part 10A) 275.

of Insurance,¹⁷ so that there exists, in effect, a type of national regulation without any responsibility for such regulation being vested in the Federal Government.

Insurance is an institution which, in serving the fundamental needs of millions for security and savings, utilizes those savings and transforms them into the investment capital that is the backbone of our democratic profit system. A similar investment institution, albeit one of far less scope, the investment trust, has in the past year been subjected, by the Investment Company Act of 1940, to federal regulation. Furthermore, we are currently faced with the necessity for coordinating all of our resources, capital and otherwise, into a program of national defense. In that connection, the functioning of the insurance companies as expert mobilizers of the nation's capital may well repay further scrutiny.

The mere magnitude of the above figures and the present-day significance of insurance are evocative of the fact that we are dealing with a national industry presenting nationwide problems. We shall shortly examine in some detail the manifest security, investment, and banking problems presented by the insurance industry, problems which in other contexts have formed the basis of judicially approved federal regulation. In the insurance field, however, not only have some of these problems not been fully appreciated, but there has been a noticeable tendency to regard the insurance industry as constitutionally exempt from the prospect of national supervision of any kind. That tendency has been in large measure based on one Supreme Court opinion, *Paul v. Virginia*.¹⁸ Our question is whether *Paul v. Virginia* is a complete bar to rational handling by the Federal Government of the problems of an industry that presents features of present significance such as these. The answer to that question throws us back seventy-five years, to an economic and political milieu entirely different from that which characterizes our present-day scene.

PAUL V. VIRGINIA AND THE INSURANCE CASES

In 1865, irked by state regulatory and tax legislation which they regarded as burdensome and unnecessarily multiplicitous,¹⁹ the insurance companies in the United States sought uniform federal regulation to supplant the existing state schemes. Prompted by the passage of the National Banking Act of 1864, they recommended a National Incorporation Act which, among other things, placed insurance companies in a

17. See, for example, *Hearings* 4183, 4191-4199, 4215, 4221, indicating the supervision exercised by the New York Department of Insurance over group life insurance rates.

18. 8 Wall. 168 (U. S. 1868).

19. For a summary of this legislation, see INSURANCE BLUE BOOK (1876-7) 32, and Nehemkis, *Paul v. Virginia, The Need for Re-examination* (1939) 27 GEORGETOWN L. J. 519, 522-3.

regulable status comparable with that of national banks.²⁰ When the bill was finally introduced in the Senate in 1868, the insurance companies, as a pendent to their legislative program, decided upon a judicial attack upon the constitutional validity of state legislation on the subject of insurance. *Paul v. Virginia*, attacking a state statute which for the protection of policyholders required insurance companies to deposit bonds with the state treasurer, was their test case.

The bulk of the opinion, which Justice Field wrote for a unanimous Court, was devoted to the then troublesome question whether the complaining fire insurance company, being a corporation, was a "citizen" entitled to the protection of Article 4, Section 2 of the Federal Constitution, providing that "the citizens of each state shall be entitled to all privileges and immunities of citizens in the several states"; and this question it decided in the negative.²¹ Our concern, however, is with the second argument advanced by counsel for the company, the syllogism that, as the Virginia statute was an attempt by the state to regulate interstate commerce, it encroached upon the exclusive power of the Federal Government to regulate that interstate commerce and hence was invalid. Justice Field found it unnecessary to discuss any question of concurrent or exclusive jurisdiction; he disposed of the contention in a brief paragraph:

"Issuing a policy of insurance is not a transaction of commerce. The policies are simply contracts of indemnity against loss by fire, entered into between the corporations and the assured, for a consideration paid by the latter. These contracts are not articles of commerce in any proper meaning of the word. . . ."

The identic rationale has dominated all the subsequent cases in which the Supreme Court has rebuffed the efforts of the insurance companies to invalidate state legislative requirements objectionable to them.²²

20. See Huebner, *Federal Supervision and Regulation of Insurance* (1905) 26 ANNALS 682-3. The O'Mahoney Bill, S. 330, 76th Cong., 1st Sess. (1939), providing for federal licensing of corporations, specifically excludes insurance companies.

21. The first successful attempt to invalidate state legislation under the privileges and immunities clause, after forty-four failures, occurred in *Colgate v. Harvey*, 296 U. S. 404 (1935), recently expressly overruled in *Madden v. Kentucky*, 309 U. S. 83 (1940). *Paul v. Virginia* and the later insurance decisions—at least until 1900—were based largely on the Court's feeling that each state had the right to exclude foreign corporations, and hence could impose conditions on their entry. *Philadelphia Fire Ass'n v. New York*, 119 U. S. 110, 120 (1886), however, says that this exclusionary power of the state does not extend to interferences with interstate commerce.

22. See *Noble v. Mitchell*, 164 U. S. 367 (1896) (companies must appoint agents upon whom process may be served); *New York Life Ins. Co. v. Cravens*, 178 U. S. 389 (1900); *National Union Fire Ins. Co. v. Wanberg*, 260 U. S. 71 (1922) (requiring certain protective provisions in policies); *Philadelphia Fire Ass'n v. New York*, 119 U. S. 110 (1886); *New York Life Ins. Co. v. Deer Lodge County*, 231 U. S. 495 (1913) (imposition of taxes).

A close analysis of Justice Field's language reveals three limitations of outlook that realistic economics and accurate etymology should by this time have dissipated. First, his statements relate only to the *contract* of insurance, and not to the insurance *company* that negotiates the insurance contracts, or to the insurance *industry* constituting the sum total of those contracts and those companies. The persistency of this emphasis on the insurance contract can be noted as late as 1927.²³ It is a partial explanation of why the references by counsel arguing before the Supreme Court to the expanding geographic terrain covered by insurance companies, the increasing number of insurance contracts, the residence of policyholders in more and more states, and the consequently greater use of the mails involved, which were attempted in the *Cravens* case,²⁴ and more elaborately by Roscoe Pound in the *Deer Lodge County* case,²⁵ were unavailing to dent the rock of constitutional doctrine established by Justice Field. In neither case was the Court invited to consider insurance companies and the insurance industry in terms of their larger functioning in the national social economy, rather than in terms of an increasing and more dispersed aggregate of insurance contracts and insurance policyholders. In this view, statistics of size, and interstate spread and movement may conspire to make insurance "interstate" in nature, but they do not make it "commerce." This failure to divert the Court's attention from the purely contractual phase of insurance also serves to explain why the Supreme Court concluded that marine insurance²⁶ and

23. See *Bothwell v. Buckbee, Mears Co.*, 275 U. S. 274, 276 (1927). In *German Alliance Ins. Co. v. Kansas*, 233 U. S. 389 (1914), the interdependency of insurance contracts was recognized as a basis for upholding state regulation of insurance rates, but this factor did not influence Justice McKenna's approach to the interstate commerce question. See *Osborn v. Ozlin*, 310 U. S. 53, 63 (1940).

24. *New York Life Ins. Co. v. Cravens*, 178 U. S. 389 (1900).

25. 231 U. S. 493 (1913). There were two dissents in the case, but no dissenting opinion; one of the dissenters was the present Chief Justice. Among the factors that undoubtedly influenced the Court were the forty-five years of *stare decisis* that had accumulated behind the proposition that insurance was not interstate commerce, and the fact that the insurance companies were attempting to uproot established state legislation in a field where no federal legislation existed.

26. *Hooper v. California*, 155 U. S. 648 (1895) (marine insurance held incident to, rather than instrumentality of, interstate commerce). Compare, however, *United States v. Ferger*, 250 U. S. 199 (1919) (bill of lading held an instrumentality of interstate commerce). As insurance is as essential to interstate shipment as a bill of lading, should it not also be regarded as an instrumentality of interstate commerce and hence subject to federal regulation? Thus, for example, interstate motor carriers have found themselves in bankruptcy when their insurers failed [see, e.g., *Gregg Cartage & Storage Co.*, Common Carrier Application, ICC No. MC-51204, Nov. 14, 1934] and the ICC is given authority to prescribe rules and regulations governing insurance policies for motor carriers. § 215 of the Motor Carrier Act of 1935, 49 STAT. 543 (1935), 49 U. S. C. § 301 (Supp. 1940).

Marine insurance is an important factor in carrying on our foreign commerce. Thus, Alexander Hamilton indicated that regulation of policies of insurance was comprehended

life insurance²⁷ stood in no different status from the fire insurance involved in the case of *Paul v. Virginia*. Each involved a form of insurance contract and hence could not possibly constitute "commerce."

Secondly, Justice Field thought of the contract of insurance as a contract of indemnification and as a purely aleatory proposition. Failure to realize that a life insurance policyholder not only purchases protection but, as will be developed below, is also contributing to an investment program, was understandable enough in the early stages of life insurance. Both in 1868, when *Paul v. Virginia* was decided (on a record involving a fire insurance company but in terms of abstractions equally applicable to the life insurance field), and in 1900, when life insurance contracts were specifically subjected to the same abstract approach, the investment income of life insurance companies, for example, was comparatively small,²⁸ the types of contracts they issued did not involve the many investment features now familiar to us, non-forfeiture values were nascent and their economic rationale improperly apprehended, and the very notions of cash surrender values and policy loans were more or less undeveloped. Even today, lawyers fail to appreciate the security features of the life insurance contract and the investment nature of the life insurance industry.

The only reference which the Supreme Court has ever made to the investment phases of the life insurance industry occurred in 1918, fifty years after *Paul v. Virginia* was decided, in a dictum in *Northwestern Mutual Life Insurance Co. v. Wisconsin*, where the Court intimated that, while the ordinary insurance business of life insurance companies did not involve interstate commerce, their investment business might involve interstate commerce.²⁹ The Court has never been called on to convert this abstract speculation into a concrete decision and decide

under the commerce power. 1 LEGAL MASTERPIECES (Veeder ed. 1903) 229. Marine insurance, which he had in mind, was then the most important form of insurance. See KNIGHT, THE HISTORY OF LIFE INSURANCE IN THE UNITED STATES TO 1870 (1920) 72. See also argument advanced by Evans in *Hearings before House Subcomm. on Merchant Marine and Fisheries*, 66th Cong., 1st Sess. (1919) 283, to the effect that the Supreme Court might alter the views recited in *Paul v. Virginia* were it shown how indispensable insurance is as a component of interstate shipment. Marine insurance, as a necessity for our merchant marine, figures prominently in our national defense. This paper, unfortunately, will not have occasion to pursue any subject except life insurance.

27. *New York Life Ins. Co. v. Cravens*, 178 U. S. 389 (1900), where Justice McKenna said: "The contract of insurance is not an instrumentality of commerce. The making of such a contract is a mere incident of commercial intercourse, and in this respect there is no difference whatever between insurance against fire and insurance against the 'perils of the sea.'"

28. Both fire and marine insurance possess investment features, but they are not as pronounced as in the case of life insurance.

29. 247 U. S. 132, 138 (1918). Justice McKenna, in *German Alliance Ins. Co. v. Kansas*, 233 U. S. 389 (1914), was aware of the credit aspects and investment power of the insurance companies, but the case involved due process, and not the commerce clause.

that the investment business of insurance companies does involve interstate commerce. The factual circumstances of the cases subsequent to 1918 may explain why the dictum in the *Northwestern* case continues, after more than twenty years, to lead a completely disembodied existence. For one thing, the only references to the relationship of insurance and interstate commerce have arisen as oblique dicta in cases involving hail and strike insurance;³⁰ the investment situation of companies engaged in these lines of insurance is of minor importance in the national economy, when contrasted with the demonstrably pivotal bearing of life insurance investments in our economic scheme. Furthermore, as was true in the cases prior to the *Northwestern* case, Supreme Court action has been confined to constitutional endorsement of the state regulation of non-investment aspects of the insurance business.³¹ Perhaps, also, failure to consolidate the apparent concession made in the *Northwestern* case is due to an apparent state of truce between the life companies and the state regulatory authorities.

In the third place, neither *Paul v. Virginia* nor any of its successors is a considered opinion embroidering the concept of commerce; they are all merely flat and unreasoned assertions that insurance is not commerce. In the following section of this Article, we shall try to show that the concept of commerce which dictated *Paul v. Virginia* is consonant neither with the intendment of the framers of the Constitution, nor with the expanding practical implications of our economic set-up and the federal scheme of government, nor with the current wise usage of the Supreme Court.

These three limitations — the concentration on the insurance contract to the exclusion of the broader patterns of the business unit and total industry involved, the lack of full appreciation of the real economic nature of insurance, and Justice Field's categorical treatment of commerce — were persisted in by Justice McKenna, the author of several leading opinions in the insurance field.³² To them we must add a fourth, and somewhat more recent error — a mistake both of logic and of comprehension of constitutional development — introduced by non-judicial commentators, and by spokesmen for the insurance companies and the commodity and stock exchanges. The courts had held that, since insurance

30. *National Fire Ins. Co. v. Wanberg*, 260 U. S. 71 (1922) (hail insurance); *Bothwell v. Buckbee, Mears Co.*, 275 U. S. 274 (1927) (strike insurance).

31. See *O'Gorman & Young v. Hartford Ins. Co.*, 282 U. S. 251 (1931); *Osborn v. Ozlin*, 310 U. S. 53 (1940) (compensation and place of residence of insurance agents); *National Fire Ins. Co. v. Wanberg*, 260 U. S. 71 (1922) (provisions of insurance policies).

32. McKenna wrote the *Deer Lodge*, *Hooper*, *Cravens*, and *German Alliance* opinions, and the dissent in *International Textbook Co. v. Pigg*, 217 U. S. 91 (1910), where the majority held that a correspondence course involving the sale of textbooks was interstate commerce.

was not commerce, state governments *could impose certain specific types* of regulation on insurance companies. From this premise was deduced the surprising proposition that the Federal Government *could not impose any* regulation on the insurance companies.³³ Such an inference clearly violates the laws of logic—there is no logical transference from the proposition that the *state can* regulate to the proposition that the *nation cannot* regulate.³⁴ The fallacy has been frequently recognized by judges and professors,³⁵ but it still crops up in the current literature.³⁶

The incompatibility of this erroneous deduction with our constitutional history must be apparent in the light of the famous case of *Coeley v. Board of Wardens*, which preceded *Paul v. Virginia* by fifteen years, holding that "the grant of commercial power to Congress does not . . . exclude the states from exercising an authority over the subject matter."³⁷ That the presence of state regulation on a subject is no bar to federal regulation has customarily been explained on two theories. The first of these, which applies when the regulated activity is called "interstate commerce," is that of "concurrent jurisdiction." According to this theory, the state may regulate certain facets of interstate commerce if nationwide uniformity of regulation is not imperative and diversified local regulation is preferable, so long as regulation by the state is not inconsistent with or superseded by federal legislation.³⁸

33. Three examples may be noted: (1) A Senate Judiciary Committee once issued a one paragraph statement to this effect, and promised a memorandum in support of its stand that was never forthcoming; see SEN. REP. 4406, 59th Cong., 1st Sess. (1904). (2) Counsel for the appellant in *Board of Trade v. Olsen*, 262 U. S. 1 (1923), in dealing with the argument advanced in support of federal regulation of commodity exchanges that grain futures contracts were entered into for hedging purposes and as insurance for shipments of grain in interstate commerce, maintained that insurance was not commerce, or an instrumentality of commerce, and that federal regulation was consequently invalid. (3) Dean Landis in an opinion on the constitutionality of proposed stock exchange legislation given in 1932. See testimony of Gay in *Hearings Before Committee on Interstate and Foreign Commerce on H. R. 7852 and H. R. 8720*, 73d Cong., 2d Sess. (1934) 238.

34. Occasionally even the major premise of this false syllogism is misstated—*Paul v. Virginia* was cited as authority that the state could regulate insurance because insurance was "intrastate commerce" in *National Fire Ins. Co. v. Wanberg*, 260 U. S. 71 (1922).

35. See *Binderup v. Pathe Exchange*, 263 U. S. 291, 311 (1923); *Swift & Co. v. United States*, 196 U. S. 375, 400 (1905); *Minnesota v. Blasius*, 290 U. S. 1 (1933); GAVIT, *THE COMMERCE CLAUSE* (1932) 137; Dowling, *Memorandum Concerning the Power of Congress to Regulate Security Exchanges*, *Hearings before Committee on Banking and Currency on Sen. Res. 84* (Stock Exchange Practices) 73d Cong., 2d Sess. (1934) Part 16, 7634, 7639.

36. See, e.g., *John Hancock Mut. Life Ins. Co. and Industrial and Ordinary Ins. Agents*, Massachusetts Labor Relations Case Nos. C.R. 20, 21, 22, 30 (1938).

37. 12 How. 299, 318-19 (U. S. 1851).

38. See, e.g., *Savage v. Jones*, 225 U. S. 501 (1912); *McDermott v. Wisconsin*, 228 U. S. 115 (1913) (upholding state regulation of food and drugs, despite existence of federal Pure Food and Drugs Act); *Hall v. Geiger-Jones Co.*, 242 U. S. 539, 557

The second theory, which is invoked when the regulated activity is denominated an "intrastate transaction" or "intrastate commerce," is that Congress may regulate intrastate transactions which directly affect interstate commerce, even to the nullification of inconsistent state regulation bearing on the transaction.³⁹ Thus, for example, Congress may regulate businesses such as commodity exchanges, livestock yards, railroads, agriculture, coal, and the communication industry with respect to activities that are themselves unmistakably intrastate but have interstate consequences,⁴⁰ and such subject matters as corporate finance and labor relations, whose legal consummation necessarily takes place within the confines of a single state.⁴¹

In the light of the economic theory which is presented in the next section, it is immaterial which of these two legal approaches is taken, for both approaches involve integration with interstate commerce, and establish the same conclusion as to the constitutional validity of federal regulation, once such integration is established. It is only a court which regards individual activities and contracts as the main factual determinants of constitutional jurisdiction that will see a substantial distinction between these two doctrines. A court which looks to broader industrial and institutional patterns will perceive that both doctrines rely on the same economic facts. We shall therefore attack our problem primarily on the basis of the first theory, but most of our discussion will also be relevant to the second.

(1917) (discussing possibility of concurrent securities regulation—now, of course, an actual fact); *John Hancock Ins. Co.*, cited *supra* note 36 (discussing possibility of concurrent jurisdiction over labor relations of insurance company). It is now being urged that before declaring a state statute in conflict with the interstate commerce power, the Court should look for a *Congressional* declaration that the state law is incompatible with the exercise of federal power. See Mr. Justice Black, dissenting, in *McCarroll v. Dixie Greyhound Lines, Inc.*, 309 U. S. 176 (1940); *cf.* for a modified view, Dowling, *Interstate Commerce and State Power* (1940) 27 VA. L. REV. 1.

39. This theory is also referred to as a "concurrent jurisdiction" theory. As a matter of fact it is, except that it is a concurrent jurisdiction over intrastate commerce and not over interstate commerce.

40. *Board of Trade v. Olsen*, 262 U. S. 1 (1923) (upholding the Grain Futures Act); *United States v. Patten*, 226 U. S. 525 (1913) (corner of cotton market a restraint of trade); *Stafford v. Wallace*, 258 U. S. 495 (1922); *Tagg Brothers & Moorehead v. United States*, 280 U. S. 420 (1930) (upholding Packers and Stockyards Act); *Mulford v. Smith*, 307 U. S. 38 (1939) (power to limit agricultural production); *Sunshine Anthracite Co. v. Adkins*, 310 U. S. 381 (1940) (regulation of coal production); *Weiss v. United States*, 308 U. S. 321 (1939) (protection of intrastate communications).

41. See *Standard Oil Co. v. United States*, 221 U. S. 1 (1911); *United States v. Reading Co.*, 253 U. S. 26 (1920); *NLRB v. Jones & Laughlin Steel Co.*, 301 U. S. 1 (1937); *NLRB v. Fainblatt*, 306 U. S. 601 (1939). In two recent cases the Court has upheld the right of the Federal Government to regulate minimum wages. *Opp Cotton Mills, Inc. v. Administrator*, 61 Sup. Ct. 524 (U. S. 1941); *United States v. Darby Lumber Co.*, 61 Sup. Ct. 451 (U. S. 1941).

It is the purpose of this Article to do more than to show the logical and factual weaknesses which characterize *Paul v. Virginia* and its descendants. It is planned to elaborate a record which will show affirmatively that insurance is interstate commerce and therefore subject to federal control.⁴² In order to do so, we shall take up in reverse order the three conceptual deficiencies which we have indicated characterized the line of cases following *Paul v. Virginia*.⁴³ This will involve us, first, in some further linguistic and political speculations concerning the meaning of "commerce," and, then, more elaborately, in a demonstration that, since the date of *Paul v. Virginia*: (a) the life insurance contract has acquired the economic characteristics of a "security" instrument, as that term is used in the ordinary corporate field; (b) the life insurance company has assimilated to itself many of the functions of savings and commercial banks; (c) the life insurance industry has become an investment industry.⁴⁴

These three economic propositions have three corollaries in the field of constitutional law: (a) The mere fact that insurance is a commodity or service sold by a company engaged in interstate business should be sufficient to constitute it interstate commerce. However, to the further extent that it can be shown that the insurance policy partakes of the nature of a "corporate security," the cases sustaining federal regulation of such securities under the commerce power become applicable constitutional

42. It is a curious historical paradox that, out of a test case intended to supplement a drive for federal regulation, there should have been derived, however invalidly, the thesis that federal regulation is constitutionally impermissible. The suggestion may be ventured that the insurance companies, in their recent shift from protagonists to antagonists of the constitutionality of federal regulation, have taken a different political viewpoint from the attitude they assumed in the 1860's and again in the period about 1905. In those earlier times, they may have considered it more advantageous to be regulated by a toothless, laissez-fairish mastiff like the Federal Government than by those smaller but possibly more harassing watchdogs, the individual states. Conversely, the Court may have realized that the only alternative to state regulation of insurance companies was no regulation at all. Perhaps, subsequently, some of the insurance industry's chagrin at vexatious and repetitious state regulation has been supplanted by a fear that the indolent federal mastiff has cut its wisdom teeth and is threatening to impose regulation of unknown effectiveness. The wisdom of or justification for such fears and for such an attitude of regulatory nihilism is, of course, not within the competence of this paper. Resort to interstate commerce as a method of avoiding state jurisdiction has already achieved the immortality of the comic strip; see the Lichty cartoon in the *Washington Post*, Mar. 17, 1939, with two puckish hoboes chorussing: "G'wan—a local constable has no jurisdiction over us. We're interstate commerce!"

43. See pp. 964-966 *supra*.

44. Inasmuch as the insurance contract, company, and industry are, respectively, (1) a *commodity or service* sold by (2) a *business unit* constituent of (3) an *industry*, it is apparent that these three propositions are to a large extent mutually probative, and that redundancy and recapitulation must necessarily characterize their proof.

precedents for the regulability of insurance.⁴⁵ (b) To the extent that insurance companies function as banks, the broad range of fiscal powers confided in the Federal Government — under which it regulates banking — becomes a constitutional base for Congressional regulation of insurance companies. Furthermore, consideration of the effect which banking processes have on the functioning of interstate commerce strengthens the argument for invoking the commerce power as a ground for federal jurisdiction over insurance companies. (c) Similar consequences in the way of making applicable the fiscal and interstate commerce powers of the Federal Government attach to the proposition that the insurance industry has become an investment industry. As a matter of fact, the effect of the present-day insurance set-up on interstate commerce becomes even clearer when the whole industry is taken into account than when the companies are viewed as separate entities.

THE CONCEPT OF INTERSTATE COMMERCE

Walton Hamilton and Douglas Adair have recently demonstrated, by reference to then current usage, that "commerce" was for the founding fathers the broad antithesis of agriculture,⁴⁶ and not, as sometimes erroneously interpreted by the Supreme Court, the narrower opposite of manufacturing.⁴⁷ "Commerce" was, as a matter of fact, interchangeable in meaning with what we would now call "business" and "industry"; these latter words had at that time, however, a moral rather than an economic connotation, and hence would not have been employed by a meticulous draftsman in 1787. If "interstate commerce" were at the present time regarded as synonymous with "interstate business" or "interstate industry,"⁴⁸ there would be no purpose to this essay, for few people will be found to deny that insurance is a business or an industry, or that it is interstate in its ramifications. But instead of this simple conclusion, the courts have seen fit to make "interstate commerce" into an unrealistic bugbear.

An equally important removal of linguistic misunderstanding would be a showing that "commerce" is not necessarily conditioned upon the presence of transportation or physical movement. In fact, frequent intimations are present in the early cases that the most obvious signification

45. The stress which the courts have placed upon the postal power as a justification for the federal regulation of securities and security exchanges is probably due to a subconscious fear that *Paul v. Virginia* might stand in the way of upholding such legislation under the commerce power. See *SEC v. Tung Corp.*, 32 F. Supp. 371 (N. D. Ill. 1940).

46. HAMILTON & ADAIR, *THE POWER TO GOVERN* (1937) 73, 94, 107-8, 160-1.

47. See, e.g., *United States v. E. C. Knight Co.*, 156 U. S. 1 (1895).

48. See *Piedras Negras Broadcasting Co. v. Commissioner of Internal Revenue*, 43 B. T. A. No. 43 (1941) (holding "commerce" a much broader concept than "doing business").

of the word "commerce" was the trade and exchange of commodities,⁴⁰ and that transportation was an afterthought and a less important part of its meaning,⁵⁰ since transportation was merely the instrument for carrying on trade or commerce.⁵¹ When the early judges identified "commerce" with intercourse, they meant commercial intercourse, and, in speaking of traffic, they were using a word which was then synonymous with trade. The emphasis on transportation and navigation which one derives from reading more recent Supreme Court cases⁵² is not inherent in the concept of "commerce"; it is probably due to the fact that most of the early situations which erupted beyond state lines, thus eluding effective state regulation and evoking problems of state and federal jurisdiction, had to do with steamship lines and railroads. When the validity of federal regulation of railroads was first being mooted in the courts, the insurance companies apparently felt that interstate movement was not the touchstone of federal regulability. They kept their ears close to the ground because they felt that "the powers of Congress in this direction could reasonably be regarded as a fair index of its constitutional ability to regulate insurance."⁵³ And currently, the Supreme Court is noting the fact that the interstate commerce power covers the instrumentalities of commerce *only* because it embraces the commerce itself.⁵⁴

That the crossing of state lines is not a true test of the existence of interstate commerce is shown by the refusal evident in some Supreme Court decisions to regard an activity as within the commerce clause merely because it involves physical movement across state boundaries. Justice

49. See *The Passenger Cases*, 7 How. 283, 401 (U. S. 1849): "Commerce is defined to be 'an exchange of commodities.' But this definition does not convey the full meaning of the term." As to the English usage, see JEVONS, *MONEY* (1875) 83: "All commerce consists in the exchange of commodities of equal value."

50. *Mobile v. Kimball*, 102 U. S. 691 (1880); *People v. Brooks*, 4 Denio 469, 476 (N. Y. 1847); *King v. American Transp. Co.*, 14 Fed. Cas. No. 7787 (C. C. N. D. Ohio 1859), all say that Congress has power over transportation and navigation *as well as* trade.

51. See particularly *Henderson v. Mayor of N. Y.*, 92 U. S. 259, 270 (1875); *Sternberger v. Cape Fear & Y. Valley R. R.*, 29 S. C. 510, 7 S. E. 836 (1883); *McCall v. California*, 136 U. S. 104, 108-9 (1890).

52. The disjunction between interstate sale and transportation, which could validly be regulated by the Federal Government, and manufacture, which could not, was the basis of the Court's decisions in *Schechter Poultry Corp. v. United States*, 295 U. S. 495 (1935) and *Carter v. Carter Coal Co.*, 298 U. S. 238 (1936). See *Utah Power & Light Co. v. Pfof*, 286 U. S. 165 (1932) (ignoring scientific as well as economic realities); *Furst v. Brewster*, 282 U. S. 493 (1931) (emphasizing importation); *National League Clubs v. Federal Baseball Clubs*, 269 Fed. 681, 684 (App. D. C. 1920) ("trade and commerce require the transfer of something, whether it be persons, commodities, or intelligence, from one place or person to another").

53. See *INSURANCE BLUE BOOK* (1875) 7.

54. See *NLRB v. Jones & Laughlin Steel Corp.*, 301 U. S. 1 (1937); *NLRB v. Bell Oil & Gas Co.*, 91 F. (2d) 509, 513 (C. C. A. 5th, 1937).

McKenna was, as has been indicated, unimpressed by the wealth of illustrative material whereby Roscoe Pound sought, in the *Deer Lodge County* case, to establish insurance as interstate commerce because it involved the movement of papers and documents across state lines, and the use of the facilities of interstate transportation and communication. The presence of extensive interstate communication and the predominance of interstate contracts were similarly unavailing to deter Justice McKenna from dissenting in the *Pigg* case, where he stated that the transportation of textbooks across state lines did not constitute interstate commerce,⁵⁵ or to prevent four members of the Supreme Court from registering a strong dissent in the *Lottery Cases* to the effect that lotteries were not interstate commerce.⁵⁶ The holdings in the two latter cases have frequently been cited as being at variance with the Supreme Court decisions in the cases following *Paul v. Virginia*, but whether or not this is true, the dissenters appear somewhat justified in their casual attitude towards the fact of interstate movement. For if a state is in a better political position to regulate an industry than the Federal Government, and the economic ramifications of the industry are primarily intrastate, the fortuitous occurrence of transportation across state lines, or the fact that extensive use of the mails is involved, should not operate to withdraw the business from the state regulatory authority best adapted to deal with it.⁵⁷

The most direct way in which insurance can be brought within the terms of the commerce clause is simply to show that it involves commercial activity—the purchase and sale of commodities—on an interstate scale. In this light, the acquisition of an insurance policy involves

55. The majority decision in the *Pigg* case has been followed in *FTC v. Civil Service Training Bureau*, 79 F. (2d) 113 (C. C. A. 6th, 1935).

56. 188 U. S. 321 (1903). Chief Justice Fuller's dissent stated: "To say that the mere carrying of an article which is not an article of commerce in and of itself nevertheless becomes such the moment it is to be transported from one State to another, is to transform a non-commercial article into a commercial one simply because it is transported." *Id.* at 364, 371.

57. The factor of interstate transportation did not make baseball a matter of interstate commerce. *Federal Baseball Club v. National League*, 259 U. S. 200 (1922). Also, in *Consolidated Edison Co. v. NLRB*, 305 U. S. 197 (1938), the Court laid to one side the fact that the company purchased various items of equipment outside of the state which then had to be transported into the state. That "... Congress may not exercise its control over the mails to enforce a requirement which lies outside its constitutional province," see *Electric Bond and Share Co. v. SEC*, 303 U. S. 419, 442 (1938).

Insurance might conceivably be said to be a profession involving the sale of certain services. On this assumption, judicial realization that "a profession partakes on its financial side of a commercial business," *Styles v. Lyon*, 87 Conn. 23, 86 Atl. 564 (1913), coupled with a recent important holding that the practice of medicine and the furnishing of medical services constitute a trade, *United States v. American Medical Ass'n*, 110 F. (2d) 703 (App. D. C. 1940), should go far towards establishing insurance as commerce, and hence subject to federal regulation.

the purchase both of a fixed amount of protection against the contingency of death and of an instrument possessing security and investment features. Realistic modern economic analysis regards the purchase of protection against death as the purchase of a consumer good;⁵⁸ in fact, even a state court has been able to regard insurance as a commodity.⁵⁹ The fact that the commodity purchased does not possess the attribute of physical tangibility is certainly no ground for refusing to regard it as an article of commerce, particularly since corporate securities — representing contractual rights as intangible as those in an insurance agreement — are today treated as matters of commerce.⁶⁰ When we deal with the second distinctive feature of the insurance contract, the purchase of a security or an investment, we are dealing with a recognized case of the sale of a commodity, and a commodity, moreover, subject to regulation by the Federal Government under its interstate commerce and mail powers. From this point of view, then, we can say simply that insurance is interstate commerce.

But the subjection of insurance to the commerce power does not depend exclusively upon the view that insurance is in itself the equivalent of commerce. Federal regulation might be grounded upon two alternative theories, either of which would be an adequate basis for bringing insurance within the ambit of the commerce clause. The first of these is that the regulation of insurance is necessary to carry out the Federal Government's fiscal powers. This point will be discussed in a later section dealing with the banking aspects of the insurance company's activities. The second view is that insurance is an intrastate transaction which directly and materially affects interstate commerce.

The rationale whereby the Supreme Court has justified federal regulation of intrastate commerce and transactions — a formula which recent federal statutes have assiduously attempted to imitate — is that intrastate transactions are subject to federal control if they constitute a "direct" and "immediate" burden on "interstate commerce." This formula

58. See NAT. RESOURCES COMM., CONSUMER EXPENDITURES IN THE UNITED STATES (1939) 98; Huebner, *Federal Supervision and Regulation of Insurance* (1905) 26 ANNALS 703.

59. *Beechley v. Mulville*, 102 Iowa 602, 608, 70 N. W. 107, 109 (1897) ("Insurance is a commodity. 'Commodity' is defined to be that which affords advantage or profit. Mr. Anderson, in his Law Dictionary, defines the word as 'convenience, privilege, profit, gain; popularly, goods, wares, merchandise.' It is common to speak of 'selling insurance.' It is a term used in insurance business, and law writers have, to quite an extent, adopted it."). Cf. *Griffin v. Palatine Ins. Co.*, 238 S. W. 637 (Tex. Comm. App. 1922).

60. See cases upholding state blue sky laws: *Alabama & N. O. Transp. Co. v. Doyle*, 210 Fed. 173 (E. D. Mich. 1914); *Bracey v. Darst*, 218 Fed. 482, 495 (N. D. W. Va. 1914); *Geiger-Jones Co. v. Turner*, 230 Fed. 233, 239 (S. D. Ohio 1916). For those sustaining the federal Securities Act of 1933, see particularly *Oklahoma-Texas Trust v. SEC*, 100 F. (2d) 888 (C. C. A. 10th, 1939). See also *Hall v. Geiger-Jones Co.*, 242 U. S. 539, 558 (1917).

seems to represent judicial shorthand for a test of regulability drawn from economic theory and political science rather than from strictly legal considerations. The standard which the Court really seems to be establishing, which may conveniently be called the "integrative test" of interstate commerce, is that the Federal Government can regulate all transactions possessing a clear-cut economic integration with activities the effective regulation of which is within the theoretical competence of government as such (as, for example, where the regulatory activity is not banned by the due process clause), but not within the practical competence of the state where the transaction takes place. Such an analysis renders irrelevant the somewhat metaphysical inquiry whether or not an event is part of the "stream" or "current" of interstate commerce, or acts as a burden to that "stream" or "current."

The showing of economic integration is a matter for an economic brief, a brief on which Time is usually, although not necessarily, of counsel for the Federal Government, because Time is on the side of the increasing integration of American industrial activity.⁶¹ Thus, for example, a later and more adequate demonstration of economic integration serves to explain why the Supreme Court seems to have reversed prior decisions in the *Coronado* cases,⁶² the farm journal cases,⁶³ and the cases involving the stockyards.⁶⁴ The integrative process may be of the forward type, where the producer reaches forth to align himself with the distribution of his product,⁶⁵ or it may be backward integration, where a

61. For a good historical and statistical description of the process, see THORP, *THE INTEGRATION OF INDUSTRIAL OPERATIONS* (1924); for lucid economic analysis, see ROBINSON, *THE STRUCTURE OF COMPETITIVE INDUSTRY* (1932). Robinson discusses vertical disintegration—the separation, into separate industries, of processes originally constituting a single industry, such as has taken place in the printing industry and in the manufacture of automobile parts. Such is the pervasiveness of integration in the American industrial scheme, however, that the disintegrated process, even when viewed in isolation, is likely to display a nationwide integration.

62. In *NLRB v. Jones & Laughlin Steel Corp.*, 301 U. S. 1, 40 (1937) Chief Justice Hughes differentiated the two *Coronado* cases on the ground that in the first case there was lacking a "showing that the action was intended to result in restraint of the supply of coal entering into interstate commerce."

63. Advertising contracts were originally held not to involve the movement of merchandise or the transmission of intelligence in interstate commerce. *Blumenstock Bros. Adv. Agency v. Curtis Pub. Co.*, 252 U. S. 436 (1920). But when it was demonstrated that advertising at compensatory rates was an essential element in publishing farm journals, and therefore more directly integrated with the transportation of the electrotypes containing the advertising and of other papers in interstate commerce, the Court reversed its original holding. *Indiana Farmers' Guide Pub. Co. v. Prairie Farmer Pub. Co.*, 293 U. S. 268 (1934).

64. See *Stafford v. Wallace*, 258 U. S. 495 (1922), distinguishing *Hopkins v. United States*, 171 U. S. 578 (1898) on the ground that the *Hopkins* case had not shown that the prices of livestock were affected by the practices complained of.

65. Forward integration comports with the constitutional fathers' notion of commerce: the fashioning of wares for market. See HAMILTON & ADAIR, *THE POWER TO*

producer seeks to command his raw material sources.⁶⁵ Whether an activity is in interstate commerce, under this test, depends upon the degree to which the particular activity is integrated with activities substantially affecting the national economy. This is a test which emphasizes the particular sort of activity being carried on, or such niceties as changes of legal title, less than it stresses the general economic circumstances surrounding the activity in question.⁶⁷ The test also involves a continual weighing of the potential regulatory efficiency of the state and federal governments, and hence may shift from a presumption in favor of state regulation to one in favor of federal regulation,⁶⁸ or vice versa.⁶⁹

GOVERN (1937) 57-S. Implicit in the facts of cases like *Local Board 167 v. United States*, 291 U. S. 293 (1934), and *Stevens Co. v. Foster and Kleiser Co.*, 61 Sup. Ct. 210 (U. S. 1940), the idea of forward integration becomes explicit in *United States v. F. W. Darby Lumber Co.*, 61 Sup. Ct. 451 (U. S. 1941), in Mr. Justice Stone's discussion of the meaning of "production for commerce."

A forward integration is most likely to occur "at moments when productive capacity outruns consumption, for [its] purpose is the appropriation of certain markets. [It is] likely therefore to be formed in times of depression." ROBINSON, 129. For excellent insight into the transition of citrus-fruit growing from the independent farm unit to the large scale combined processing and marketing activities of the modern packing plant, see *North Whittier Heights Citrus Ass'n v. NLRB*, 109 F. (2d) 76 (C. C. A. 9th, 1940). See also *NLRB v. Crowe Coal Co.*, 104 F. (2d) 633 (C. C. A. 8th, 1939) (indicating integration of production and selling activities in the coal industry).

66. Backward integration is frequently created under monopoly conditions in an effort to prevent exploitation by the owners of raw materials, and is most likely to be created in times of prosperity. See ROBINSON 127-S. For judicial recognition of backward integration see *NLRB v. Tovrea Packing Co.*, 111 F. (2d) 626 (C. C. A. 9th, 1940) (stock raising and feeding regarded as incident to meat-slaughtering and packing rather than to agricultural operations); cf. argument of counsel in *Stafford v. Wallace*, 258 U. S. 495, 504 (1922).

67. See *NLRB v. Tovrea Packing Co.*, *supra* note 66, at 628; *North Whittier Citrus Heights Ass'n v. NLRB*, 107 F. (2d) 76 (C. C. A. 9th, 1940) ("*the nature of the work modified by the custom of doing it determines whether the worker is or is not an agricultural laborer*") (italics supplied). See also *Associated Press v. NLRB*, 301 U. S. 103 (1937); *NLRB v. Bell Oil & Gas Co.*, 91 F. (2d) 509 (C. C. A. 5th, 1937); *Clover Fork Coal Co. v. NLRB*, 97 F. (2d) 331, 334 (C. C. A. 6th, 1938) (question of whether employer paid freight charges held immaterial); *NLRB v. Henry Levaux, Inc.*, 115 F. (2d) 105 (C. C. A. 1st, 1940).

68. Note, for example, how the validity of milk control legislation is accepted [*Neb. v. New York*, 291 U. S. 502 (1934); *Hegeman Farms Corp. v. Baldwin*, 293 U. S. 163 (1934)] until it begins to burden interstate commerce [*Baldwin v. Seelig*, 294 U. S. 511 (1935)], or federal legislation of a similar character steps into the field [*United States v. Rock Royal Co-operative, Inc.*, 307 U. S. 533 (1939)].

69. See *Palmer v. Massachusetts*, 308 U. S. 79 (1939) (in holding that jurisdiction to compel trustees of railroad in reorganization to abandon local stations remained in a state authority rather than in a federal judge, the Court distinguished ICC regulation of intrastate phases of railroad business as "a delicate exercise of legislative policy in achieving a wise accommodation between the needs of central control and the lively maintenance of local institutions"). For an account of repeated unsuccessful efforts to establish state legislation as a burden on interstate commerce, see *Missouri Pac. R. R. v. Norwood*, 283 U. S. 249 (1931).

The application of the test is, of course, largely dependent upon the schools of economics and political science to which the judges adhere. Let us take as a specific illustration Justice McKenna's upholding of state regulation of insurance in *German Alliance Insurance Co. v. Kansas*.⁷⁰ In this decision he relied heavily on Supreme Court precedents upholding the right of the states to regulate the affairs of grain elevators.⁷¹ Reliance on these cases may have been quite appropriate at a time when it could be assumed that grain elevator and insurance activities affected primarily the interests of local farmers and local policyholders, respectively, and that the state was the proper agency to protect either of those classes from extortion and abuse. And, in the absence of appropriate federal legislation, there is no reason why the state should not continue to protect those classes,⁷² as it has continued to do in the field of insurance. However, at the present time, interests far removed from the locality of a grain elevator or the consummation of an insurance contract may be affected by these local, intrastate transactions. Grain elevator charges and insurance company investments, to take two specific incidents, have an impact upon the entire national economy. When local activities become affected with national concern, the states may no longer be competent to regulate them, and the Federal Government may be obliged to step in.

The "integrative" test seems to provide one adequate explanation for the current stand of the Supreme Court in upholding the Labor Relations Act, federal regulation of agricultural production and prices, compulsory federal inspection, and public utility holding company regulation. Does it, in addition, help us put insurance within the category of activities regulable by the Federal Government?

There are several reasons for concluding that it does. As will be shown, the insurance industry, viewed as an investment medium, like the "credit" aspects of industry in general, interpenetrates our whole productive and consumptive economy.⁷³ It therefore cannot be regarded as merely preceding interstate transportation, which is in turn erroneously assumed to constitute the whole of interstate commerce.⁷⁴ In our modern economic

70. 233 U. S. 389 (1914).

71. *Munn v. Illinois*, 94 U. S. 113 (1876); *Budd v. New York*, 143 U. S. 517 (1892); *Brass v. Stoeser*, 153 U. S. 391 (1894).

72. See Mr. Justice Brandeis, dissenting, in *Lemke v. Farmer's Grain Co.*, 258 U. S. 50, 61, 63-5 (1922) (holding Congress did not intend in Grain Standards Act to supersede state inspection and grading acts). Even now the Federal Government does not attempt to encompass the entire field of agricultural inspection, but merely supersedes state inspection laws to the extent that it can. *Curran v. Wallace*, 306 U. S. 1 (1939).

73. It is in a real sense more "basic" than the coal industry, the significance of which in our industrial scheme has been a constitutional mainspring for its federal regulation. See *Sunshine Anthracite Co. v. Adkins*, 310 U. S. 381 (1940); *Clover Fork Coal Co. v. NLRB*, 97 F. (2d) 331, 334 (C. C. A. 6th, 1938).

74. This was the view of interstate commerce taken by the Supreme Court in a series of decisions invalidating New Deal legislation, culminating in *Carter v. Carter Coal*

system, credit and investment activity of the sort carried on by the insurance companies precedes, succeeds, and is contemporaneous with, even the most restricted conception of interstate commerce. It is the medium which gives interstate commerce its vitality.

The "integrative" test fits in admirably with the judicial notion that interstate commerce is characterized by planning on a national scale;⁷⁵ insurance companies particularly must operate in terms of a national investment policy centrally conceived in response to nationwide economic developments. Becoming a little more speculative, it may be suggested that perhaps the psychological concept of "intent," which has been anomalously employed as a determinant of the applicability of the anti-trust laws,⁷⁶ is nothing more than a subconscious surrogate for the economic concept of "integration"⁷⁷ set forth in the *Labor Board*⁷⁸ and *Electric Bond and Share*⁷⁹ cases. Furthermore, what the Supreme Court has done in the *Labor Board* cases is merely to attach the same constitutional consequences to manufacturing businesses possessing a nationwide *vertical* integration that it had attached to financial combinations which were *horizontally* integrated thirty years ago, when it sustained the anti-trust laws.⁸⁰ In any event, it appears that the proper pursuit for the proponent of federal regulation of insurance is not a statistically exhaustive recapitulation of the numerous incidents attached to the insurance industry and

Co., 298 U. S. 238 (1936). A circuit judge has recently criticized the Court in the *Carter* case for considering the bituminous coal industry as made up "of 'distinct and separate activities,' the 'production,' the distribution after the product has 'come to rest,' and the other activities, including the movement in commerce," and said: ". . . it is manifest that in the later opinions of the court the concept of an extensive industry thus delineated in three 'distinct and separate' activities has not controlled decision. It is evident that the concert of the activities in the various industries and the effect of the concert of the activities upon commerce, rather than the delimitation of the parts of the industries, has come to have more weight in the conclusions arrived at by the court." *NLRB v. Crowe Coal Co.*, 104 F. (2d) 633, 637 (C. C. A. 8th, 1939).

75. See *Bay City v. Frazier*, 77 F. (2d) 570 (C. C. A. 6th, 1935). Compare the significance attached by Chief Justice Hughes to service contracts by utility holding companies, which likewise involve nation-wide policy making, in *Electric Bond and Share Co. v. SEC*, 303 U. S. 419 (1938).

76. See, e.g., *Loewe v. Lawlor*, 208 U. S. 274 (1908); *Coronado Coal Co. v. United Mine Workers*, 268 U. S. 295 (1925); *Bedford Cut Stone Co. v. Journeymen Stone Cutters' Ass'n*, 274 U. S. 37 (1927).

77. The two courts concerned with the development of German Cartel Law have differed as to whether a psychological or economic test is to be applied. The German Supreme Court has held an association to be a cartel only if the members *intended* to influence the market, while the Cartel Court has considered decisive the *objective capacity or potentiality* of the cartel to influence the market. 11 TNEC, VERBATIM REC. OF PROCEEDINGS (1940) 323.

78. 301 U. S. 1 (1937).

79. 303 U. S. 419 (1938).

80. See *United States v. Northern Securities Co.*, 193 U. S. 197 (1904); THOMP, *THE INTEGRATION OF INDUSTRIAL OPERATIONS* (1924).

their widespread dispersion and movement across the United States, but the demonstration that all of these individuated transactions are inter-related and that, viewed in their totality, they unmistakably constitute interstate commerce.

THE LIFE INSURANCE POLICY AS A SECURITY

The possibility of valid federal control over securities under the interstate commerce power was recognized in *Hall v. Geiger-Jones Co.*, the first Supreme Court case to sustain the validity of state security regulation under the due process clause.⁸¹ Many cases have since recognized that the state and federal governments possess concurrent jurisdiction over investments and securities.⁸² Recently, however, the courts have realized that the interstate nature of the problems involved and the frequent and continuing use of the mails and the instrumentalities of interstate commerce require the Federal Government to take the lead in security regulation.⁸³ To the extent that it is shown that insurance contracts possess security features, both the need and the constitutional justification for federal regulation of insurance become enhanced.

A demonstration that life insurance contracts have in effect become securities or investment contracts⁸⁴ can be divided into discussion of three aspects of the development of insurance:

(1) The increasing incorporation in whole life policies⁸⁵ of such security features as surrender values, policy loans, optional settlements, and dividends. (2) The gradual emergence of types of life insurance contracts other than whole life which possess an even greater preponderance of security elements. Endowment and annuity contracts furnish examples. (3) The question whether, taking into consideration both of

81. 242 U. S. 539, 558 (1917).

82. See *Dickson v. Uhlmann Grain Co.*, 288 U. S. 188 (1933); *SEC v. Time Trust, Inc.*, 28 F. Supp. 34 (N. D. Cal. 1939); *Bogy v. United States*, 96 F. (2d) 734 (C. C. A. 6th, 1938).

83. *SEC v. Torr*, 15 F. Supp. 315 (S. D. N. Y. 1936); *Coplin v. United States*, 88 F. (2d) 652 (C. C. A. 9th, 1937); *Oklahoma-Texas Trust Co. v. SEC*, 100 F. (2d) 888 (C. C. A. 10th, 1938); *McMann v. SEC*, 87 F. (2d) 377 (C. C. A. 2d, 1937).

84. In this and the succeeding sections of this essay, we shall have frequent occasion to refer to the following: *Transactions*, Actuarial Society of America, referred to as *TRANSACTIONS*; *Record*, American Institute of Actuaries, referred to as *RECORD*; *Report of Joint Meeting*, American Institute of Actuaries, October, 1938, referred to as *Joint Meeting*; *Proceedings*, Association of Life Insurance Presidents, referred to as *PROCEEDINGS*; *MACLEAN, LIFE INSURANCE* (5th ed. 1939), referred to as *MACLEAN*; *MOWBRAY, INSURANCE* (2d ed. 1937), referred to as *MOWBRAY*; *HUEBNER, LIFE INSURANCE* (3d ed. 1935), referred to as *HUEBNER*.

85. Whole life insurance covers the insured for the whole of his life, and must be distinguished from endowment insurance, which provides that insurance will be paid either in the event of death during a specified period or survival to the end of the period, and term insurance, which covers the insured only for a stated period. *MACLEAN* 37, 43, 48.

the above factors, insurance policies, viewed by and large, have become security and investment contracts.

Security Features in the Whole Life Contract

General investment attributes of the whole life contract. We have already indicated that, of the three important successor cases to *Paul v. Virginia* which specifically involved life insurance, counsel in the first two attempted to counteract the abstract contractual approach of *Paul v. Virginia* merely by resort to the multiplicative process; only in the third case were there mentioned the economically salient, but hitherto ignored, investment features of the life insurance industry.⁸⁶ These investment features were not, of course, a matter of full-blown creation. They were rather the product of institutional development from a puny and veiled origin; commonplaces of the insurance industry today were largely unknown to Justice Field in 1868 or to Justice McKenna in 1900 or 1913.⁸⁷ Acceptance of the proposition that life insurance is interstate commerce, or an insurance contract a security is, therefore, not a confession of past judicial error; it is merely a recognition that changing economic factors may have conferred on a group of activities different and more far-reaching effects than they originally possessed.

The increasing importance of whole life protection has emphasized the investment aspect of insurance. The early insurance cases that came before the Supreme Court on the interstate commerce issue usually concerned fire, marine, and casualty insurance. All such types of property insurance have but one purpose—the protection of the policyholder against loss;⁸⁸ life insurance, on the other hand, fulfills a double objective for the policyholder—protection and investment.⁸⁹ Furthermore, while presently we are accustomed to think of life insurance in terms of whole life insurance, a nineteenth century judge might very possibly have been thinking of term insurance, which protected the insured for a limited period only and was originally the only type of insurance sold;⁹⁰ at present, term insurance con-

86. See pp. 964-966 *supra*.

87. Add, to the fact that some of these features were non-existing, the ignorance resulting from the temporal lag between the time an appellate judge like Field or McKenna derived his economic schooling and the time he decided the controversy before him.

88. HUEBNER 221.

89. MOWBRAY 152. The actuarial expression of this double purpose is that the whole life policy is composed of two parts: term insurance, directed towards protection against the contingency of death, and an accumulating investment fund, available upon the contingency of survival. As a policyholder pays in more premiums, he reduces the amount of his term insurance protection and increases the amount of his investment fund. HUEBNER 45, 103, 221.

90. MACLEAN 517, 520-1. This was true in 1847. By 1860 it was no longer true and over 90% of the business consisted of whole life insurance. KNIGHT, *THE HISTORY OF LIFE INSURANCE IN THE UNITED STATES TO 1870* (1920) 118.

stitutes only 15 or 20 per cent of the total life insurance written.⁹¹ Its displacement by whole life insurance has furnished the life companies with investment problems of their own. They have had to anticipate and make their premiums cover claims reaching far into the indefinite future, instead of being able to wipe the slate clean at the end of the year or at the normal expiration of the term of insurance.⁹² Since the law demanded that they accumulate reserves which would be sufficient to pay these claims when they arose at death, life insurance companies acquired far greater reserves than were necessary for other types of insurance,⁹³ thus accumulating large reservoirs of funds clamoring for investment. Furthermore, since the investments of the companies bore a higher rate of interest than the interest upon which the policyholders' premiums were calculated, the reserves, which originally had consisted only of policyholders' premiums, began to consist largely of investment profits,⁹⁴ themselves in turn seeking reinvestment. The accumulation and conservation of such large reserves⁹⁵ supplied a tremendous impetus towards investment activity by the life insurance companies, a condition which was aggravated when the companies began granting policyholders individual rights in the reserve, of the character described in the following section.

Cash values and policy loans. The idea that the insured has a right to the pro rata share of the insurance company's reserves to which his individual premiums have contributed originated with Elizur Wright in 1858. It bore fruit, even before *Paul v. Virginia* was decided, in various state laws providing that a policy could not be forfeited while the in-

91. Furthermore, the term insurance written currently is usually written on a basis permitting ready conversion into whole life insurance. MACLEAN 49. About two-thirds of all life policies issued are whole life; and about 80 to 85%, whole life and endowment. HUEBNER 222. Term insurance has been described as the only non-investment type of life insurance. HUEBNER 102. Both the short period of coverage and the fact that it is directed to the goal of protection make it more comparable to property insurance than any other type of life insurance. HUEBNER 115.

92. *Penn Mut. Life Ins. Co. v. Lederer*, 252 U. S. 523, 534 (1920). The fire companies also have investment problems, but of more limited nature, and it cannot be said that their policyholders regard fire insurance as an investment.

93. For example, the fire and marine insurance companies doing business in New York, which insure risks of considerably more than twice the face value of the outstanding policies of the life insurance companies doing business in that state, possess only one-sixth of the invested assets of these life insurance companies. Linton, *The National Asset in Life Insurance*, BEST'S INSURANCE NEWS (Life ed.) June 1, 1933, 80, 82. See also Hurd, (1933) 34 TRANSACTIONS 317.

94. It has been pointed out that investment earnings of a specific company made up more than one-half of the whole reserve. *Duffy v. Mutual Benefit Life Ins. Co.*, 272 U. S. 613, 617 (1926).

95. Amounting to from 80 to 90% of their total liabilities. HUEBNER 276; Hurd, (1933) 34 TRANSACTIONS 317.

sured's share in the reserves was unexhausted, and that this share must be applied by the company to the purchase of additional insurance.⁹⁶

However, it was not until much later that Wright's companion idea, that the insured is entitled to withdraw his share in cash or to borrow on it, *i.e.*, that his policy has a certain cash or loan value, was made a statutory requirement.⁹⁷ The fact that whole life insurance had a cash value on which the policyholder could draw was one of the reasons why it displaced term insurance in popularity, for the term policyholder had no right to a cash value, either during or at the expiration of his period of protection.⁹⁸

The policyholder was not only entitled to the cash surrender value of his policy; he was also able to borrow on the security of his share in the company's reserve. Currently, one third of all life insurance policyholders borrow on their policies.⁹⁹ Policy loans in 1906 were 8.9 per cent of the total assets of the life companies; by 1932 they had risen to 17.9 per cent, but by 1938 they were down to 12.1 per cent.¹⁰⁰ Cases have been reported of companies with as much as 33 per cent of their assets in this status. The companies have supposedly made strenuous efforts to discourage borrowing, largely out of apprehension that the ultimate consequence of borrowing would be termination of the policy,¹⁰¹ but this endeavor has not checked the popularity of these loans.

The cash surrender and policy loan devices have found their chief employment in periods of depression. Although cash and loan values were

96. See MACLEAN 139, 529. The first such statute was the Massachusetts law of 1861. See Shepherd, *The Legal Reserve System in the United States* (1939) 28 RECORD 274. For discussion of the various so-called non-forfeiture options, *i.e.*, reduced paid-up insurance, extended term insurance, and the automatic premium loan, see MACLEAN 196.

97. Provision for a cash surrender value was first made in the Massachusetts law of 1880. See Shepherd, *supra* note 96, at 287-288. See Linton, *The National Asset in Life Insurance*, BEST'S INSURANCE NEWS (Life ed.) June 1, 1933, p. 80; Phillips, (1932) 21 RECORD 67; Thompson, *Address of the President* (1932) 33 TRANSACTIONS 323, 327.

98. Even now state laws generally do not require cash and loan values on policies for shorter terms than twenty years.

99. *Hearings* 4371.

100. *Hearings* 1211. In the period from 1929 to 1938, policy loans of the twenty-six leading companies increased from 1,923 million dollars to 2,882 million dollars. *Hearings* 14813. These figures must be viewed with a certain amount of caution. Inasmuch as policy loans are very frequently followed by surrenders, an increasing cash demand for loans may very well be accompanied by a decrease in the policy loan account.

In 1933, when policy loans amounted to \$3,117,465,000, they were over 20% of the admitted assets of 15 of the 25 principal life companies. *Hearings* (part 10A) 93, 103.

101. Berman, *Borrowing on Life Insurance Policies* (1938) 196 ANNALS 176-7. A policyholder who has already been compelled to borrow on his policy is more likely, in the ultimate analysis, to prove unable or unwilling to meet his policy premiums than the holder of an unencumbered policy. Higher termination rates characterize both encumbered policies [Thompson, (1932) 33 TRANSACTIONS 323, 325] and policies replacing heavily loaned insurance.

a novel and untried phenomenon at the time of the financial panic of 1901,¹⁰² and the increase in the volume of policies surrendered for cash and policy loans which took place in connection with the financial panics of 1907-8 and 1920-1 was slight,¹⁰³ resort to cash and loan values occurred in the depression years following 1929 on an epoch-making scale. The volume of cash surrenders and policy loans has been estimated at \$7,000,000,000 for the six-year period 1930-1935.¹⁰⁴ The increase in policy loans by many companies was greater than the increase in total assets, meaning that other assets of the company had declined in value. This tidal wave could not be stopped by any efforts the insurance companies made to discourage it,¹⁰⁵ and resort was ultimately had to moratory legislation calling for deferred or installment payments. Twenty-seven states adopted moratory regulations; the rules they adopted differed considerably in minor details, and frequently resulted in undesirable conflicts of jurisdiction.¹⁰⁶ The all-inclusive nature of the embargoes on cash values that had to be imposed,¹⁰⁷ and the conflicts in jurisdiction among the states, together with the realization that, for competitive reasons, it was necessary that all the major state insurance departments come to a general agreement in order to declare an effective moratorium,¹⁰⁸ justified the suggestion made by at least one insurance official that emergency legislation of this type should come under the jurisdiction of the Federal Government.¹⁰⁹ Had one or two leading states failed to take the necessary measures to meet these wholesale withdrawals, the insurance in-

102. Strong, (1932) 33 TRANSACTIONS 409.

103. Linton, *Panic and Cash Values* (1932) 33 TRANSACTIONS 365, 373, is a stimulating discussion of this whole subject, and will hereafter be drawn on without specific citation. In 1907, cash surrenders plus the increase in the policy loan account amounted to 6.1% of total life insurance reserves as contrasted with lows of 1.9% in 1894 and 3.9% in 1911 and 1912. The short post-war panic in 1921 drove the percentage up to 5.5%, from the 1.7% that it had been in 1919.

104. Linton, *Joint Meeting* 56. The 1929 depression skyrocketed the percentage of cash surrenders and increases in the policy loan account to 7.1%; the 1932 estimate was 11.4%. Such a run would be impossible under the British system, since British policies do not have guaranteed cash values. Elderton, *Joint Meeting* 66.

105. *Hearings* 1187. The high rate of interest attaching to policy loans acts as something of an automatic deterrent.

106. For a good analysis of the moratory legislation, see Laird, *The Moratorium on Cash Withdrawals* (1933) 34 TRANSACTIONS 55.

107. These embargoes "applied to every form of voluntary withdrawal such as loans, cash values, dividends on deposit, and proceeds which had been left with the company after death or maturity." Laird, *supra* note 106, at 58.

108. Although the insurance companies had delay clauses in their contracts, the clauses could not become practically effective unless the companies took unanimous action under them. The imposition of legal sanctions did impose unanimity of action on the companies. Phillips, (1932) 21 RECORD 65.

109. Corbett, (1933) 22 RECORD 77-8.

dustry might have been plunged into a financial situation perilous for itself and dangerous to the national economy.¹¹⁰

Public realization that even the vast premium and interest income of the insurance companies could not meet the cash drain occasioned by policyholders who wished to cash in or borrow on their policies (the depression made it impossible for the companies to sell their bonds without incurring heavy losses) and that the statutory limitations on cash and loan values were but temporary stopgaps, focused attention on the importance of the cash value and policy loan in the insurance contract. Speculation was rife that the next depression might see the life companies in an even worse position, since the rate of policy loans and surrenders would probably increase. Furthermore, since the new depression period would probably be one in which the rate of new insurance business would not be increasing (and might even decline), there would be less cash premium income available to pay cash values, precisely at a time when there would be higher cash values to pay.¹¹¹

The problems raised by the necessity for accumulating reserves and, in addition, by the cash drain on the company caused by cash surrenders and policy loans are primarily investment problems.¹¹² Thus, for example, in order to meet cash demands, an insurance company must adjust its investments so as to obtain nonfluctuating and liquid assets.¹¹³ Since

110. It may be argued that the situation which confronted the insurance companies in the 1929 depression was unusual and that, therefore, any constitutional arguments predicated on that situation are made *in terrorem*. But it is the function of the Federal Government to prepare for emergency situations as well as cope with them when they arise. Besides, every constitutional argument is based in some degree on similar *in terrorem* considerations.

111. Strong, (1932) 33 TRANSACTIONS 409, 410.

112. A cash value, viewed retrospectively, may be considered the equivalent of an endowment, which is clearly an investment enterprise (see p. 990 *infra*). Cash surrenders and loans have, as a matter of fact, been considered destructive of the purpose of life insurance. *Hearings* 14758. The policyholders' premiums have been said to be funds entrusted to managers to invest; and managers alleged to have a trustee's responsibility to the policyholders. Comment (1939) 48 YALE L. J. 839; MACLEAN 139. However, the cases, although they sustain a trust analysis for the managers of fraternal organizations [*National Circle v. Hines*, 88 Conn. 676, 92 Atl. 401 (1914); *Die Gross-Loge Des Ordens Der Hermanns-Soehne v. Wolfer*, 42 Colo. 393, 94 Pac. 329 (1903); *Most Worshipful Grand Lodge v. Callier*, 224 Ala. 364, 140 So. 557 (1932)], disclaim such a theory for insurance companies. *Equitable Life Assur. Soc. v. Brown*, 213 U. S. 25 (1909); *Uhlman v. New York Life Ins. Co.*, 109 N. Y. 421, 17 N. E. 363 (1888); *Townsend v. Equitable Life Assur. Soc.*, 263 Ill. 432, 105 N. E. 324 (1914); *Pierce v. Equitable Life Assur. Soc.*, 145 Mass. 56, 12 N. E. 858 (1887); *Moore v. Pilot Life Ins. Co.*, 86 F. (2d) 197 (C. C. A. 4th, 1936).

113. Evans, (1933) 22 RECORD 333; Poorman, (1934) 23 RECORD 130. For a statement as to how liquidity is obtained see Law, *Investment Trends and Traditions* (1931) PROCEEDINGS 66, 76. The companies' liquidity is primarily due to their premium income; liquidity may be unobtainable even in the case of government bonds. McAndless, *Joint Meeting* 77-8.

liquid assets are low-interest bearing assets, their acquisition necessarily reduces the interest returns of the company;¹¹⁴ in addition, it cuts down on more profitable investment opportunities which the company might find in other directions.¹¹⁵ Furthermore, should the company be forced to liquidate a large portion of its assets in order to procure cash, the sudden liquidation of these assets would result in depreciated values, thereby posing still further investment problems.¹¹⁶

It may be concluded that, on the whole, intensive surrendering of policies for cash creates investment problems with respect to the underlying security behind a policy comparable with those which would be experienced by the managers of other investment enterprises. The fact that cash withdrawals from the company operate to reduce dividends and raise the cost of insurance for persisting policyholders and, in times of stress, reduce the value of the company's underlying security has been advanced as a justification for requiring the imposition of surrender charges when the policyholder withdraws his reserve in the form of a cash value.¹¹⁷ But it is generally agreed that surrender charges, however high, will neither perceptibly check the flow of withdrawals¹¹⁸ nor appreciably mitigate the company's investment problems.

Policy loans pose for the companies the same sort of investment problems raised by cash surrenders, but they have one outstanding difference: they constitute an actual investment activity of the company,¹¹⁹ while cash surrenders furnish compulsions to investment and disinvestment in critical times without being themselves investment activities. In addition, policy loans, ever since the depression, have carried a higher rate of interest — despite the absence of risk to the company — than characterizes any other insurance company investment.¹²⁰

114. Thompson, (1934) 23 RECORD 146. Conversely, the fact that an investment cannot be turned at once into cash involves getting a higher interest rate on it. See Collins, *Joint Meeting* 84.

115. Linton, *Joint Meeting* 65.

116. Little, (1933) 22 RECORD 64. For a more optimistic way of stating the same proposition, see Howland, *America's Great Reserves* (1933) PROCEEDINGS 9.

117. Coburn, (1933) 22 RECORD 69, 74. See Hardin, *Three Years of Performance* (1932) PROCEEDINGS 81, 90. In England, in lieu of surrender charges, the valuation basis of reserves was changed. Coler, (1932) 21 RECORD 74.

118. Rhodes, (1932) 33 TRANSACTIONS 411, 412; Little, (1933) 22 RECORD 77; Larsen, (1932) 21 RECORD 62; Phillips, (1932) 21 RECORD 63 (also indicates that moratory legislation is but a temporary aid); Coler, (1932) 21 RECORD 76; Budinger, (1932) 21 RECORD 77; Rietz, (1933) 22 RECORD 66.

119. Compare *Home Life Ins. Co. v. Stephens*, 190 Ark. 1018, 82 S. W. (2d) 515 (1935) (policy loan unsuccessfully urged to constitute a mortgage).

120. Berman, *supra* note 101, at 180. The average rate of income from policy loans was 5.79%. Although the policy loans of the twenty-six leading companies were 11.62% of their admitted assets as of December 31, 1938, they produced 18.66% of their total investment income. *Hearings* 14813. For the relation of policy to bank loans see Thompson, (1932) 33 TRANSACTIONS 327; Coler, (1933) 22 RECORD 61.

Insurance creates investment problems for the policyholders as well as for the companies. The experience of the twenties and early thirties demonstrates the correlation between insurance policies and the credit and investment needs of the policyholders. Policyholders employ their insurance as other investors use mortgages or bonds—as a basis for conversion into ready cash or as collateral for a loan.¹²¹ In depression times, the policyholder avails himself of these conversion privileges out of financial stringency; in boom times, he will presumably be motivated to do so by a desire to invest in more speculative, potentially more remunerative, fields.¹²²

So much for cash values which are distributed to the policyholder. Undistributed cash values may be regarded merely as funds, in the nature of savings deposits, left with the company. They have been said by the courts not to amount to life insurance at all.¹²³

Dividends. Spokesmen for the insurance companies proudly announce that dividends constitute 12 per cent of the premium dollar contributed by the policyholder.¹²⁴ Dividends are also an integral component of the company's investment situation. In the first place, they are intimately related to cash values and policy loans. Thus, for example, a dividend reduction may increase premium income to the company, but it will at the same time result in increased cash surrenders, thereby imposing a counterbalancing cash drain, involving investment difficulties, on the company.¹²⁵ Furthermore, the greater the surrender values accorded retiring policyholders, the less the dividends available for continuing ones.¹²⁶ In addition to this indirect effect of dividends upon the company's investment problems, a special class of dividends, those that have been left with the company by the policyholder to accumulate at interest, may impose a direct cash drain on the company.

The relationship of dividends to cash values and loans has been a matter of actuarial speculation which has not been passed upon by the courts. Most courts, in describing the nature of insurance policy dividends, as they have had occasion to do in other connections, unfortunately have muddled the issue. They have correctly assumed that the premium collected by the company exceeds the cost of furnishing insurance pro-

121. For an example of another use to which an insurance policy may be put—a testamentary instrument—see *Helvering v. Le Gierse*, 61 Sup. Ct. 646 (U. S. 1941).

122. This is even more characteristic of annuities. See pp. 992-993 *infra*. The situation is analogous to a bondholder turning in his bonds so that he may invest in stocks, with their potentially larger profits.

123. *Minnesota Mut. Life Ins. Co. v. United States*, 66 Ct. Cl. 481 (1928), *cert. denied*, 279 U. S. 856 (1929).

124. *The Case for Insurance*, NATION'S BUSINESS, January 1940, pp. 35, 41.

125. *Linton*, (1932) 33 TRANSACTIONS 428. See *Rhine v. New York Life Ins. Co.*, 273 N. Y. 1, 13, 6 N. E. (2d) 74, 78 (1936).

126. See *Thompson*, (1932) 21 RECORD 78; *Henderson*, (1932) 33 TRANSACTIONS 426.

tection — the amounts necessary to pay death claims plus the operating expenses of the company — and that this excess allows the company to engage in investment activity.¹²⁷ They have incorrectly concluded, however, that a dividend is merely a refund of part of the premium paid for the year, and have overlooked the fact that a dividend consists of an investment element: interest earnings on the reserve maintained during the year.¹²⁸

There may be some justification for their conclusion in the case of term insurance taken out for one year, where the dividend might be construed as a return to the policyholder of part of his current year's premium, based on unexpectedly favorable mortality during the year or on savings in administrative expenses.¹²⁹ Such an inference is not justified, however, in the case of whole life insurance. As has been pointed out by Mr. Justice Brandeis and by the taxation experts, a class quite wary of procedures involving fiscal segregation, a return on the current premium is only one component of the policy dividend; the dividend also involves a return based on investment income.¹³⁰ Its payment is dependent upon "the business sagacity exhibited in financial management, the state of the investment market and a variety of factors always present in the conduct of the business."¹³¹

Accounting agnosticism would easily have shown the courts wherein they erred. In sustaining state acts requiring insurance companies to declare annual dividends, courts have said that such laws were only one

127. The Supreme Court has recently pointed out that premium receipts "were not true income but were analogous to permanent capital investment." *Helvering v. Oregon Mutual Life Ins. Co.*, 61 Sup. Ct. 207, 208 (U. S. 1940). *Cf.* *United States Life Ins. Co. v. Spinks*, 126 Ky. 405, 96 S. W. 889 (1906), 103 S. W. 335 (1907). An English actuary has estimated that 30% of a policyholder's premium goes to secure a fluid and flexible contract which takes the form of sharing in the profits and dividends of the company. Elderton, *Joint Meeting* 72.

128. The cases state that a policy dividend is not the equivalent of an ordinary corporate dividend. *Comm'r v. Illinois Life Ins. Co.*, 80 F. (2d) 280 (C. C. A. 7th, 1935); *Coons v. Home Life Ins. Co.*, 368 Ill. 231, 13 N. E. (2d) 482 (1938); *United States Life Ins. Co. v. Spinks*, *supra* note 127.

129. See *United States Life Ins. Co. v. Spinks*, *supra* note 127. In other words, the policyholders' premiums minus the dividends returned to them presumably is the cost of insuring their group for the current year.

130. See *Penn Mut. Life Ins. Co. v. Lederer*, 252 U. S. 523 (1920); *cf.* Crane, C. J., dissenting in *Rhine v. New York Life Ins. Co.*, *supra* note 125, at 83. 1 PARKER, PRELIM. REP. ON FED. TAXATION OF LIFE INSURANCE COMPANIES TO JOINT COMM. ON INT. REV. TAXATION, 71st Cong. (1929) Pt. 6, p. 6. Taking a policy premium as a contribution of capital, the courts consider a policy dividend as a return of capital. It would be better to say that a dividend constitutes a return of capital *plus* income on the company's investment. It might be still better to describe dividends merely as a competitive feature related neither to earnings nor to capital, since they are paid when neither earnings nor capital condition warrant payment. MACLEAN 168.

131. *Minnesota Mut. Life Ins. Co. v. United States*, 66 Ct. Cl. 481, 497 (1928).

jump removed from non-forfeiture laws, since non-forfeiture laws endeavored to preserve the policyholder's "reserves" from confiscation, while the enforced allocation of dividends assured the return to the policyholder of his contribution to "surplus."¹³² Had the courts reflected on the fact that this so-called surplus could consist of "earned" surplus, *i.e.*, investment income, as well as "paid-in" surplus, *i.e.*, the premium, they would have been saved from an accounting fallacy and would have realized that an insurance policy dividend contains an investment element totally divorced from the cost of insurance protection.

Optional settlements. There is another large and increasingly important class of payments made by insurance companies, which commence with the death of the insured, continue for long periods of time thereafter, and constitute investment programs for the policyholder's dependents. Policyholders who are anxious to see that the proceeds of a policy are not dissipated at once by their beneficiaries but are made available to them over a period of years generally enter into what are known as optional settlements. These options involve keeping the proceeds of the policy on deposit with the insurance company, accumulation by the company of interest which is ultimately made available to the beneficiary, and the making of annual payments to the beneficiary.¹³³

About 15 or 20 per cent of the total proceeds applied under settlement options are applied under options involving life annuities,¹³⁴ which will be dealt with below. Although the great number of settlement options may carry out the insured's intention to protect his beneficiary, they are less contracts of life insurance than they are banking and trust services performed for the beneficiary.¹³⁵ They do not essentially differ from the life insurance trusts ordinarily administered by a trust company or bank, except that the bank or trust company can exercise greater discretion. Recognition of the novel non-insurance aspects of these settlements is found in the fact that most companies repossess the original insurance policy and issue a new supplementary contract to embody the terms of the settlement options. The companies have admitted that if the settlement option were to be issued as an entirely new contract, it would constitute an invasion of the banking field,¹³⁶ and they have therefore recom-

132. Tontine and semi-tontine schemes had the opposite effect. In them, the policyholder's dividend was lost if the policy lapsed or the insured died before the end of the tontine period. *United States Life Ins. Co. v. Spinks*, *supra* note 127.

133. See MACLEAN 213; Linton, *Joint Meeting* 64; *Hearings* 4570.

134. The beneficiary under the original contract becomes the annuitant under the supplementary contract containing the settlement option. As in the case of annuities, the company's profits in the case of settlement options are adversely affected by declining interest rates and low mortality. Larsen, (1935) 24 RECORD 74.

135. Marshall, (1935) 24 RECORD 69, 72.

136. Marshall, (1935) 24 RECORD 72-3. See Clark, (1935) 24 RECORD 79.

mended endorsement of the original policy in lieu of the issuance of a new document. Life insurance executives have deplored the interpolation in these supplementary contracts of phraseology derived from banking rather than life insurance; the proceeds of the policy, for example, are described as the "principal sum" or "trust fund," the beneficiary as the "owner or depositor."¹³⁷ But this kind of linguistic diffusion is quite understandable in view of the similarity of function involved.

Settlement options, in short, merely represent trust company and investment services rendered the beneficiary by the insurance company.¹³⁸ Their importance is considerably greater than their volume would indicate, since they are a distinct competitive feature in the insurance industry, and have latterly shown a marked tendency to increase in volume.¹³⁹

Other Security Aspects. Half of the insurance companies have in their contracts an automatic premium loan feature which permits policyholders who are unable to meet their premiums to borrow sums sufficient to pay those premiums up to the cash value of their policies. Inasmuch as interest is paid on the loan, options of this sort represent an investment activity for the company. Insurance policies may also be used as collateral for loans from sources other than the insurance company itself; in addition, they are a medium for the investment of corporate funds,¹⁴⁰ and the possession of insurance improves the policyholder's credit rating.¹⁴¹

It seems unnecessary, however, to dwell further on these security and investment aspects which feature not only whole life insurance policies, but other types of life insurance as well. Instead, let us suggest two provisional queries which we may shortly be in a position to answer more exhaustively: First, might it not be said that insurance policies possess many features in common with installment investment bonds? The latter frequently contain provisions for cash surrenders, loan values, and optional settlements.¹⁴² Secondly, are not insurance policies analogous to the face amount installment certificates sold by investment trusts¹⁴³

137. Marshall, (1935) 24 RECORD 70-1.

138. *Hearings* 4540, 4586. See also Wood, (1935) 24 RECORD 80; Fassel, (1935) 24 RECORD 81.

139. *Hearings* 4588. The records further indicate that in the case of the leading 26 companies alone, special contracts for the disposition of matured policy proceeds not involving life contingencies increased from 241 millions in 1929 to 1,182 millions at the end of 1938. *Hearings* 14697. As with other cash drains, the companies have had to defer or stagger withdrawals in connection with settlement options during the depression.

140. Policies on the lives of corporate officers, over and above their function of minimizing the loss of the officers' services, furnish a means of tax avoidance. See PAUL, *SELECTED STUDIES IN FEDERAL TAXATION* (2d ser. 1938) 163.

141. For further discussion see HUEBNER 65-70.

142. *Motter v. Bankers Mtge. Co.*, 93 F. (2d) 778 (C. C. A. 10th, 1937).

143. See SEC, *REP. ON INVESTMENT TRUSTS AND INVESTMENT COMPANIES*, 75th Cong., 1st Sess. (1939), Pt. 1, 43-4. These face amount installment certificates differ from other installment investment plans in that the date of maturity, the maturity value,

which, besides possessing the above-mentioned features,¹⁴⁴ contain insurance provisions and annuity options,¹⁴⁵ and have been treated as securities by the courts?¹⁴⁶

Endowment and Annuity Contracts

The earliest class of whole life policies provided for continuous payments throughout the life of the insured. Limited payment and single premium policies, which were a later development, represent a greater proportionate payment for investment than for insurance protection. Indeed, single premium policies are said to attract the policyholder chiefly because of their investment features.¹⁴⁷ They also introduce investment considerations for the company which the continuous payment policies do not possess, since the entire premium has to be invested at once. Most of the increase in the use of single premium policies has been said to be "due entirely to a desire to have the advantages of the life insurance

and the surrender values of the certificate are stipulated at the outset [*Investors' Syndicate*, YOUR INVESTMENTS, Jan. 1940, p. 57], whereas other installment investment plans give their certificate holders fluctuating amounts. SEC, REP. ON COMPANIES SPONSORING INSTALLMENT INVESTMENT PLANS (1940) 5-6.

144. For example, selling commissions, or "loading," are taken out of the installments paid within the first and second years and materially reduce the surrender values of the installment certificates. *Id.* at 33. Similar initial expenses have led insurance companies in the past to insist upon reduced surrender values or none at all for contracts surrendered in their early years. MOWBRAY 159. For discussion of loans to certificate holders, see SEC, REP. ON COMPANIES SPONSORING INSTALLMENT INVESTMENT PLANS (1940) 37.

145. Only one face amount installment certificate series sold since 1934 contains an optional insurance provision; they have typically, however, carried optional settlement provisions reminiscent of annuities. See SEC, REP. ON INVESTMENT TRUSTS AND INVESTMENT COMPANIES, *supra* note 143, at 33. Installment investment plans, on the other hand, frequently have contained insurance options, in order to increase the allure of the plan to investors. See SEC, REP. ON COMPANIES SPONSORING INSTALLMENT INVESTMENT PLANS (1940) 3. Despite the fact that the provision in effect inured to the benefit of the company [*Installment Investment Plans*, YOUR INVESTMENTS, Jan. 1940, p. 51], the certificate holders were led to believe that they were getting insurance policies on their lives. See SEC, REP. ON COMPANIES SPONSORING INSTALLMENT INVESTMENT PLANS (1940) 117-20.

146. *Wilcutts v. Investors' Syndicate*, 57 F. (2d) 811 (C. C. A. 8th, 1932); *Nat. Thrift Corp. v. Welch*, 56 F. (2d) 1077 (S. D. Cal. 1931). *Contra*: *Fidelity Investm. Ass'n v. United States*, 5 F. Supp. 19 (Ct. Cl. 1933).

147. The buyers of single premium policies are actuated by the same motive as the buyers of annuities—fear of other forms of investment. *Harrison*, (1932) 21 RECORD 104. A positive correlation has been found between the issuance of single premium policies on the one hand, and bank failures and undermining of public confidence in banks on the other. *Bassford*, (1932) 21 RECORD 108. Furthermore, it has been feared that the Government might view single premium policies as an encroachment on the investment field justifying the withdrawal of present tax exemptions accorded insurance policies. *Stevens*, (1932) 21 RECORD 106.

companies' investment organization."¹⁴⁸ It should be noted, however, that while single premium policies will improve the company's cash position at the outset, it is also quite possible that many of their holders will ask for their cash surrender values at times unpropitious for the company.

Endowment and annuity contracts, like single premium payments, are investment contracts purchased primarily to take advantage of the insurance company's investment services. In fact, a "pure endowment" — a promise to pay the insured a certain face amount at a stipulated time if he is still alive¹⁴⁹ — is said not to be life insurance at all, for in such contracts payment of the sum due the insured is conditioned only upon the event of survivorship and not at all upon the occurrence of death.¹⁵⁰

If a life protection feature is added to a "pure endowment" contract (as is almost invariably the case), the policyholder collects the same face amount of insurance in the event *either* of death *or* of survivorship at the stipulated date. Since the face amount of the endowment is the product of investment activity by the insurance company,¹⁵¹ and is available to the policyholder whether he lives or dies, the status of the holder of a single premium ten-year endowment policy does not seem to differ very materially from that of the holder of a ten-year bond.

There seems, therefore, to be more than a nominal coincidence in the fact that some life insurance companies have raised capital through the medium of a special type of security called an "endowment bond."¹⁵² Face amount installment certificates and government baby bonds are particularly close analogues to endowment insurance, since in neither case is the holder entitled to draw interest before maturity. In fact, so similar are endowments to ordinary investments that litigants have contended, unsuccessfully, that they are not life insurance.¹⁵³

148. Stevens, (1932) 21 RECORD 106.

149. *Ibid*; cf. McCankie, *Address of President* (1936) 25 RECORD 434-5. See Lucas v. Alexander, 279 U. S. 573 (1929), where the Court in effect decided that the value of a policy was not its actual surrender value but its worth in terms of its ultimate investment potentialities.

150. MACLEAN 44. See U. S. Life Ins. Co. v. Spinks, 126 Ky. 405, 96 S. W. 889 (1906), 103 S. W. 335 (1907); Comm'r v. Illinois Life Ins. Co., 80 F. (2d) 280, 282 (C. C. A. 7th, 1935).

151. The actuaries express this thought by saying that endowment insurance can be considered either as (a) level premium term insurance plus a "pure endowment" or as (b) decreasing term insurance plus increasing sinking fund accumulations. The "sinking fund" element is purely an investment element. MACLEAN 44-5.

152. See *In the Matter of Bankers Union Life Co.*, 2 S. E. C. 63 (1937) (endowment bonds floated by a holding company of an insurance company possessed cash surrender and loan values but neither was available until payment of third annual installment).

153. The courts have refused to accept the argument. *Comm'r v. Illinois Life Ins. Co.*, 80 F. (2d) 280 (C. C. A. 7th, 1935); *Endowment & Benev. Ass'n v. State*, 35 Kan. 253, 10 Pac. 872 (1886) (action to oust mutual life company from doing endowment busi-

The annuity contract, while it has a history antedating¹⁵⁴ and a purpose divergent from that of life insurance proper, attained an unparalleled development in the nineteen thirties.¹⁵⁵ It is a promise to pay the insured a certain stipulated income each year for the period of the policy or the duration of his life. The making of annuity contracts is not specifically restricted by statute to insurance companies;¹⁵⁶ furthermore, the authority conferred upon insurance companies to enter into annuity contracts is usually conferred in a different section of the authorizing statute.¹⁵⁷

The primary objective of life insurance is the upbuilding of an investment fund throughout the life of the policy, so as to have the face amount of the policy available upon the death of the insured; the specific mission of the annuity, on the other hand, is to liquidate a specific sum, and nothing remains to be refunded upon the annuitant's death.¹⁵⁸ Annuities therefore raise investment complications not present in life insurance proper; they are more nearly similar to those applicable to endowments.¹⁵⁹ An annuity contract is not a wagering contract in the sense in which insurance is,¹⁶⁰ it neither insures against a risk or contingency nor states a promise to pay a fixed or ascertainable amount. In cases where life annuities are not involved, the company has little concern with mortality tables; an annuity for a definite period is solely an investment proposition between the company and the annuitant.¹⁶¹ Furthermore, insurance is usually paid for in the form of recurrent payments, weekly, monthly,

ness on ground that law restricted it to a life insurance business); *Townsend v. Equitable Life Assur. Soc.*, 263 Ill. 432, 105 N. E. 324 (1914).

Endowments, it should be noted, date from just about the time of *Paul v. Virginia*. WRIGHT, *THE BIBLE OF LIFE INSURANCE* (1932) 62.

154. In France, for example, and in Great Britain, where the government was selling annuities before insurance companies were formed. Melsted, (1935) 24 *RECORD* 105. In the United States, up to the middle of the nineteenth century, the companies selling life insurance found their annuity business much more important. See MacLEAN: 64-5, 518-21.

155. Annuity premiums, which totalled only \$41,000 in 1866, aggregated 90 million dollars in 1930, 454 million dollars in 1935 and 363 million dollars in 1938. See *Hearings* 15468; *id.* (part 10A) 55, 62.

156. *Carroll v. Equitable Life Assur. Soc.*, 9 F. Supp. 223 (W. D. Mo. 1934).

157. *Commonwealth v. Metropolitan Life Ins. Co.*, 254 Pa. 510, 98 Atl. 1072 (1916).

158. HUEBNER 107, 108, 114. See *Rishel v. Pacific Mut. Life Ins. Co.*, 78 F. (2d) 881 (C. C. A. 10th, 1935).

In the case of life annuities unduly low mortality experience inflicts losses upon companies, whereas gains would result in the case of life insurance proper. *Cf. Hearings* 4545.

159. An annuity contract theoretically provides nothing more than a series of annual matured "pure endowments." Marshall, (1935) 24 *RECORD* 69; MOWBRAY 154. A pure endowment, we have already seen, is investment. Furthermore, a policyholder may convert a fixed endowment into an annuity contract, if he exercises the option of taking the face amount of his endowment in annual payments rather than in a lump sum.

160. *People v. Knapp*, 193 App. Div. 413, 184 N. Y. Supp. 345 (3d Dep't 1920).

161. *Carroll v. Equitable Life Assur. Soc.*, 9 F. Supp. 223 (W. D. Mo. 1934).

or annual, and results in the payment of a lump sum; annuities are usually paid for in a stipulated sum and result in monthly or annual payments.¹⁶² It is small wonder, therefore, that the courts have so frequently held that annuity contracts are not insurance contracts.¹⁶³ However, since companies doing only an annuity business can properly be described as insurance companies, we must take account of the annuity business in any exhaustive consideration of the insurance industry.

The present abnormally large demand for annuities is a depression phenomenon, deriving from investors who, for one reason or another, have decided to shift away from speculative investments and put either a lump sum or a fixed number of annual payments to work in a form which will insure them a conservative return.¹⁶⁴ Due to fiscal demands caused by low rates of mortality and generally disorganized investment conditions, annuity contracts have added to the insurance companies' current investment difficulties.¹⁶⁵

Annuities not only call for work analogous to that performed by the investment and commercial banker,¹⁶⁶ they also contain a distinct savings bank element. Deferred or retirement annuities are usually sold with cash values attaching to them, although the law does not compel this result.¹⁶⁷ The buyer of an annuity may therefore be one who has simply decided upon the insurance company as a safe place to keep his money while interest rates are low, without any intention of ever beginning to take his annuity. When the general money market offers him higher rates of interest than the rate at which the premiums on his annuity are accumulating interest, he will surrender his contract for whatever cash value it may then have.¹⁶⁸ In other words, he is merely looking for a

162. See cases cited *supra* notes 156, 157, 160. As we have seen, large single payments aggravate the company's investment situation. See p. 989 *supra*.

163. *Rishel v. Pacific Mut. Life Ins. Co.*, *supra* note 158 (statute requiring filing of insurance contract not applicable to annuity contract); *accord*, *Hall v. Metropolitan Life Ins. Co.*, 146 Ore. 32, 28 P. (2d) 875 (1934); *Carroll v. Equitable Life Assur. Soc.*, *supra* note 156 (annuity contract, since not insurance, need not be on mutual basis even if issued by mutual company); *Commonwealth v. Metropolitan Life Ins. Co.*, *supra* note 157 (payment for annuity not premium subject to premium tax). See *Helvering v. Le Gierse*, 61 Sup. Ct. 646 (U. S. 1941).

164. See (1932) 21 RECORD 102-5; MACLEAN 552.

165. MACLEAN 62. The mortality situation has been met by projecting tables of future mortality rather than past mortality and can, of course, be met by raising interest rates.

166. See McCankie, (1936) 25 RECORD 434; Evans, (1933) 22 RECORD 333. This is particularly true of group annuities. Little, (1932) 21 RECORD 121; Sullivan, *The Life Insurance Company as a Banking Concern* (1932) 5 J. BUS. OF U. OF CHI. 346.

167. Robbins, (1933) 34 TRANSACTIONS 320, 322. A deferred annuity is one which commences after a stated period of years. It may be purchased either by a single premium or over a period. MACLEAN 59.

168. Possibly at a time when such a surrender would be unprofitable to the company. Smith, (1935) 24 RECORD 283. See generally Melsted, (1935) 24 RECORD 106.

safe depository for his surplus money, in which funds that might otherwise be seeking investment may lie until investment circumstances become more propitious.¹⁶⁹ Viewed in such a light, the annuity contract seems very much like a savings contract or a savings account,¹⁷⁰ and the insurance companies stand in the place of savings banks and building and loan associations. It is, therefore, not at all strange to hear Government baby bonds described as an annuity system¹⁷¹ (they have also been described as endowments) and it is quite understandable that litigants should have urged upon the courts the proposition that an annuity is a security regulable under state blue sky laws.¹⁷² Since those who advanced such contentions usually did so as a means of avoiding their just obligations under the annuity contract, the judicial decisions that an annuity is not a security are probably quite justified from an equitable standpoint. However, such holdings are inconsistent both with the rationale of the cases which announce that an annuity is not an insurance contract, and with the economic realities behind the annuity contract.

The annuity business of two important companies in the insurance field has in recent years amounted to as much as one-third of their total annual business.¹⁷³ Even if one takes the smaller percentage of annuity business characterizing the industry as a whole,¹⁷⁴ the amount would still be significant because the annuity and endowment business is an inseparable part of the total activity of an insurance company. Even the large companies do not maintain separate departments for the sale of endowments and annuities (except for group annuities) despite the non-insurance character of this type of business. Annuity, endowment, and all other life policyholders alike contribute to one general fund from which the insurance company subsequently pays its claims, dividends, and other obligations.¹⁷⁵ It is impossible to confer a favor or disadvantage in the way of dividends or rates upon any one class of policyholder, such as the annuitant, or to bear losses in any one class of business, such as the annuity business,¹⁷⁶ without necessarily reacting upon the interests of

169. Melsted, (1935) 24 RECORD 106; Little, (1934) 23 RECORD 129.

170. See Reitz, (1932) 21 RECORD 114-5.

171. *The Case for Insurance*, NATION'S BUSINESS, January 1940, 35, 51.

172. *Bates v. Equitable Life Assur. Soc.*, 206 Minn. 482, 288 N. W. 834 (1939); *Rinn v. New York Life Ins. Co.*, 89 F. (2d) 924 (C. C. A. 7th, 1937).

173. The Equitable in 1936, and the National Life of Vermont in 1935. *Hearings* (part 10A) 6, 55, 62.

174. In the ten-year period 1929-1938 individual annuity premiums accounted for 6.83% and group annuity premiums for 1.73% of the total premium income of the 26 largest companies. *Hearings* 14707-09. The increase in reserves which were set aside for annuities during this period was 565%. *Id.* at 14716.

175. See *Rhine v. New York Life Ins. Co.*, 273 N. Y. 1, 6 N. E. (2d) 74 (1936).

176. As was claimed, for example, by the Metropolitan Life [*Hearings* 4563], but denied by the New York Life. *Id.* at 4506.

Mr. Stevenson of Penn Mutual admitted that losses on annuity business were made good by holders of other policies. *Hearings* 14768-69. There is probably no way of

other classes of policyholders. Furthermore, as we have already indicated, death benefits and matured endowments frequently transform themselves into annuities. Moreover, all the funds of an insurance company are subject to a unified investment policy. Since it cannot be forecast with certainty what losses will be sustained through the death of policyholders, or through the depreciation of securities and other assets,¹⁷⁷ it is obvious that the endowment and annuity business, however small, affects the entire operating and investment structure of the companies and the interests of all classes of policyholders.

Summary

We have thus found that life insurance "has come to mean more than mere payment of losses in case of death. It has come to include cash surrender values, guaranteed loan values, dividend, endowment, and ton-tine funds."¹⁷⁸ The payments which are made under these various types of contracts and options protect the insured in the case of survivorship as well as in the case of death. Although mortality and expense factors are necessarily involved in insurance policies, they cannot be separated from the interest and investment factor.¹⁷⁹ Life insurance is an investment program under the terms of which "the members pay premiums which when invested would, if the member lived exactly the average life, produce the sum agreed to be paid. Those who do not reach the expected age gain, those who exceed the age lose, but in the long run there cannot be either gain or loss. The policyholder takes his chances of being a gainer or loser, but the fundamental idea is investment."¹⁸⁰

Having advanced thus far, may we assert that an insurance contract is a "security"? It must be conceded that, so far as the courts have spoken, no type of insurance contract is a security for purposes of the state blue sky laws, nor is it likely that any type of policy will be regarded as a security for purposes of the Securities Act of 1933.¹⁸¹ Insurance

demonstrating this point statistically, since profit and loss exhibits do not show the profits and losses on this class of business. *Id.* at 14792. However, since an insurance company is a business enterprise, it may be assumed to be guided by competitive considerations in apportioning losses and profits among its various classes of business.

177. See *Home Life Ins. Co. v. Stephens*, 190 Ark. 1018, 1026, 82 S. W. (2d) 515, 518 (1935).

178. *Commissioner v. Illinois Life Ins. Co.*, 80 F. (2d) 280, 282 (C. C. A. 7th, 1935). The court obviously meant to include annuities.

179. See *Shepherd, The Legal Reserve System in the U. S.* (1939) 28 RECORD 309; *cf. New World Life Ins. Co. v. United States*, 61 Sup. Ct. 314 (1940).

180. *Eckersley v. Federal Life Assur. Co.*, 19 Ont. W. R. 507, 508 (1911); see also *Guggenheim v. Rasquin*, 61 Sup. Ct. 507 (U. S. 1941); *cf. Crab Orchard Improvem. Co. v. Chesapeake & Ohio Ry.*, 115 F. (2d) 277 (C. C. A. 4th, 1940).

181. The Congressional hearings and reports on the Securities Act of 1933 originally ignored the question of insurance. The Act derives from a background of state regula-

contracts thus do not come within the jurisdiction of state security commissions or of the Securities and Exchange Commission. However, the fact that the administration of the legislation relating to insurance and securities, respectively, is normally entrusted to two different sets of governmental agencies, should not be allowed to obfuscate economic realities. It should be borne in mind that state regulation of insurance originated at a time when the general investment activity of the insurance industry and its relationship to the public weal were not as prominent as the potentialities of abuse to the individual policyholder.¹⁸²

An insurance policy fulfills the function of a security or investment contract in furnishing capital for a business venture;¹⁸³ the capital furnished is the policyholder's premium, and the business venture is the farflung investment activities of the insurance companies.¹⁸⁴ Capital in the case of large issues of corporate stocks and bonds is characteristically furnished by a large number of investors;¹⁸⁵ the policyholder is the largest class of small investor in the community.¹⁸⁶ Policyholder and general corporate investor alike rely on the stability of the company issuing the policy or the security that is the source of their investment.¹⁸⁷

tory legislation which never has included insurance within its scope. The final House Report says that insurance policies are not to be regarded as securities. However, the only inference that can be drawn from the statute itself rather than from its legislative history is a negative one, for insurance policies are listed under a section entitled "Exempt Securities"; a possible inference from this is that insurance policies are securities, albeit securities exempt from the scope of the Act. See H. R. REP. NO. 85, 73d Cong., 1st Sess. (1933).

182. Note that early legislation concerning the investments of insurance companies was enabling rather than regulatory. *McAndless, Joint Meeting* 73-4.

183. *Brownie Oil Co. v. Railroad Comm.*, 207 Wis. 88, 240 N. W. 827 (1932); *People v. Leach*, 106 Cal. App. 442, 290 Pac. 131 (1930); *State v. Bushard*, 164 Minn. 455, 205 N. W. 370 (1925).

184. A fact well realized by the Supreme Court when, in a case involving the war excess profits tax, it held the premiums paid in by policyholders to be "invested capital." *Duffy v. Mutual Benefit Life Ins. Co.*, 272 U. S. 613 (1926).

185. See *SEC v. Wickham*, 12 F. Supp. 245, 248 (D. Minn. 1935); *Mortgage Guarantee Co. v. Welch*, 38 F. (2d) 184 (C. C. A. 9th, 1930). The insurance companies, to the extent that they dominate the "private placement" market, are the main exception to this generality, but this is largely because they represent the savings of so many small policyholders that they are able to keep security issues off the public market.

186. *PARKER, op. cit. supra* note 130, estimated that 62,000,000 out of 65,000,000 policyholders were exempt from the pre-1940 federal income tax. See also *Hamilton Nat. Bank v. United States*, 14 F. Supp. 736 (D. Tenn. 1936).

187. See *Lawyers Mtge. Co. v. Anderson*, 67 F. (2d) 889, 891 (C. C. A. 2d, 1933), *cert. denied*, 297 U. S. 719 (1936); *Wilcutts v. Investors' Syndicate*, 57 F. (2d) 811 (C. C. A. 8th, 1932), *cert. denied*, 287 U. S. 618 (1932); *Hamilton Nat. Bank v. United States*, *supra* note 186. The securities which constitute the basis of the insurance company's reserves will of course change, but this is like the position of the general security holder who frequently finds himself with a claim against a shifting security. *Mortgage Guarantee Co. v. Welch*, *supra* note 185; *Title Guar. & Trust Co. v. Bowers*, 67 F. (2d)

Policyholders and other investors expect a profit to accrue to them by efforts other than their own, and because of operations carried on by the issuing company.¹⁸⁸

As has been pointed out, the amount of the policyholder's premium may be determined to some extent by the success or failure of investment activity by the insurance company management, and the use of the word "dividend" in connection with insurance policies is not as unrelated as the courts suppose to its significance in general corporate law. An insurance policy, like some corporate securities, is an agreement to pay a fixed face amount.¹⁸⁹ The policyholder, like the security holder, has the right to receive property which is not in his actual possession, *i.e.*, his share of the assets going to make up the company's reserves.¹⁹⁰ The surrender charge which an insurance company deducts from the full reserve that a policyholder might otherwise withdraw has its counterpart in the face amount installment certificates sold, for example, by Investor's Syndicate.¹⁹¹

The insurance contract is directly analogous to a security in such matters as the investment nature of the contract, the source of initial capital and subsequent operating profits, the claims of its holders, the convertibility of the policy and its use as collateral. It is true, however, that an insurance contract contains certain limitations which do not inhere in ordinary investment contracts. For example, an insurance policy is not negotiable.¹⁹² To this it may be answered that negotiability is no longer

892 (C. C. A. 2d, 1933) (mortgage certificate pool); *People v. Ferguson*, 134 Cal. App. 41, 24 P. (2d) 965 (1933) (trading in general California real estate). Some courts take the narrow view that the facts that underlying mortgages or other security are not pooled, and that a certificate merely evidences an interest in a specific bond and mortgage, are indications that the certificate is not a security. See *Dauphin Deposit Trust Co. v. United States*, 80 F. (2d) 893 (C. C. A. 3d, 1935). *Contra*: *Title Guar. & Trust Co. v. Bowers*, *supra*. Insurance policies obviously meet this additional criterion of what constitutes a security.

188. *SEC v. Wickham*, *supra* note 185; *Domestic and Foreign Petroleum Co. v. Long*, 4 Cal. (2d) 547, 51 P. (2d) 73 (1935) and cases there cited. Contracts for personal services are not considered securities. *Lewis v. Creasey Corp.*, 198 Ky. 409, 248 S. W. 1046 (1923); *State v. Heath*, 199 N. C. 135, 153 S. E. 855 (1930).

189. Said to be a necessary attribute of a security in *Wilkinson v. Mutual Bldg. and Sav. Ass'n*, 13 F. (2d) 997, 999 (C. C. A. 7th, 1926). Life insurance is distinguished from property insurance in that, upon death, the entire face value is payable instead of merely the value of the property insured. HUEBNER 223.

190. Compare *Mortgage Guarantee Co. v. Welch*, *supra* note 185; *Grobby v. State*, 109 Ohio St. 543, 143 N. E. 126 (1924).

191. See note 143 *supra*.

192. There is a lingering but moribund notion that this fact is significant today. See *Wilkinson v. Mutual Bldg. and Sav. Ass'n*, *supra* note 189, at 999.

Restraints on the alienation of corporate stock have taken the form of (1) giving preemptive or optional rights to the corporation, its stockholders, or its directors, (2) requiring the prior approval or consent of the directors or stockholders, (3) imposing a lien

an indispensable characteristic of a security. Many securities provide for transferability only with the consent of the issuing company; since insurance policies are freely assignable by the insured or by an irrevocable beneficiary, they would seem to do better than meet this test.¹⁹³ Also, the fact that obligations under an insurance contract are contingent upon conditions such as death and survivorship is immaterial;¹⁹⁴ it is no longer a requisite of a security that it be an unconditional obligation for the payment of money.¹⁹⁵ It is clearly accepted, too, that the owner of security instruments need not have a title interest in the basic security underlying them.¹⁹⁶ The fact that a withdrawing policyholder cannot get the face amount of his policy, but only his cash surrender value, does no more than parallel the situation with respect to installment investment bonds; in neither case does partial payment of an obligation allow the obligation holder to secure the full maturity value of the obligation. It is true that, among insurance contracts, only endowments and annuities are payable at a definite ascertainable time; but this consideration seems overridden by the fact that all insurance policies possess at any one time, either a cash or loan, or a death, value — an attribute which seems comparable to the marketability, and general availability as collateral, that characterize corporate securities.

When, finally, we canvass the negative features that distinguish insurance policies from ordinary corporate securities, we find that they boil down to these: that insurance policies and other corporate securities, as a matter of custom and statute, have been regulated by separate administrative agencies;¹⁹⁷ that ordinary corporate securities possess certain curlicues such as registered coupons¹⁹⁸ which insurance policies do not

for indebtedness due the corporation, (4) limiting the persons to whom a transfer can be made. See Comment (1929) 42 HARV. L. REV. 555. See also *Comm'r of Banks v. Chase Secur. Corp.*, 298 Mass. 285, 10 N. E. (2d) 472 (1937).

193. MACLEAN 220. Even the *Deer Lodge County* opinion conceded that life insurance policies are subject to sale and transfer, and may be used for collateral security and other commercial purposes, but the Court's narrow contractual approach led it to dismiss the observation by pointing out that this was a use (1) *by the insured* (2) *after the creation of the contract*. 231 U. S. 495, 510 (1913).

194. Note that if insurance policies cover both survivorship and death they cover all eventualities to which flesh is heir.

195. Compare *Wilcutts v. Investors' Syndicate*, *supra* note 187; *Hamilton Nat. Bank v. United States*, *supra* note 186.

196. *People v. Ferguson*, *supra* note 187; *State v. Swenson*, 172 Minn. 277, 215 N. W. 177 (1927).

197. This is not invariably true. Banking and insurance, for example, are under the control of the same department in many states.

198. See *Fidelity Investm. Ass'n v. United States*, 5 F. Supp. 19 (Ct. Cl. 1933); *Dauphin Deposit Trust Co. v. United States*, *supra* note 187. The cases which have emphasized the importance of this factor have all concerned the question of whether certain documents were securities subject to specific federal taxes. In applying a tax measure, the Commissioner may well be permitted to rely on general popular acceptance and ex-

share; and that the popular mind does not identify insurance policies as a member of the class of corporate securities.¹⁹⁹ What we have to deal with, then, are differences in legal precedent and in popular vocabulary; insurance policies have economic functionings basically the same as other corporate securities.

Verbal and nonscientific differences of this kind, it is submitted, should not be allowed to dictate different conclusions with respect to the Congressional power to regulate insurance contracts and other corporate securities. If Congress can use the police power which it has been developing over interstate commerce so as to subject securities to regulation in the public interest,²⁰⁰ a similar constitutional consequence ought to follow in the case of insurance contracts. The same possibilities are present in both cases that the instrumentalities of interstate commerce will be put to illicit use and transactions engaged in which will be "detrimental to the financial health of the public generally."²⁰¹

THE INSURANCE COMPANY AS A BANK

The miscellany of federal constitutional powers referred to as the Government's fiscal powers, which bottom the currency, borrowing, revenue-raising, and banking functions of the Federal Government, have been subjected to almost no judicial limitations. Thus, for example, state monetary systems have been held validly taxed out of existence so as to make way for national currency.²⁰² Twice in the most critical times of the Republic, in the *Legal Tender* and *Gold Clause* cases,²⁰³ the Supreme Court has in effect held Congress entitled under these powers to expropriate the creditor classes of the nation and overhaul the financial economy of the country. For our purposes, however, the importance of the fiscal powers is in laying a constitutional base for our banking system, an unchallenged, unspectacular achievement but an inevitable one in view of our need for a national credit system. To the extent that insurance companies serve functions comparable to those of our national banking system, they render themselves constitutionally subject to the same type of federal regulation that may be imposed upon banks.

ternal indicia as tests of whether the instrumentalities in question are corporate securities; questions of constitutionality call for a less superficial approach.

199. Nor are annuity contracts identified with life insurance. See *Rishel v. Pacific Mut. Life Ins. Co.*, 78 F. (2d) 881 (C. C. A. 10th, 1935).

200. *Jones v. SEC*, 79 F. (2d) 617 (C. C. A. 2d, 1935), *rev'd on other grounds*, 298 U. S. 1 (1936); *SEC v. Jones*, 85 F. (2d) 17 (C. C. A. 2d, 1936); *Newfield v. Ryan*, 91 F. (2d) 700 (C. C. A. 5th, 1937), *cert. denied*, 302 U. S. 729 (1937); *SEC v. Crude Oil Corp.*, 93 F. (2d) 844 (C. C. A. 7th, 1937); cases cited *supra* notes 82 and 83.

201. See *SEC v. Torr*, 15 F. Supp. 315 (S. D. N. Y. 1936).

202. *Veazie Bank v. Fenno*, 8 Wall. 533 (U. S. 1869).

203. 12 Wall. 457 (U. S. 1871); *Norman v. Baltimore & Ohio R. R.*, 294 U. S. 240 (1935).

This section will stress primarily the savings bank features of the insurance industry;²⁰⁴ its commercial and investment banking attributes have already been discussed in some measure above, and will be more fully treated in the succeeding section. The similarity between insurance premiums and bank deposits on the one hand, and cash surrender and loan features and bank withdrawals on the other, has frequently been noted.²⁰⁵ It is the reason that actuaries have so frequently denominated an insurance cash value a demand-deposit account and described the insurance company, the recipient of the premiums and the payor of the cash and loan values, as a combination bank and medical department.²⁰⁶ The courts, as well, have recognized the analogousness of the relationship between the insurance company and the policyholder and that of the bank and its depositor.²⁰⁷ In the legislative field, insurance companies have asked Congress for exemption from taxation on the ground of their similarity to savings banks, which are exempt from taxation, but have been denied their request because Congress realized that they were more than savings banks — that they were investment enterprises and commercial banks.²⁰⁸

The resemblance between insurance company and bank may serve to explain why people desirous of making life insurance benefits more generally available and at lower cost have sponsored such ideas as savings bank life insurance.²⁰⁹ The banks are places where people are accustomed to make "deposits," and it takes no magic, only the application of these

204. Considered by some more important than its commercial banking functions. See Laird, *The Moratorium on Cash Withdrawals* (1933) 34 TRANSACTIONS 55.

205. MACLEAN 488; PARKER, *op. cit. supra* note 130, at 5.

206. This is particularly true of single premium policies. Harrison (1932) 21 RECORD 104-5; Strong, *Address of the President* (1932) 33 TRANSACTIONS 2. For a contrary view see Zimmerman, President, Nat. Ass'n of Life Underwriters, Chicago News, Dec. 28, 1939. The companies sponsoring installment investment plans also persuaded their certificate holders "that they were putting money in a savings program; that payments on the installment investment certificates were tantamount to deposits in a savings bank." SEC, REP. ON COMPANIES SPONSORING INSTALLMENT INVESTMENT PLANS (1940) 113, 114, 174; *Installment Investment Plans*, YOUR INVESTMENTS, Jan. 1940, p. 43. See Sullivan, *supra* note 166.

207. See cases cited *supra* note 112. Later cases have added the qualification that the insurance company pays its insured back an averaged amount, whereas the savings bank returns to its depositors their individual deposits. See Penn Mut. Life Ins. Co. v. Lederer, 252 U. S. 523 (1920); Minnesota Mut. Life Ins. Co. v. United States, 66 Ct. Cl. 481 (1928). In adding this qualification the courts are thinking of matured death claims, rather than of cash surrenders and loans.

208. See Penn Mut. Life Ins. Co. v. Lederer, *supra* note 207, at 534.

209. On the Massachusetts savings bank life insurance system, see MASON, THE BRANDEIS WAY (1938) 116-120; BERMAN, THE MASSACHUSETTS SYSTEM OF SAVINGS-BANK LIFE INSURANCE (1935); *Hearings* 4450-4500. For discussion of other legislative proposals see *id.* at 4419-4440. National banks in places of less than 5,000 inhabitants are authorized to sell life insurance. See 39 STAT. 753 (1916), 12 U. S. C. § 92 (1934).

deposits to the purchase of insurance, to convert these "deposits" into "premiums."²¹⁰ Furthermore, since people come to banks anyway to make deposits, it has been felt that the agency and other selling expenses which characterize insurance company activity and result in high premiums can be greatly decreased by using already established instrumentalities like the banks.²¹¹ After all, "in the conduct of the life insurance business there are only three elements not common to the savings bank business: fixing the terms on which insurance shall be provided, the work of an actuary . . . the medical examination, a physician's function . . .; and, finally, verifying the proof of death, as already performed by the savings banks with respect to their depositors." It has also been pointed out that insurance companies in their handling of settlement options closely parallel banks in their administration of insurance trusts.²¹²

Another aspect of the interrelation between insurance companies and savings banks is the extent to which the companies became disbursers of cash in the panics of 1907, 1921, and 1929, in place of banks which had closed down. When the companies found the demand for cash and loan values too much for them, shortly after the bank closing of 1933, they were forced to resort to moratory legislation similar to that adopted for the banks. Not only did the inability of the banks to supply cash to their depositors impose this added cash strain on the life companies, but the companies were further hampered by the fact that a large part of their floating cash was deposited in closed banks. Thus the insurance companies discovered that they could not continue to grant cash values when the banking system was not functioning properly.²¹³ Although they had obviously been in the banking business prior to 1929, it took that financial catastrophe to bring the fact vividly to the companies' attention.²¹⁴ Insurance companies with their terminating policies, like the banks with their deposit withdrawals, were confronted with the imminent

210. In fact, the premium payment is frequently made out of the policyholders' savings accounts. *Hearings* 4482, 4494.

211. Massachusetts savings banks have a cost of \$2.74 per \$1,000 straight life insurance while the least expensive mutual company averages \$4.60 per \$1,000. *Id.* at 4482-83. This is attributable to the absence of agents' commissions and overhead expenses such as building space. *Id.* at 4481, 4485; MASON, *THE BRANDEIS WAY* (1938) 140.

212. Insurance companies were originally more interested in their trust business than in their life insurance activities. Three important companies early gave up their insurance business to devote themselves to trust work. MACLEAN 521-22. When insurance companies have acted as trustees, their trust and banking responsibilities frequently have conflicted with their efforts to avoid liability as insurers. *Johnson v. New York Life Ins. Co.*, 75 F. (2d) 425 (C. C. A. 5th, 1935) (insurance company as trustee forced to give proof of death); *New York Life Ins. Co. v. O'Brien*, 27 F. (2d) 773 (W. D. Mich. 1927) (insurance company removed as trustee).

213. Lincoln, *A Colloquy on Life Insurance* (1933) PROCEEDINGS 89, 103.

214. Evans, (1933) 22 RECORD 333; Brown, *Progress Towards Uniformity in Supervision* (1933) PROCEEDINGS 125, 132.

liquidation of their businesses.²¹⁵ They began to realize the need for a stabilized central banking system,²¹⁶ as well as the fact that the burdens imposed on them could easily be aggravated by changes in the monetary system of the country.²¹⁷ Insurance officials frequently suggested that the companies keep their banking business subsidiary and subservient to the life protection aspects of their enterprise; at the same time, they stressed the fact that the investment features of a policy should be kept in distinct subordination to its insurance features.²¹⁸ Nor are the insurance companies today immune from the possibility of future cash drains rivalling those of 1933, for, as of December 31, 1938, the total sum liable to immediate cash withdrawal in twenty companies aggregated almost eight billion dollars.²¹⁹ In any event, in the recent history of the insurance business, the companies' banking and investment problems have been far more disputed than problems relating to mortality, selling expenses, and other features inhering in the "pure insurance" end of the industry; actuaries can agree upon the treatment of the latter question but solution of the former is largely dependent upon the general economic situation.

Not only have the functions and problems of the insurance and banking industries dovetailed, but their actual and proposed subjection to governmental regulation has followed somewhat similar patterns. It was, for example, the federal regulation of banking which laid a basis for the first systematic insurance company campaign for federal regulation of insurance.²²⁰ Furthermore, since insurance companies are moneyed corporations and are classified as competitors of banks, they have been taxed in the same way,²²¹ and have had the same types of statutory

215. Meade, *Address* (1933) 22 RECORD 7.

216. Linton, *The National Asset in Life Insurance*, BEST'S INSURANCE NEWS (Life ed.) June 1, 1933, p. 80; Linton, *The Investment Aspects of Life Insurance Today*, BEST'S INSURANCE NEWS (Life ed.) Aug. 1, 1933, p. 213. Longing eyes were cast upon the stable banking system of Canada.

217. For example, a period of inflation might mean increased resort on the part of the policyholders to cash values, which they would then seek to convert into speculative investment. Linton, (1933) 22 RECORD 32; Evans, (1933) 22 RECORD 333. This would usually occur at a time when the assets of the insurance company had depreciated values.

218. Graham, (1933) 22 RECORD 60. But see Evans, (1933) 22 RECORD 333, 334. Whether banking and investment features have actually been kept subordinate requires an economic analysis far beyond the scope of this paper.

219. *Hearings* (part 10A) 275. The twenty companies did *not* include the Metropolitan, N. Y. Life, Equitable, Mutual Benefit, Massachusetts Mutual, and Pacific Mutual.

220. See pp. 962-963 *supra*. Compare the dissent in *Commonwealth v. Vrooman*, 166 Pa. St. 306, 312, 30 Atl. 217, 222 (1894).

221. By Connecticut ever since 1818. See GAMBLE, TAXATION OF INSURANCE COMPANIES (Spec. Rep. N. Y. State Tax Comm., No. 12, 1937) 87-90. By the Federal Government since 1921. *Id.* at 36, 93; *National Life Ins. Co. v. United States*, 277 U. S. 503 (1928). See generally GAMBLE 56-7.

restrictions imposed on their investments.²²² Since the same social considerations of safety and protection are involved in regard both to policyholders and bank depositors, the list of legalized investments for both insurance companies and banks have been guided by similar conservatism; both have been limited in the scope of their purchases of corporate stock.²²³ It is true that in the case of banks there has been a greater awareness of the necessity that deposit liabilities be met on demand and hence that long-term investments, of the type that insurance companies specialize in, not be permitted.²²⁴ But even here a clear line of distinction cannot be drawn. Banks frequently indulge in long-term loans,²²⁵ and, at the same time, insurance companies are becoming increasingly cognizant of the extent to which they have acquired deposit liabilities and are therefore investing in more liquid securities. Without hazarding definite statistical conclusions, it seems safe to say that the investment fields of the insurance companies and the banks have been tending to overlap, and that banks and insurance companies are in effect competitors in the security markets.²²⁶

It may well be queried whether Congress can properly achieve a unified central banking system and otherwise carry out its constitutional fiscal powers if insurance companies remain outside the scope of federal regulation.²²⁷ Let us consider, for example, the premium income and death claim and cash value expenditures of the insurance companies, which represent a cash currency system whose volume rivals that of the currency system which clears through our banks. The currency system clearing through the insurance companies is largely independent of the currency system which uses the banks as its medium. To the

222. Insurance companies, as moneyed corporations, were originally the subject of enabling acts which merely authorized them to perform banking functions: loans, discounts, and deposits. Regulatory restraints on management, in place of enabling legislation, are a more modern development. McAndless, *Joint Meeting* 73-4.

223. But the original restrictions on insurance companies were later relaxed. See MASON, *THE BRANDEIS WAY* (1938) 98. Compare the list of states prohibiting banks from purchasing corporate stocks [1 *Hearings before the Committee on Banking and Currency pursuant to H. R. Res. 141*, 71st Cong., 2d Sess. (1930) Part 6, 596] with the partial list discussed in *Hearings* 14800. See also Comment (1933) 33 *COL. L. REV.* 324, 325.

224. See statement of Winthrop W. Aldrich, *Hearings before the Committee on Banking and Currency pursuant to Sen. Res. 84*, 72d Cong., and *Sen. Res. 56*, 73d Cong., 1st Sess. (1933) Part 8, 3979 (Stock Exch. Bill).

225. See McCormick, *Commercial Banking*, *WALL STREET JOURNAL*, Dec. 23, 1939, p. 4, col. 3; cf. Gates, *Investment Subsidiaries Enhance Bank Prestige and Income* (1929) 44 *MAG. OF WALL ST.* 998, 999.

226. See note 233 *infra*. In the 1920's, for example, a large number of farm loans shifted from the commercial banks to the insurance companies. *Hearings* 14867-68.

227. For the centralization of insurance company wealth in the East, contravening the policy of the Federal Reserve System, see p. 961 *supra*; see HAMMOND, *THE FEDERAL RESERVE SYSTEM, ITS PURPOSES AND FUNCTIONS* (1939) 20-22; (1934) 43 *YALE L. J.* 754.

extent that it is independent, it injects into the total currency situation an imponderable element which may conceivably be at variance with the major purpose of the Federal Reserve System: the attainment of a volume of currency adequate for the needs of the whole commercial community.²²⁸ It also is clear that the cash transactions engineered through the insurance companies impose a direct strain on our national banks, and vice versa. In sum, the desirable unification of our banking system cannot come about unless the banking currency system is co-ordinated with the insurance currency system, so that some central authority is at least able to estimate, if not to regulate, possible inflationary and other aspects of insurance cash disbursements.²²⁹

It has already been indicated that banks and insurance companies compete for the same investment obligations. The notion that the banks, because of their short-term obligations, are interested only in short-term investments and that, conversely, the insurance companies are interested only in long-term investments, is belied by the actual facts. The federal constitutional power to provide for a uniform currency has already been called upon to protect national fiscal instruments from harmful restraints: to tax state currencies out of existence,²³⁰ and to endow national banks with exemptions from state law²³¹ and with various competitive privileges,²³² so that they might compete with the purely private activities of state banks and rival financial institutions. If the factor of competition is as important as this legislative activity seems to indicate, it seems not impossible that Congress some day may be compelled to include the banking phases of the insurance company, an increasingly vigorous competitor of the national bank,²³³ within its orbit of fiscal regulation.

228. To some extent, the two currency systems are interlocking. For example, benefits and premiums are paid by check. Also, the insurance companies leave cash on deposit in the banks; in this case, the banks compete with the insurance companies for investment obligations. Cf. Laing, *Joint Meeting* 91; Penman, *Joint Meeting* 94.

229. "There can be but one American credit system of nation-wide extent, and it will fall short of satisfying the business judgment and expectation of the country and fail of attaining its full potentialities if it . . . leaves out of its membership any considerable part of the banking strength of the country." *FEDERAL RESERVE BULL.*, July, 1915, p. 145; cf. *American Sumatra Tobacco Corp. v. SEC*, 110 F. (2d) 117 (App. D. C. 1940).

230. *Veazie Bank v. Fenno*, 8 Wall. 533 (U. S. 1869).

231. *Farmers & Mechanics Nat. Bank v. Dearing*, 91 U. S. 29 (1875) (state usury laws); *Davis v. Elmira Sav. Bank*, 161 U. S. 275 (1896) (state law giving savings banks preference as depositors in other banks in case of insolvency of latter); *Easton v. Iowa*, 188 U. S. 220 (1903) (state law making it a crime to receive deposits while a bank was insolvent).

232. *Missouri v. Duncan*, 265 U. S. 17 (1924) (national bank permitted to act as executor, despite state law forbidding such banks to act as executors); *First Nat. Bank v. Union Trust Co.*, 244 U. S. 416 (1917) (allowing national banks to act as trustees, executors, and administrators).

233. While time deposits in commercial banks, in the period 1929-38, declined from nineteen billion to fourteen billion dollars, the increase in insurance company assets was

Insurance companies, like the national banks, are indispensable to the exercise of the Federal Government's borrowing operations — one of its most vital constitutional powers.²³⁴ The companies at present hold in their portfolios a total of four and one-half billion dollars of Government obligations — 11 per cent of the total federal debt, direct and guaranteed.²³⁵ During the period 1929–1938 they purchased 8.3 billion dollars of federal bonds.²³⁶ Federal land banks are held to be federal fiscal instrumentalities — subject to federal regulation — merely because 5 per cent of their assets are required to be invested in federal bonds; federal savings and loan associations enjoy a similar position, even though they are not compelled, but are merely authorized, to invest in government bonds.²³⁷ In subjecting agencies of this sort to federal control, the courts do not undertake to ascertain whether or not the particular institution is actually engaged in the exercise of any federal power; it is sufficient that the institution is susceptible of being employed as a federal agent — the fact of actual employment is irrelevant.²³⁸ If instrumentalities of this sort are without question subject to federal power, it seems that insurance companies, with their extensive investments in federal bonds, are clearly effectuating an important federal power and therefore may be designated by Congress as federal instrumentalities.

Insurance companies may also be regarded as federal instrumentalities because of their important place in our national financial life. The *Smith* case, which declared that federal land banks were federal fiscal agents and instrumentalities, did so on the ground that "*whether technically banks, or not, these organizations may serve the governmental purposes declared by Congress in their creation.*"²³⁹ To the extent that they func-

85% of the increase in total assets of the principal savings institutions in the United States. These principal savings institutions included, in addition to life insurance companies, commercial banks, mutual savings banks, building and loan associations, government pension funds, fraternal associations, trust funds, savings deposits, and baby bonds. *Hearings* 14725.

234. See the discussion of this power by Chief Justice Marshall in *Weston v. City Council*, 2 Pet. 449, 465 (U. S. 1829).

235. This constitutes 17.9% of their total portfolio. *Hearings* 1207. Insurance companies might hold even more of these obligations, since they furnish an excellent backlog of liquidity for the company, were it not for the low rate of interest they bear. See McAndless, *Joint Meeting* 78. The insurance companies' investment in this field has increased very rapidly; in 1930 they owned only \$303,000,000 in federal bonds, accounting for only 1.8% of their assets. Linton, *Joint Meeting* 58-9.

236. TNEC Release, Feb. 10, 1940, p. 4. This resulted in an increase in their holdings of 1394%. *Hearings* 14715.

237. *First Fed. Sav. & Loan Ass'n v. Loomis*, 97 F. (2d) 831, 838 (C. C. A. 7th, 1938).

238. *Smith v. Kansas City Title & Trust Co.*, 255 U. S. 180, 210 (1921); *Knox Loan Ass'n v. Phillips*, 300 U. S. 194, 202 (1937).

239. Italics supplied. *Smith v. Kansas City Title & Trust Co.*, *supra* note 238, at 210-211.

tion as units in the country's credit system, insurance companies, even if technically they are not banks, are serving Governmental purposes—among others the general welfare.²⁴⁰ As a matter of fact, insurance companies are eligible for membership in the federal home loan banks in the same way that savings and loan associations are.²⁴¹ To the extent that insurance companies are factually serving the Federal Government in the exercise of its currency, borrowing, and general welfare powers, this should be more than sufficient to constitute them federal instrumentalities, should Congress desire so to designate them.

A Supreme Court case, *Hopkins Federal Savings and Loan Association v. Cleary*, seems to be the major obstacle to such a conclusion. The court there held that a majority vote of the stockholders of a state building and loan association could not, consistently with the Tenth Amendment, convert the association into a federal savings and loan association, if the conversion were not permitted by state law.²⁴² However, the Court left at least three large reservations which still seem to make it constitutionally permissible to regard quasi-banking financial institutions, such as life insurance companies, as federal instrumentalities. In the first place, the case must be restricted, as a subsequent lower court case says, to its specific facts, which involve "the conversion of state associations into federal ones in contravention of the laws of the place of their creation."²⁴³ Second, the Court assumed that the state system of building and loan associations and the federal system of savings and loan associations could exist side by side without impairment to each other, and conceded that a different conclusion might be reached if it were shown that the state associations constituted an obstruction to the activities of their federal competitors. No such showing was made in the *Hopkins* case, but it is clear that insurance companies and national banks compete, and sometimes strenuously, for available investment opportunities. Third, the Court's opinion specifically stated that no interstate commerce point was involved.²⁴⁴ While this may be true for building and loan associa-

240. *First Fed. Sav. & Loan Ass'n v. Loomis*, *supra* note 237, at 840; *cf.* *Federal Land Bank v. Gaines*, 290 U. S. 247 (1933).

241. 47 STAT. 726 (1932), 12 U. S. C. § 1424 (1934).

242. 296 U. S. 315 (1935). But *cf.* *Texas Unemployment Compensation Comm. v. Metropolitan Bldg. & Loan Ass'n*, 139 S. W. (2d) 309 (Tex. Civ. App. 1940) (question whether associations are federal instrumentalities from state tax viewpoint).

Mr. Justice Cardozo, who wrote the Court's opinion, was admittedly afraid of two contingencies: first, that if a building and loan association could be converted into a federal savings and loan association with a federal charter, the same thing might happen to savings banks and insurance companies, and second, that once it was conceded that compulsory conversion into instrumentalities of the Federal Government was valid, the percentage of assenting shares necessary for such a conversion might be lowered below a majority and might even be completely dispensed with.

243. *First Fed. Sav. & Loan Ass'n v. Loomis*, *supra* note 237, at 836.

244. See also *id.* at 841.

tions, which have the greater part of their investment in local real estate mortgages, it is not true of insurance companies, with their preponderant investment in interstate railroads and public utilities.

The foregoing discussion is intended merely as tentative reflection on the possible relationships which insurance companies might have to the fiscal powers of the Federal Government. But it may be appropriate to conclude with a reminder that one of the original constitutional sources of the power to create national banks, according to *McCulloch v. Maryland*,²⁴⁵ was the commerce power. Must we now assume that the fiscal powers of the Federal Government are completely split off from the interstate commerce power? A proper construction of Chief Justice Hughes' opinion in the *Gold Clause* cases²⁴⁶ and of the Labor Board's assumption of jurisdiction over national banks and insurance companies,²⁴⁷ seems to show that the two powers are interrelated. Banks and banking functions (which, as we have seen, are carried on by insurance companies) are the life blood of interstate commerce, and their regulation is therefore a promotion of the proper functioning of interstate commerce and well within the Congressional province.

INSURANCE AS AN INVESTMENT INDUSTRY

General

We have already indicated the extent to which life insurance combines insurance protection and savings and investment elements. For an investor desiring primarily security of principal, life insurance is better than most other forms of investment because of the wide diversification of the investments of a company and the fact that a company can rely on a large volume of premium and interest income. Life insurance, even in the narrow sense of pure protection against the contingency of death, can be described as a speeding up of slower methods of systematic saving so that, in the event of death, the insured's beneficiary may have a larger sum available to him than would be his share were this an ordinary type of investment.²⁴⁸

President Roosevelt has recently compared the status of the insurance company with that of the investment trust, ". . . the tremendous invest-

245. 4 Wheat. 316 (U. S. 1819).

246. See 294 U. S. 240, 303 (1935). Note that both the issuance of legal tender, *Julliard v. Greenman*, 110 U. S. 421 (1884), and the erection of a federal farm credit system, *Smith v. Kansas City Title & Trust Co.*, 255 U. S. 180, 208 (1921), were based on the interstate commerce power as well as on federal fiscal powers.

247. In the Matter of Bank of America Nat. Trust & Sav. Ass'n, 14 N. L. R. B. 207 (1939); In the Matter of John Hancock Mut. Life Ins. Co., Case Nos. R 1747, 1748 (1940).

248. Linton, *supra* note 93.

ment funds controlled by our great insurance companies have a certain kinship to investment trusts," he said, "in that these companies invest as trustees the savings of millions of our people."²⁴⁹ Both investment trust and insurance company afford cash and loan values, and encourage the policy holders not to withdraw dividends but to leave them with the company for further investment.²⁵⁰ Like the insurance company, the investment trust is primarily an opportunity for the small investor and operates on the principle that the insured cannot invest for himself as profitably as he can through experienced investment managers.²⁵¹ It is true that investment trusts, unlike life insurance companies, can and have invested extensively in common stocks,²⁵² but this distinction does not cut to the essence of insurance company investment activity. The prohibitions against stock investments by insurance companies are the result of restrictions which our states have imposed but which are not necessarily of irrefragable wisdom and, in fact, have not been adopted in Great Britain.

Another illustration of the investment industry nature of insurance is the stand of tax experts with respect to the investment income of insurance companies. They have considered it the natural base for taxing these companies rather than the premium income taxes which most states levy;²⁵³ such a tax is, in fact, levied by the Federal Government, Connecticut, and Great Britain.²⁵⁴ Insurance reserves, it is argued, by

249. Message to Congress, Apr. 20, 1938, p. 8. The court in *Investors' Syndicate v. Hirning*, 40 S. D. 251, 167 N. W. 141 (1918) indicated that the installment and savings certificates sold by Investors' Syndicate differed "but little, if any, from the ordinary tontine insurance contract or policy issued by many life insurance companies." Like the insurance contracts, the certificates had "certain savings features and aspects in connection with them."

250. SEC, REP. ON COMPANIES SPONSORING INSTALLMENT INVESTMENT PLANS (1940) 34.

It is estimated that 62,000,000 out of 65,000,000 policyholders are exempt from the federal income tax. Parker, *supra* note 130, at 18.

251. MacLEAN 55-6; Linton, *Investment Aspects of Insurance Today*, BEST'S INSURANCE NEWS (Life ed.) Aug. 1, 1933, p. 216.

252. In the availability of stocks as a source of investment, the investment trust is comparable to the fire insurance company. The investment trust, although it has some roots in the life insurance field, derives more strongly from fire insurance companies. SEC, REP. ON INVESTMENT TRUSTS AND INVESTMENT COMPANIES (1939) 38-42. Note the statement in FIRE INSURANCE MONTHLY BULL., May 30, 1926, that "investment bankers who have been associated with fire insurance companies for a long time have now come to regard them as investment trusts." Investment companies frequently acquire insurance companies so that they may continue operating them as investment trusts; they discontinue the insurance business of the companies and reinsure the risks with other companies.

253. PARKER, *supra* note 130, at 2; GAMBLE, *supra* note 221, at 15.

254. See *Helvering v. Oregon Mut. Life Ins. Co.*, 61 Sup. Ct. 207 (U. S. 1941); *National Life Ins. Co. v. United States*, 277 U. S. 508 (1928). In Great Britain, a tax computed on the basis of investment income yields more revenue than a tax computed on

virtue of the fact that they are savings, are to be considered private capital of the policyholders and should be taxed in the same way as other private capital.²⁵⁵ In further logical articulation of a tax system based on investment income, the law provides that only investment expenses, and no others, should be allowed as deductions.²⁵⁶ It has also been urged that life insurance companies be treated in the same way as other companies through recognition of their capital gains and losses, but this suggestion has not been embodied in the law.²⁵⁷

The introduction to this Article cited statistics illustrative of the dominant position taken by insurance companies in the investment activity of the nation. Subsequent sections have discussed the security and investment features of the insurance contract, and the extent of insurance company investment in Government securities and farm and urban mortgages. With respect to insurance company investment in industrial enterprises, which amounts to 11.7 per cent of the total debt in that field, one need only note that the obligations held by the insurance companies are mainly those of large corporations possessing an interstate character, and that these investments therefore have a very direct bearing on interstate commerce. In this section, we shall confine ourselves to the extensive insurance company investment in the railway and public utility field. This selection is for the reasons that those enterprises are universally conceded to be interstate in nature, and that there has been accumulated, with respect to those railroads and utilities, a body of legal precedent concerning the permissible scope of federal regulation which we may find of some help in our own inquiries.

Railroad Financing

Life insurance companies have invested \$3,000,000,000, roughly speaking, in railroad securities and an equivalent amount in public utility bonds.²⁵⁸ Taken together, these investments represent 24.9 per cent

net profits. The government, which has the option of choosing the tax yielding the higher return, has uniformly availed itself of the former.

255. Insurance company reserves "compete with immobilized private savings for investment opportunities. There can be no equitable reason to tax some private capital and to permit the equally private capital of policyholders, deposited with an insurance company, to escape tax free." GAMBLE, *supra* note 221, at 62.

256. See *National Life Ins. Co. v. United States*, 277 U. S. 508 (1928). These expenses include real estate expenses, depreciation, and interest.

257. See PARKER, *supra* note 130, at 43. Linton in 1933 felt that policyholders of insurance companies could not expect large appreciation or depreciation in capital because of the conservative and diversified character of their investment, which was largely in bonds. Linton, *supra* note 251, at 215. Compare this, however, with his admission in 1938 that the market values of insurance company investments had fluctuated widely. *Joint Meeting* 57.

258. *Hearings* 1208. The book value (86% of the par value) of the railroad bonds held by the twenty-six largest companies is 2.3 billion dollars. TNEC Release, Feb. 10,

of the total portfolio of the insurance companies and approximately a quarter of the country's total outstanding railroad debt.²⁵⁹

Because of state statutes forbidding insurance companies to invest in equity securities, practically all of this public utility investment is in bonds. Even with the statutory bars relaxed so that the companies can now invest more freely in stocks, the proportion of common stock in the entire insurance company portfolio, as of 1937, was only $\frac{1}{2}$ of 1 per cent; the investment in preferred and guaranteed stocks was only 1.9 per cent of the total.²⁶⁰ On this basis it is likely that the insurance companies, seeking to deny too close a connection with interstate commerce, will contend that stock ownership is the only type of security ownership which the law thus far has recognized as involving "control" of the instrumentalities of interstate commerce; bonds, they will say, whether or not held by insurance companies, represent merely a creditor's right against the nation's transportation and public utility systems. Furthermore, they will question whether the creditor influence exerted by the insurance companies through the medium of bond ownership is an economic evil, and, if so, whether it is within the Congressional province to mitigate it. It is to these two propositions that we now address ourselves. In so doing, our more specific comments will be limited to the railroad industry.

To say that railroad bondholders do not exercise "control" over railroads is to ignore several important factors. One is the extent to which the railroads are in reorganization.²⁶¹ With 31 per cent of the railroad mileage of the country in bankruptcy or receivership,²⁶² it is clear that from a practical standpoint the bondholders, who constitute the senior interests, are in control of these lines and that the stockholders have

1940. Although the insurance companies have three times as many railroad securities as in 1906, the importance of railroad investments in their total portfolio has declined from 34.8% to 12.1%, while public utilities have expanded in importance from 3% to 12.8%.

259. See ADDITIONAL REP. OF COMM. ON INTERSTATE COMMERCE PURSUANT TO SEN. RES. 71 (74th Cong.), 76th Cong., 1st Sess. (1939) Rep. No. 25, part 2, 2; *Hearings before Committee on Judiciary on H. R. 6249*, 74th Cong., 1st Sess. (1935) 74 (Railroad Reorganization).

260. Linton, *Joint Meeting* 60. It should be noted that preferred and guaranteed stocks possess many of the attributes of income bonds. See PRELIM. REP. OF COMM. ON INTERSTATE COMMERCE PURSUANT TO SEN. RES. 71 (74th Cong.), 76th Cong., 1st Sess. (1939), Rep. 25, pt. 1, 9. See Comm'r Eastman, dissenting, in *Chicago, M. & St. P. Reorg.*, 131 I. C. C. 673, 701, 706 (1928).

261. The total par value of defaulted bonds deposited by the 26 largest insurance companies with bondholders' protective committees aggregated \$490,404,000, most of which was in railroad securities. See *Hearings* 15414, 15573-77; 2 SEC. REP. ON PROTECTIVE AND REORG. COMMITTEES (1937) 422 *et seq.*

262. As of July 31, 1939. 53 ANN. REP. OF ICC (1939) 20. This does not include the B. & O. and the Lehigh Valley and their subsidiaries, which were pursuing other plans of adjustment. One-quarter of the country's total railroad debt has been said to be delinquent. *Palmer v. Massachusetts*, 308 U. S. 79 (1939).

relinquished control. Bondholders might, in fact, be said to exercise an even fuller domination over a railroad on the verge of insolvency, waiting to be precipitated into that unhappy state by inability to meet payrolls or the fixed interest charges of the bondholders. The desire of the railway management group to avoid reorganization proceedings may make it even more acquiescent to bondholder demands while the railroad is still solvent than when reorganization proceedings have been commenced and management is in a position to jockey the contending claims of various interested parties against each other.²⁶³ To say that stock ownership is the only means whereby control may be exerted over a railroad enterprise is to make a statement which is true only in fair weather circumstances and ignores the proverbial critical condition of our railroads.

The courts have admitted that, even in a financially healthy enterprise, less than a majority stock control is sufficient to control the business. As far back as 1904, the Supreme Court was^o willing to concede that under special circumstances a 33½ per cent stock ownership might constitute a controlling influence in an enterprise,²⁶⁴ and recent Congresses, if the Public Utility Holding Company Act of 1935 is any criterion, seem to be willing to put the figure as low as 10 per cent.²⁶⁵ The Supreme Court has recognized that, in addition to stock ownership, property ownership and property leasing are modes of control of an interstate enterprise amenable to federal regulation,²⁶⁶ and has held that the interposition of a voting trust, which assumes the legal ownership of shares of stock and

263. For a discussion of stockholders' nuisance value in reorganization proceedings, see Comment (1937) 47 YALE L. J. 247. Among other factors which enhance bondholder control are the ability of the bondholders to control a minority stock interest which may have a litigable case against the railroad [*cf.* *Continental Ins. Co. v. United States*, 259 U. S. 156 (1922)], and the allowance of voting privileges to preferred stock or income bonds after a company has failed to declare dividends. See note 260 *supra*; Stevens, *Voting Rights of Capital Stock and Shareholders* (1938) 11 J. Bus. 311.

264. See *Northern Securities Co. v. United States*, 193 U. S. 197 (1904) (especially Mr. Justice White dissenting at 364); *cf.* *United States v. Union Pac. R. R.*, 226 U. S. 61 (1912); *Delaware & H. Co. v. Albany & S. R. R.*, 213 U. S. 435 (1909); *Rochester Tel. Co. v. United States*, 307 U. S. 125 (1939); *accord*, *Natural Gas Pipeline Co. v. Slattery*, 302 U. S. 300 (1937).

265. Section 2(a)(7). The legislative history preceding this law's passage indicated that control of a public utility could be attained by groups holding as little as 3% of the total voting stock of the corporation. *Hearings before the Senate Committee on Interstate Commerce* (Public Utility Holding Co. Act), 74th Cong., 1st Sess. (1935) 469. See also FTC, REP. ON UTILITY CORPS., SEN. DOC. NO. 92, Pt. 72-A, 70th Cong., 1st Sess. (1935) 136-151. The SEC has recently indicated that under one type of corporate history approximately 20% stock ownership constituted control, whereas in another historical context it did not. In the Matter of Detroit Edison Co., SEC Holding Co. Act Release No. 2208 (1940); see also In the Matter of Byllesby & Co., SEC Holding Co. Act Release No. 1882 (1940).

266. See *FTC v. Western Meat Co.*, 272 U. S. 554 (1926); *N. Y. Central Securities Corp. v. United States*, 287 U. S. 12 (1932).

leaves the stockholders with only equitable ownership, is inoperative to divest the original stockholders of their "control" over the company.²⁶⁷ In short, the courts, guiding their approach "by reference to realities and not by reference to legal abstractions," have conceded both that control may be exercised over a corporation through forms other than an undiluted stock interest, and that a stock interest far short of a majority may suffice to control a corporation. Furthermore, it has long been recognized that ownership and control are tending to bifurcate, and that management desires and tends to be self-perpetuating, regardless of the way in which stock is allocated.²⁶⁸ It seems reasonable to surmise that a management which desires to remain in operating control of an enterprise will be more responsive to the wishes of bondholders whose primary liens against the enterprise they cannot overlook, than to the interest of the stockholders whose dividends they have a legal privilege and perhaps a duty to pass; the stockholders incidentally may themselves be only too aware that failure to meet bond charges will wipe out their own equity in the enterprise.

From the premise that the bondholders, in the current distressed circumstances confronting the railroads, have in great measure succeeded to the economic grip over a railroad that stock ownership should theoretically command, it is but a short step to the conclusion that, proven their effect on interstate commerce, bondholders, like stockholders, are subject to the federal commerce power under the doctrine first established in the *Northern Securities* case.²⁶⁹

Leaving this thesis, let us examine the insurance company bondholders in their formal legal status as creditors, sharers in the pot of earnings developed by the railroads. Since, because of irrational capitalization and unnecessary duplication of facilities, this pot of earnings is a limited one and inadequate to meet all the demands on it, the bondholders, in striving to enforce their share in the pot, must necessarily come into conflict with other classes involved in the enterprise. Specifically, the influence of the insurance company bondholders is adverse to, and must be reconciled with, the passenger public, shippers, and employees—classes whose welfare Congress has hitherto protected under its broad interstate commerce power. Protection of these other classes requires

267. *Rochester Tel. Co. v. United States*, 307 U. S. 125 (1939); see also *In the Matter of Byllesby & Co.*, *supra* note 265.

268. "The modern growth of the corporate form of business has been accompanied by ingenious and artificial legal devices designed to divorce the stockholder from any semblance of control over his investment." *Blaustein v. Pan American Petroleum Co.*, 174 Misc. 601, 655, 21 N. Y. S. (2d) 651, 711 (Sup. Ct. 1940). See also VELEN, *ABSENTEE OWNERSHIP* (1923); BERLE AND MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1932); DIMOCK AND HYDE, *BUREAUCRACY AND TRUSTEESHIP IN LARGE CORPORATION* (TNEC Monograph No. 11) 7, 22.

269. 193 U. S. 197 (1904).

expenditures and deductions from earnings which must necessarily cut down the return allocable to the bondholders; conversely, the bondholders' interest leads them to press for reductions in expenditures which are inconsistent with the safety of passenger public and railroad employees, high wage levels and other factors promoting the general welfare of the employees,²⁷⁰ and the protection of passengers and shippers from unreasonable rates.

In promoting the welfare of the various groups connected with the railroads, Congress has uniformly assumed the power to regulate intrastate transactions. For example, the Interstate Commerce Commission, to provide for the safety of the passenger public and employees, requires the railroads to make outlays for equipment; the Federal Safety Appliance Act, calling for certain types of equipment, has been held applicable to cars moving in intrastate traffic and not connected with any cars used in interstate commerce.²⁷¹ The Federal Employers Liability Act has been held applicable to a lineman wiping insulators on a supporting wire conducting electricity.²⁷² In further pursuit of contented employee morale, the Federal Government has insured to railway workers the right of collective bargaining, which has meant the retention of a high wage structure constituting a primary lien on the railroad enterprise,²⁷³ it has also enacted old age unemployment insurance schemes and authorized the Interstate Commerce Commission, in approving consolidations, to impose conditions which will protect displaced employees.²⁷⁴ To protect consumers, the Government has long regulated rates, even asserting the right to nullify intrastate rates;²⁷⁵ it has also ordered the discontinuance of intrastate branches and forbidden the erection of a union station.²⁷⁶ In view of these and other regulations affecting the various classes involved in the railroad enterprise, there seems no reason why that portion of

270. REP. OF EMERGENCY BOARD UNDER § 10 OF RY. LABOR ACT (1938) 17-8. 75% of the savings that will result from the ICC's proposed consolidation of the railroads will be at labor's expense. See *United States v. Lowden*, 308 U. S. 225, 233 (1939).

271. *Southern R. R. v. United States*, 222 U. S. 20 (1911).

272. *Southern Pac. R. R. v. Industrial Accident Comm.*, 251 U. S. 259 (1920).

273. *Texas and N. O. R. R. v. Brotherhood of Ry. and Steamship Clerks*, 281 U. S. 548 (1930); *Virginian Ry. v. System Federation No. 40*, 300 U. S. 515 (1937). Strikes even in the coal industry materially affect the financial status of the coal-carrying railroads involved. See *Clover Fork Coal Co. v. NLRB*, 97 F. (2d) 331, 335 (C. C. A. 6th, 1938).

274. *United States v. Lowden*, *supra* note 270.

275. It was not until 1920 that the ICC was given the affirmative power to prescribe minimum intrastate rates. *United States v. Louisiana*, 290 U. S. 70 (1933). Prior to that time it could only issue negative orders commanding the carriers to desist from state-established intrastate rates. *Shreveport Rate Cases*, 234 U. S. 342 (1914); *Wisconsin Rate Cases*, 257 U. S. 563 (1922).

276. *Colorado v. United States*, 271 U. S. 153 (1926); *Railroad Comm. v. Southern Pac. R. R.*, 264 U. S. 331 (1924).

the investor class represented by the bondholders should be specially exempted from regulation.

It may also be noted that the interest charges required to meet the claims of the bondholders must necessarily add to the cost of service to the general public, and affect the rate which will be charged passengers and shippers. As conditions affecting price structures are particularly susceptible to federal regulation,²⁷⁷ the interest payments made by the railroads to the insurance companies — to the extent that they affect the railroad rate structure — may furnish another justification for federal control.

It may, however, be inquired: Where, in the case of bond financing, are there the disastrous consequences to the railroad and to the public comparable to the abrupt disruption of transportation occasioned by labor warfare, or the depletion of a carrier's financial resources caused by unwise construction? The answers are manifold. Not only have top-heavy bond structures led to the necessity of reorganization, but frequently the bondholders, in their desire to preserve for themselves as much as possible of the corporate earnings, have in the course of reorganization proceedings been responsible for creating unsound capital structures which have ultimately led to further reorganizations.²⁷⁸ Even where the effect of meeting bond interest payments does not precipitate insolvency, the strain of meeting existing bond charges affects the efficiency and quality of the service rendered by the railroads, the interests of railway labor, the cost of the service to the passenger and shipper, and the ability of the carrier to attract needed new capital.²⁷⁹ Furthermore, not only does the presence of the bondholder interest produce frictional patterns within the railroad industry itself, but it tends to place that industry at a disadvantage as contrasted with competitive industries, such as motor trucking.²⁸⁰ All of these attritional effects occur at the expense of classes which Congress has hitherto striven to protect, and may serve in a large measure to nullify the beneficial effects of prior legislation enacted in their favor. There is no reason why Congress should be powerless to regulate tendencies which may tend to defeat its own

277. *Stafford v. Wallace*, 258 U. S. 495 (1922); *Chicago Board of Trade v. Olsen*, 262 U. S. 1 (1923).

278. Commissioner Eastman has dissented from three successive reorganizations of the Denver & R. G. W. R. R. [70 I. C. C. 102, 107 (1921); 82 I. C. C. 745, 764 (1923); 90 I. C. C. 141, 156 (1924)] on the ground that earnings would not be adequate to support fixed charges on the reorganized capital structure. See also his dissenting opinion in *Chicago, M. & St. P. Reorg.*, 131 I. C. C. 673, 701, 705 (1928).

279. 47 ANN. REP. OF ICC 25-6 (1933); 52 ANN. REP. OF ICC 3-4, 10 (1938); see Comm'r Eastman, dissenting in *Missouri-K.-T. Reorg.*, 76 I. C. C. 84, 103 (1922).

280. See Comm'r Eastman, dissenting in *Chicago, M., St. P. & P. Bonds*, 193 I. C. C. 725, 733 (1933). The motor trucking industry makes greater resort to stock financing and is not saddled by the heavy continuous capital charges and recurrent demands for refunding characteristic of the railroads.

prior legislation and lead to the further disintegration of an industry which it has striven to conserve since 1918.

The extensive investment of insurance companies in bonds and their abstention from purchases of stock is but one result of a mass of state regulatory legislation bearing upon insurance companies. Most, if not all, of that legislation probably falls within the permissible bourne of state sovereignty, and it may be that Congress will be content to let it remain there.²⁸¹ It is theoretically possible, however, that some of this state legislation impedes objectives which Congress, acting under the commerce power, deems desirable.

Without attempting an exhaustive discussion of this problem, let us examine the implications of such a situation in connection with a specific problem — the question of state legislation which requires insurance companies to invest only in bonds. Excessive concentration on bonds in the capital structure of an enterprise not only imposes a heavy drain for current servicing on the operating income of the business, but also subjects the enterprise to a recurrent and severe liability to refinance when the obligation expires, which may be at a period when capital is scarce, interest rates high, and earnings low.²⁸²

It is these factors that have led even conservative observers, including insurance company officials, to deplore as injurious to the national economy our present emphasis on bond financing and long-term private debt.²⁸³ The Interstate Commerce Commission, besides persistently recommending diminished resort to bond financing,²⁸⁴ has denied solvent railroads leave to increase their bonded indebtedness further²⁸⁵ and

281. Thus, for example, although § 20(a) of the Transportation Act validly confers on the ICC exclusive and plenary jurisdiction over the issue of securities [*Pittsburgh & W. Va. Ry. v. ICC*, 293 Fed. 1001 (App. D. C. 1923); see *Railroad Comm. v. Southern Pac. R. R.*, 264 U. S. 331 (1924)], the ICC has, as a matter of policy, given considerable weight to limitations on capital structure imposed by state laws. See 2 SHARFMAN, *THE INTERSTATE COMMERCE COMMISSION* (1931) 218, 249.

282. MOULTON *et al.*, *THE AMERICAN TRANSPORTATION PROBLEM* (1933) 310-11; In the Matter of Consumers Power Co., Holding Co. Act Release No. 1854 (1939); see *Bonds of Chesapeake & O. Ry.*, 105 I. C. C. 748, 750 (1926).

283. NATIONAL ASS'N OF MFRS. *DECLARATION OF PRINCIPLES RELATING TO CONDUCT OF AMERICAN INDUSTRY* (1939); 20TH CENTURY FUND, *DEBTS AND RECOVERY* (1938) 253-5. DEWING, *FINANCIAL POLICY OF CORPORATIONS* (1937) 354 indicates that public utility bond interest charges should not absorb more than half of the company's established net earnings. See *Western Pac. R. R. Reorg.*, 230 I. C. C. 61, 90 (1938); *accord*, Comm'r Porter's dissent in *Charleston & W. C. Ry. Bonds*, 193 I. C. C. 309, 313 (1933); dissenting opinion in *Missouri-K.-T. Reorg.*, *supra* note 279, at 108. See McAndless, *Joint Meeting* 77 (pointing out that British have only 28% of their railroad capital in bonds).

284. 36 ANN. REP. OF ICC 32 (1922); 41 ANN. REP. OF ICC 10 (1927); 42 ANN. REP. OF ICC 10 (1928).

285. *Bond Application of Texas Short Line Ry.*, 67 I. C. C. 400 (1921); *Bonds of Chesapeake & O. Ry.*, 105 I. C. C. 748 (1926); *Chicago, I. & L. Ry.*, 189 I. C. C. 752 (1933). Cf. *Acquisition & Operation by Peoria Terminal Co.*, 117 I. C. C. 377, 382 (1926).

ordered carriers to limit their new financing to stocks instead of bonds.²⁸⁶ In the case of railroads undergoing financial readjustment, it seems latterly to have taken a stand, frequently contended for in the dissenting opinions of Commissioners Eastman and Porter, restricting the amount of permissible bonds in the new capital structure.²⁸⁷ Other regulatory and investigating federal agencies, such as the Securities and Exchange Commission and the Senate Committee Investigating Railway Financing have also denounced this tendency to the extent that it affects the railroads and public utilities.²⁸⁸ Public disfavor of bond financing is further reflected by the fact that in the past some states have adopted legislation forbidding railroad companies to issue bonds at all.²⁸⁹ It accordingly seems at least a tenable hypothesis that state regulation requiring insurance companies to restrict themselves to the more conservative type of investment²⁹⁰ may be inconsistent with a national policy which Congress may decide to adopt on the subject of railway financing. When that moment comes, the federal power will be paramount and any state regulation—however constitutional standing by itself—which interferes with that national policy must fall.

A similar fate would befall those state investment laws which, instead of a conservative mandate to invest in bonds, pose a command to invest in local securities, should Congress find such a requirement too parochial to suit the national economy.²⁹¹ Much concern has recently been directed at the trade barriers which state agricultural and motor vehicle legislation have placed in the way of interstate commerce;²⁹² much more could be

286. *Securities of Elkin & Allegheny R. R.*, 138 I. C. C. 341 (1928); *Public Convenience Certif. to Idaho Central R. R.*, 70 I. C. C. 265 (1921) (financing for construction of new line so limited).

287. *Western Pac. R. R. Reorg.*, 230 I. C. C. 61 (1938) (proposed bond issuance scaled down in amount and interest rate); cf. *Lehigh Valley R. R.*, 230 I. C. C. 685, 705 (1939).

288. See *In the Matter of Consumers Power Co., Holding Co.* Act Release No. 1854 (1939); Comm'r Frank, dissenting in *North American Co., Holding Co.* Act Release No. 1427 (1939) 26.

289. Frank, *Too Much Interest in Interest*, Address, Sept. 22, 1938, p. 3; Halaas, *Legal Control of Insurance Company Investments* (1932) 5 J. BUS. OF U. OF CHI. 321, 332.

290. Note also that in view of their size, insurance companies are probably better equipped to carry speculative investments than are other classes of investors.

291. See, e.g., the Robertson Law, TEX. STAT. (Vernon, Supp. 1940) Art. 4765 (75% of legal reserves required to be invested in Texas real estate or Texas securities); N. C. CODE ANN. (1939) §7880(116) (reduction of premium tax if one-fifth of company's prescribed assets are in North Carolina securities). For an early attempt, see *INSURANCE BLUE BOOK* (1875) 9. For retaliation resulting from such legislation see *Employers Casualty Co. v. Hobbs*, 107 P. (2d) 715 (Kans. 1940).

292. *Best & Co. v. Maxwell*, 61 Sup. Ct. 334 (U. S. 1940); *Clements v. Hughes*, 30 N. E. (2d) 643 (Ill. 1940); TAYLOR, BURTIS & WAUGH, *BARRIERS TO INTERNAL TRADE IN FARM PRODUCTS* (1939). Cf. *South Carolina Hwy. Dep't v. Barnwell Brothers*, 303 U. S. 177 (1938); *Clark v. Paul Gray, Inc.*, 306 U. S. 583 (1939).

said about the barriers created by statutory taxation policies and investment restrictions, which have operated to keep even large insurance companies from transacting business within a state.²⁹³

CONCLUSION

The decisions of the Supreme Court demonstrate that events in productive industry, regardless of whether or not they are part of the stream or movement of commerce, may be regulated if they impinge directly upon or are integrated with interstate commerce.²⁹⁴ The smallness of the impinging activity, for example, the negligible amount of electricity required to light airplane beacons or to heat railway stations, or the small number of workers involved in a labor dispute, or of the interstate activity affected, is immaterial.²⁹⁵ It therefore seems reasonable to say that the insurance industry, with its exhaustive financial implications for the national economy, is similarly subject to regulation by Congress.²⁹⁶

Merely to illustrate, let us paraphrase two excerpts from the *Jones and Laughlin* case, holding the National Labor Relations Act applicable to a manufacturing enterprise:²⁹⁷

ORIGINAL

When *industries* organize themselves on a national scale, making their relation to interstate commerce the dominant factor in their activities, how can it be maintained that their *industrial labor relations* constitute a forbidden field into which Congress may not enter when it is necessary to protect interstate commerce from the paralyzing consequences of *industrial war*?

And of what avail is it to protect the facility of transportation, if interstate commerce is throttled with respect to the *commodities to be transported*!

PARAPHRASE

When *insurance companies* organize themselves on a national scale making their relation to industries directly engaged in interstate commerce the dominant factor in their activities, how can it be maintained that their *investment and credit policies* constitute a forbidden field into which Congress may not enter when it is necessary to protect interstate commerce from the paralyzing consequences of *the drying up of financial credit*?

And of what avail is it to protect the facility of transportation, if interstate commerce is throttled with respect to the *credit facilities required to conduct it*!

293. See *Hearings* 1170; (1931) 45 HARV. L. REV. 184.

294. See pp. 973-978 *supra*; *Santa Cruz Fruit Packing Co. v. NLRB*, 303 U. S. 453 (1938).

295. *Consolidated Edison Co. v. NLRB*, 305 U. S. 197 (1938); *Southern Colo. Power Co. v. NLRB*, 111 F. (2d) 539 (C. C. A. 10th, 1940). *NLRB v. Fainblatt*, 306 U. S. 601 (1939).

296. This is not to imply that state regulation may not coexist with federal control in the same way in which state and federal authorities concurrently regulate trading in securities and on the commodity exchanges.

297. *NLRB v. Jones & Laughlin*, 301 U. S. 1 (1937). Italics supplied.

Is it not fair to say of insurance companies, which hold in their portfolios so much of the railroad investment of the country, that they also can be subsumed in the category of businesses possessing a highly important relationship to interstate commerce? If Congress has taken to regulating, under the interstate commerce power, such intangible intellectual constructs as "radio waves,"²⁹⁸ or rays of light,²⁹⁹ why can it not take to regulating "credit tremors"?³⁰⁰

298. See *Federal Radio Comm. v. Nelson Bros.*, 289 U. S. 266 (1933); *Fisher's Blend Station v. Tax Comm.*, 297 U. S. 650 (1936). In the *Nelson* case, the Court said: "no state lines divided the radio waves, and national regulation is not only appropriate but essential to the efficient use of radio facilities"—a remark which seems equally applicable to credit facilities. Cf. *Piedras Negras Broadcasting Co. v. Comm'r of Int. Rev.*, 43 B. T. A. No. 43 (1941).

299. *Pantomimic Corp. v. Malone*, 238 Fed. 135 (C. C. A. 2d, 1916) (prize fight film reproduced across Canadian border).

300. The NLRB has recently assumed jurisdiction over an insurance company. In the Matter of John Hancock Mut. Life Ins. Co., Case Nos. R1747, 1748 (1940), 35 *ILL. L. REV.* 469.