NOTES

ALLOCATING TAX AND POWER: AN EXAMINATION OF THE NONADMITTED AND REINSURANCE REFORM ACT

Zackary O. Crawford[*]

INTRODUCTION ... 305
I. THE NRRA ... 307
A. *Background* ... 307
B. *Federal Treatment of Insurance* ... 311
C. *Congress and the NRRA: Intent, Rationale, and Legislative Course* ... 312
D. *States' Responses to the NRRA* ... 316
1. SLIMPACT ... 317
2. NIMA ... 318
II. THE INADEQUACY OF STATES' RESPONSES ... 320
A. *Critiques of SLIMPACT* ... 320
B. *Critiques of NIMA* ... 322
III. POSSIBLE CONGRESSIONAL REMEDIES ... 324
A. *Preempt State Law* ... 324
B. *Incentivize an Interstate Compact* ... 327
1. Conditional Spending ... 329
2. Taxation ... 331
3. Threaten Preemption ... 332
CONCLUSION ... 335

INTRODUCTION

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank) brought significant and controversial changes to federal regulation of financial services.[1] Though Dodd-Frank's chief goal was

---

[*] J.D. Candidate, Boston University School of Law, 2014; B.A., Political Science, Emory University. I thank the *Boston University Law Review* editing staff for their excellent editorial efforts, particularly Christine Han and Frank Ren. Also, I am grateful for Professor Maria O'Brien Hylton's thoughtful input and guidance. Finally, I offer my thanks to my family for their constant support and encouragement.

[1] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified as amended in scattered sections of 31 U.S.C. (2012)); Daniel Indiviglio, *Dodd-Frank Financial Regulation Bill Turns One. Not Nearly Potty-Trained.*, ATLANTIC (July 21, 2011, 12:13 PM), http://www.theatlantic.com/business/archive

regulating the financial sector comprehensively, reforming the insurance industry was not its focus. Still, Dodd-Frank included at least two significant provisions that directly affected the insurance industry. The first provision established the controversial Federal Insurance Office (FIO),[2] which threatened to upset the primacy that states enjoy over insurance regulation. In contrast, the industry and many members of Congress[3] welcomed the Nonadmitted and Reinsurance Reform Act of 2010 (NRRA),[4] the second Dodd-Frank insurance provision. The NRRA sought to streamline and bring uniformity to taxation and regulation of nonadmitted insurance, a subset of insurance that faced burdensome and even conflicting multistate regulations.[5]

The devil, however, proved to be in the details. The NRRA, though popular initially, has now become controversial because it failed to achieve its goals. With the NRRA, "Congress intend[ed] that each state adopt uniform requirements, forms, and procedures, such as an interstate compact, that provide for the reporting, payment, collection, and allocation of premium taxes for nonadmitted insurance."[6] In other words, with respect to tax allocation, Congress left the details to the states. Unsurprisingly, states reacted in different ways – some entered into an interstate compact, some entered into an interstate contractual agreement, and most did nothing at all.[7] Some states argued that

/2011/07/dodd-frank-financial-regulation-bill-turns-one-not-nearly-potty-trained/242294.

[2] Dodd-Frank §§ 501-502, 124 Stat. at 1580-89 (codified as amended at 31 U.S.C. § 313 (2012)).

[3] *See, e.g.*, 155 CONG. REC. H9362 (daily ed. Sept. 9, 2009) (statement of Rep. Dennis Moore) ("In the 109th Congress, this House unanimously approved the [NRRA] by a vote of 417-0. In the 110th Congress, [it] was unanimously approved by voice vote.").

[4] Dodd-Frank §§ 521-527, 124 Stat. at 1589-95 (codified as amended at 15 U.S.C. §§ 8201-8206 (2012)). Although the NRRA concerns both nonadmitted insurance and reinsurance, this Note focuses primarily on the nonadmitted insurance aspects of the bill.

[5] *See* H.R. REP. NO. 109-649, pt. 1, at 6 (2006).

[6] 15 U.S.C. § 8201(b)(4). In this Note, just like in the NRRA itself, "state" means "any State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, Guam, the Northern Mariana Islands, the Virgin Islands, and American Samoa." *Id.* § 8206(16).

[7] *See* Matthew Gaul et al., *Recent Developments in Excess Insurance, Surplus Lines Insurance, and Reinsurance Law*, 47 TORT TRIAL & INS. PRAC. L.J. 185, 193-95 (2011) (listing the different ways states responded to the NRRA). There are currently two interstate systems: the Surplus Lines Insurance Multi-State Compliance Compact (SLIMPACT) and the Nonadmitted Insurance Multi-State Agreement (NIMA). *See* discussion *infra* Part I.D (exploring SLIMPACT and NIMA). As the names suggest, one is a compact and one is an agreement. A compact is more formal and binding than an agreement. Consequently, when specifically referring to SLIMPACT and NIMA, this Note purposefully uses the distinct terms "compact" and "agreement," intending their different legal meanings. Generally, however, "compact" and "agreement" are used interchangeably in this Note, with "compact" being used more often. Congress will likely be indifferent over such a technicality, since Congress only specified interstate compacts as an example of a valid uniform system. *See* 15 U.S.C. § 8201(b)(4). For a more extensive discussion on the subtle

one taxation regime would raise costs for consumers, while other states argued that these new regimes made taxation just as complicated as before; most states, if not all, agreed that Congress did not intend such results.[8]

This Note proceeds in three main parts. Part I explores the conditions that gave rise to the NRRA, analyzes its path through Congress, and describes how states responded to the bill. Next, Part II explains why these inadequate state responses signal a need for a congressional response. Part III then evaluates the legal and political feasibility of four congressional remedies. First, as a brute-force approach, Congress could outright preempt state taxation of insurance. Such an approach would be undesirable, however, since it would invade traditional state primacy over insurance law.

The other three approaches are incentives-based schemes. Congress could induce the states to enter into a single compact via its taxing power by levying an excise tax on nonadmitted insurance policies or prohibiting a deduction for insured individuals and entities domiciled in states that elect not to join a single interstate compact. Independent of or in conjunction with a tax incentives scheme, Congress could also use its spending power to condition the receipt of certain federal funds on whether a state joined an interstate compact.

Finally, Congress could threaten to preempt state tax law on such insurance policies to incentivize the formation of a national compact. This Note concludes that Congress's best choice is to threaten federal preemption because it is the most politically and administratively expedient solution.[9] Though Congress did not achieve its policy objectives through the NRRA, Congress can threaten preemption to attain the NRRA's desired effects while simultaneously respecting states' traditional power to regulate insurance.

I. THE NRRA

A. *Background*

With the NRRA, Congress focused on reforming nonadmitted insurance.[10] Though nonadmitted insurance is only a subset of domestic insurance policies,[11] there were over thirty billion dollars paid in premiums for such policies in 2005.[12] According to the NRRA, nonadmitted insurance is property and casualty insurance from an insurer that is not licensed or "admitted" to

---

differences between compacts and agreements, see *infra* notes 81-82 and accompanying text.

[8] *See* discussion *infra* Part II.

[9] *See* discussion *infra* Part III.B.3.

[10] 15 U.S.C. § 8201(b)(4) (describing the policy goal of the NRRA to create "nationwide uniform requirements" for "nonadmitted insurance").

[11] *Id.* § 8206(9) (defining "nonadmitted insurance" as a subset of insurance).

[12] *See* SURPLUS LINES INSURANCE MULTI-STATE COMPLIANCE COMPACT app. A (2010) [hereinafter SLIMPACT], *available at* http://www.csg.org/programs/policyprograms/NCIC/documents/finalcompactlanguage-slimpact.pdf.

extend such insurance in the insured individual's or entity's state.[13] Known as the "secondary market" for insurance, these policies are available only when the "primary" or admitted market for a given state does not offer a desired insurance policy.[14] These policies typically cover entities facing atypical risks, such as amusement parks, chemical manufacturers, or private security companies.[15] For these unusual risks with smaller insurance pools, states understandably do not provide the same protections[16] as they do for admitted insurance. Consequently, states have struck a compromise where they permit the out-of-state insurance, but do not provide traditional governmental insurance protections – a risk insured with riskier insurance is better than an uninsured risk.[17]

Before the NRRA, states were willing to let out-of-state, nonadmitted insurers extend policies within their respective state borders, but states were unwilling to risk losing tax revenue.[18] In many states, the first mechanism to ensure they did not lose policies (that is, revenue) to nonadmitted insurers was

---

[13] *See* 15 U.S.C. § 8206(9) ("The term 'nonadmitted insurance' means any property and casualty insurance permitted to be placed directly or through a surplus lines broker with a nonadmitted insurer eligible to accept such insurance."); *id.* § 8206(11) ("The term 'nonadmitted insurer' . . . means, with respect to a State, an insurer not licensed to engage in the business of insurance in such State . . . .").

[14] *See* KENNETH S. ABRAHAM, INSURANCE LAW AND REGULATION 738 (4th ed. 2005).

[15] *See, e.g.*, 155 CONG. REC. H9363 (daily ed. Sept. 9, 2009) (statement of Rep. Spencer Bachus) ("Surplus lines insurance, also known as 'nonadmitted' insurance, is highly specialized property and casualty insurance for exceptional risks, such as hazardous materials and amusement parks.").

[16] These protections include regulating rates, scrutinizing policy contracts, or providing the policy guaranty funds should the insurer be unable to pay proceeds. *See* ABRAHAM, *supra* note 14, at 738.

[17] *See id.* ("[U]nregulated insurance may well be preferable to none at all, which is the alternative in such situations."). Although states do not provide the same aggressive protections for nonadmitted insurance as they do for admitted insurance, at the time of the NRRA's enactment, most states had "eligibility" requirements of some sort. *See* EDWARDS WILDMAN PALMER LLP, EXCESS AND SURPLUS LINES LAWS IN THE UNITED STATES (John P. Dearie, Jr. ed., 2013), *available at* http://www.edwardswildman.com/files/upload/ExcessandSurplusLinesManual032013.pdf (cataloging eligibility requirements and taxation rates for nonadmitted insurance for every state and territory). To be an eligible nonadmitted insurer, many states merely require submission of financial information, premium information, and a fee payment. *Id.* at iii.

[18] *See* Richard A. Brown, *Surplus Lines Regulatory Picture for 2013*, INS. J. (Jan. 10, 2013), http://www.insurancejournal.com/news/national/2013/01/10/276976.htm ("[S]tates are desperate for cash [and] are suspicious that NRRA has cut into their surplus lines premium tax revenues."); *cf. Commercial Insurance Modernization: Hearing Before the Subcomm. on Capital Mkts., Ins. & Gov't Sponsored Enters. of the H. Comm. on Fin. Servs.*, 109th Cong. 6 (2006) [hereinafter *Commercial Insurance Modernization Hearing*] (statement of Rep. Gwen Moore) ("No state has an incentive under this bill to lose premium tax revenue.").

to require companies to complete intrastate due diligence. Due diligence included searching and applying for policies, receiving denials, and verifying the unavailability of the desired policy within the state's admitted insurance market[19] – all cumbersome processes that increased transaction costs.

A second method for states to avoid losing revenue was to impose eligibility requirements for nonadmitted insurers. Many states required the nonadmitted insurer to register with the state and pay a fee.[20] Such a requirement increased transaction costs for the insurance, making such out-of-state insurance less attractive.[21] For multistate risk policies, a broker may have been required to register, meet various requirements, and pay periodic fees in many states just to issue a single policy.[22]

Once a state permitted purchase of nonadmitted insurance, states avoided revenue loss by taxing the policy premiums themselves.[23] Such taxation is simple and uncontroversial for policies where all of the risk is located within one state. In contrast, taxation of multistate risk policies proved to be enormously complicated and controversial. States developed different, incompatible, and even collectively unfair schemes to tax such policies.[24] The rationale was equitable: each state taxed the premium based on how much of the risk was located within its jurisdiction. Different states, however, had different tax and risk allocation formulas, with some jurisdictions having no

---

[19] *Commercial Insurance Modernization Hearing*, *supra* note 18, at 4 (statement of Rep. Ginny Brown-Waite) ("[I]n most states, these companies are required to shop around the admitted market and be denied several times for coverage that they know they cannot get, so they should have to make those phone calls, and only then are they permitted to shop in the surplus lines market."); *see also, e.g.*, N.Y. INS. LAW § 2118(b)(4) (McKinney Supp. 2013) (requiring a buyer to be denied at least three times by admitted insurers before he or she can purchase insurance from a nonadmitted insurer).

[20] *See Commercial Insurance Modernization Hearing*, *supra* note 18, at 4 (statement of Rep. Ginny Brown-Waite) ("Insurers and brokers who want to provide insurance across State lines are subject to a myriad of different State tax and licensing requirements."); *see also* EDWARDS WILDMAN PALMER LLP, *supra* note 17 (cataloging eligibility requirements, including licensing fees).

[21] Many of these eligibility requirements are, in some capacity, in place to protect the insured as well, since the state does not provide the traditional, more aggressive protections to nonadmitted insurance as it does for admitted insurance. *See* ABRAHAM, *supra* note 14, at 738 ("[T]he purchaser who is relegated to the non-admitted market does not receive the same kinds of protections available when she purchases from a licensed insurer. Rates in the non-admitted market are unregulated; policy provisions are unscrutinized; solvency assurance and guaranty fund protection are unavailable.").

[22] *See* EDWARDS WILDMAN PALMER LLP, *supra* note 17 (describing various requirements that each state imposes for nonadmitted insurance).

[23] *See id.* (listing state tax rates on nonadmitted insurance).

[24] *See Commercial Insurance Modernization Hearing*, *supra* note 18, at 7 (statement of Rep. Sue Kelly) ("Fifty different States found 50 different ways to make money from the agents who were trying to just take care of their customers, and it really wasn't fair.").

taxation allocation laws at all, and many states having different tax schedules.[25] This complexity notwithstanding, there was also little to no guidance on which state's formula applied to a given policy.[26] Was it the state of the insured company's headquarters? Primary place of business? Where most of the risk was located? What if the risk was evenly split among several states?

In 2006, Richard Bouhan, then-Executive Director of the National Association of Professional Surplus Lines Offices, Ltd., summarized the taxation problems succinctly before Congress:

> If I am a broker and I have exposure in five States, and the five States have different allocation systems, I do not know which allocation system to use. . . . Some may be based on square footage. Some base it on revenues of the plant. We do not know which one to use. The whole system is confusing.[27]

Consequently, in the realm of multistate nonadmitted insurance, leaving coordination to over fifty jurisdictions did not yield efficient outcomes. In the face of these status quo difficulties, the market needs a new approach to remedy the states' failure to form a workable, coherent regulatory regime. Congress is the most logical actor, since it has the enumerated powers contained in Article I, Section 8 of the Constitution to resolve such coordination or collective action problems among the states.[28]

---

[25] Representative Dennis Moore of Kansas described the challenges as follows:

> In the case of State premium tax payments[,] the patchwork of 55 different laws in the areas of allocation formulas, tax due dates, and competing tax authorities, make little sense . . . . In most States surplus lines premium taxes are levied at the State level, but at least in one State, Kentucky . . . those taxes are actually levied at the city and county level as well, creating a situation in which one State alone has several hundred different taxing authorities. In addition, 11 states and the District of Columbia have no laws stipulating how or even whether surplus lines taxes should be allocated to other States if there is a risk insured in those States.

Id. at 5 (statement of Rep. Dennis Moore); *see also id.* at 7 (statement of Rep. Sue Kelly).

[26] *See id.* at 64 (statement of Tom Minkler, Chairman, Independent Insurance Agents and Brokers of America Government Affairs Committee) ("Premium tax allocation and remittance schedules vary significantly from state to state. . . . State laws do not, however, contain mechanisms for the remittance of premium taxes to other states. Moreover, nonresident surplus lines agents and brokers have no guidance on which state surplus lines laws govern . . . .").

[27] *See id.* at 32 (statement of Richard Bouhan, Executive Director, National Association of Professional Surplus Lines Offices, Ltd.).

[28] *See* Robert D. Cooter & Neil S. Siegel, *Collective Action Federalism: A General Theory of Article I, Section 8*, 63 STAN. L. REV. 115, 183-84 (2010) ("Article I, Section 8 empowers Congress to solve collective action problems that predictably frustrate the states.").

B. *Federal Treatment of Insurance*

Although Congress has many tools at its disposal to remedy this interstate insurance problem, it must take into account the political realities and histories of the industry. Congress faces – and continues to face – weighty constraints, such as the traditional primacy of states in insurance regulation, when attempting to create federal policy. Consequently, before crafting a measured remedy to cure the unintended consequences of the NRRA, Congress must deal with these historical constraints.

In step with early Commerce Clause jurisprudence, the Supreme Court explicitly stated that the Clause did not cover insurance.[29] The Constitution prohibited federal regulation of insurance until 1944, when the Supreme Court overturned itself and held in *United States v. South-Eastern Underwriters Ass'n* that the act of purchasing insurance across state lines constitutes interstate commerce.[30] After this holding, the industry and states became very concerned, unsure of what the federal government could and would do with this newly declared power.[31] The states and industry quickly lobbied the federal government to deny the use of its new power, essentially asking for the status quo ante.[32] These requests resulted in the McCarran-Ferguson Act.[33] Explicitly assuaging state and industry concerns, the law states that "silence on the part of Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States."[34] Furthermore, the Act states that "[n]o Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business," with the exception of enumerated antitrust acts.[35]

---

[29] Paul v. Virginia, 75 U.S. (8 Wall.) 168, 183 (1868) ("Issuing a policy of insurance is not a transaction of commerce. . . . They are not commodities to be shipped or forwarded from one State to another . . . . Such contracts are not inter-state transactions . . . . They are, then, local transactions, and are governed by the local law."), *abrogated by* United States v. S.-E. Underwriters Ass'n, 322 U.S. 533 (1944).

[30] *S.-E. Underwriters Ass'n*, 322 U.S. at 553 ("No commercial enterprise of any kind which conducts its activities across state lines has been held to be wholly beyond the regulatory power of Congress under the Commerce Clause. We cannot make an exception of the business of insurance.").

[31] BAIRD WEBEL & CAROLYN COBB, INSURANCE REGULATION: HISTORY, BACKGROUND, AND RECENT CONGRESSIONAL OVERSIGHT 7 (2005) ("*South-Eastern Underwriters* . . . caused consternation among insurers, regulators, and state legislators. The decision created uncertainty about whether and to what extent states could tax or regulate and about whether insurers could continue to use rating bureaus.").

[32] *See id.* at 7-8.

[33] McCarran-Ferguson Act, ch. 20, 59 Stat. 33 (1945) (codified as amended at 15 U.S.C. §§ 1011-1015 (2012)).

[34] 15 U.S.C. § 1011.

[35] *Id.* § 1012(b).

Ever since McCarran-Ferguson, states have generally been the chief regulators of insurance.[36] The industry and the states have entrenched and coordinated their behavior based on this assumption. Moreover, the states still vigorously lobby to protect their primacy in this area of law.[37] Dodd-Frank's creation of the FIO in 2010 was controversial for this reason. Though the statutory provision creating the FIO states that the office does not have any regulatory power,[38] states still fear that Congress has begun a march toward enhanced federal regulation. Consequently, the historical primacy of state law in insurance regulation informs how Congress can salvage the shipwrecked goals of the NRRA.[39]

C. *Congress and the NRRA: Intent, Rationale, and Legislative Course*

Problems arising from regulation and taxation of interstate insurance are not new.[40] Specifically in the context of multistate risk nonadmitted insurance, the National Association of Insurance Commissioners (NAIC) attempted to resolve such regulation and taxation for thirty years.[41] When NAIC failed on its own, it eventually turned to Congress for help.[42] Congress, too, attempted to resolve the problem for some time, as the NRRA was introduced to the House

[36] While states have primacy in regulating the insurance industry, the federal government has occasionally legislated in the area. *See, e.g.*, Gramm-Leach-Bliley Financial Modernization Act, Pub. L. No. 106-102, 113 Stat. 1338 (1999) (codified as amended at 15 U.S.C. §§ 6751-6766) (establishing national uniform broker licensing requirements); Employee Retirement Income Security Act (ERISA), Pub. L. No. 93-406, 88 Stat. 829 (1974) (codified as amended at 29 U.S.C. §§ 1101-1461 (2012)) (preempting state insurance regulation of employee benefit plans).

[37] *Proposed Federal Insurance Regulation*, NAT'L ASS'N OF INS. COMM'RS & CTR. FOR INS. POLICY & RESEARCH, http://www.naic.org/cipr_topics/topic_federal_insurance_regulator.htm (last visited Jan. 5, 2014) (compiling letters of opposition from various government and industry entities, including state legislative resolutions disapproving proposed federal regulation of insurance); *see also* Letter from Bob Riley et al., Governor, Ala., to Barney Frank et al., Chairman, House Fin. Servs. Comm. (Mar. 23, 2009), *available at* http://www.naic.org/documents/topics_governors_opposition_ofc_letter.pdf (compiling signatures from thirty-three state governors in opposition to a proposed congressional bill that would increase federal regulation of insurance).

[38] 31 U.S.C. § 313(k) (2012) ("Nothing . . . shall be construed to establish or provide the Office or the Department of the Treasury with general supervisory or regulatory authority over the business of insurance.").

[39] *See* discussion *infra* Part III.

[40] In fact, one of the issues in *Paul v. Virginia* was discriminatory taxation of out-of-state insurers. *See* Paul v. Virginia, 75 U.S. (8 Wall.) 168, 177 (1868).

[41] STEWART KEIR, LOCKE LORD LLP, NRRA – NOT A SURPLUS LINES PANACEA 1 (2011), *available at* http://www.lockelord.com/files/Publication/98a2789b-e727-4027-ade7-a172781ac50b/Presentation/PublicationAttachment/55e827a6-7f24-4776-9c2a-a51ca00365d2/corpins_2011-10_06th_NRRA_Keir.pdf.

[42] *Id.*

floor several times.[43] Enjoying rare bipartisan support, the House passed the bill in 2006, 2007, and 2009, passing the first two versions unanimously.[44] Either due to lack of salience, partisanship, or agenda considerations, the Senate never passed the bill until it was included as part of Dodd-Frank.[45] The NRRA did not continually die in the Senate without any supporters;[46] it just lacked sufficient support to gain traction.

Though a recession created the impetus for Dodd-Frank and many other regulations unpopular with the industry, Dodd-Frank served as the vehicle that gave nonadmitted insurers what they wanted. The NRRA, included in Dodd-Frank, mandates that only an insured's "home State" can regulate a nonadmitted insurance policy, foreclosing all other states' laws.[47] By setting the policy's home state, Congress eliminated many of the issues arising from states' nonadmitted insurance regulation. A broker issuing nonadmitted insurance only had to be licensed or permitted to sell nonadmitted insurance in one state, not potentially fifty-five jurisdictions.[48] To simplify interstate policies even further, the NRRA forced the states to have eligibility requirements for nonadmitted, out-of-state insurers that complied with NAIC's Nonadmitted Insurance Model Act.[49] This required states to have consistent and workable general eligibility requirements while permitting the states to decide the specifics.[50] Finally, the statute excluded "exempt commercial purchasers" – certain wealthy purchasers of large amounts of commercial insurance[51] – from states' due diligence requirements.[52] Congress largely

[43] *E.g.*, H.R. 4173, 111th Cong. (2009); H.R. 2571, 111th Cong. (2009); H.R. 1065, 110th Cong. (2007); H.R. 5637, 110th Cong. (2006); *see also* 155 CONG. REC. H9363 (daily ed. Sept. 9, 2009) (statement of Rep. Spencer Bachus) ("This will be the third time we are sending this important insurance reform proposal to the other body . . . .").

[44] *See* 155 CONG. REC. H9362 (daily ed. Sept. 9, 2009) (statement of Rep. Dennis Moore) ("In the 109th Congress, this House unanimously approved the bill by a vote of 417-0. In the 110th Congress, our bill was unanimously approved by voice vote."); OFFICE OF THE CLERK: U.S. HOUSE OF REPRESENTATIVES, FINAL VOTE RESULTS FOR ROLL CALL NO. 492 (2006), http://clerk.house.gov/evs/2006/roll492.xml (indicating that House Bill 5637 received 417 "Yeas" and zero "Nays").

[45] *See* 155 CONG. REC. H9362 (daily ed. Sept. 9, 2009) (statement of Rep. Dennis Moore) ("Unfortunately, the Senate has yet to act.").

[46] *See* 153 CONG. REC. S6852 (daily ed. Mar. 20, 2007) (statement of Sen. Mel Martinez) (indicating that the NRRA was presented on the Senate floor).

[47] 15 U.S.C § 8202(a) (2012) ("Except as otherwise provided in this section, the placement of nonadmitted insurance shall be subject to the statutory and regulatory requirements solely of the insured's home State.").

[48] *Id.* § 8202(b) ("No State other than an insured's home State may require a surplus lines broker to be licensed in order to sell, solicit, or negotiate nonadmitted insurance with respect to such insured.").

[49] *Id.* § 8204(a).

[50] *See id.*

[51] *Id.* § 8206(5).

eliminated transaction costs related to whether a broker could issue a policy, in theory making such insurance more easily available at a lower cost.

Besides making it easier to issue a policy, Congress also streamlined premium taxation: only the insured's home state had authority to tax the premiums of a policy.[53] To prevent states from losing revenue, the NRRA provides that "[t]he States may enter into a compact or otherwise establish procedures to allocate among the States premium taxes paid to an insured's home State."[54] Importantly, the explicit permission for the states to enter into a compact removes all doubt as to whether the states have constitutional authority to enter into a compact on this matter; generally, interstate compacts are unconstitutional without explicit congressional approval.[55] This permission, however, was not a possible extra benefit that the states may choose to avail. As the NRRA unequivocally states: "Congress *intend[ed]* that each state adopt nationwide uniform requirements, forms, and procedures, such as an interstate compact."[56] Thus, for Congress's scheme to work, states were *expected* to avail themselves of this permission to form a compact and create interstate tax allocation agreements.[57]

When Congress determined which state's taxation scheme governed, it unintentionally created perverse incentives. The problem is one of collective action,[58] and at first blush, the states' failure to come up with a single, uniform tax allocation scheme on their own should have signaled this. Since the states failed to come up with a workable national scheme, what in the statute would push the states to come together to form a single compact? The natural response is lost tax revenue, as states had an interest in taxing risks that fell

[52] *Id.* § 8205.

[53] *Id.* § 8201(a) ("No state other than the home State of an insured may require any premium tax payment for nonadmitted insurance.").

[54] *Id.* § 8201(b)(1).

[55] *See* U.S. CONST. art. I, § 10, cl. 3 ("No State shall, without the Consent of Congress . . . enter into any Agreement or Compact with another State . . . ."). Exactly when the Constitution requires congressional consent for states to enter interstate compacts is not as clear as the Constitution's language would suggest. For more on when congressional approval is required for interstate compacts, see Matthew Pincus, Note, *When Should Interstate Compacts Require Congressional Consent?*, 42 COLUM. J.L. & SOC. PROBS. 511, 524-26 (2009) (citing U.S. Steel Corp. v. Multistate Tax Comm'n, 434 U.S. 452 (1978)).

[56] 15 U.S.C. § 8201(b)(4) (emphasis added).

[57] *See id.*

[58] *See* MANCUR OLSON, JR., THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS 51 (1965) ("Only a *separate and 'selective' incentive* will stimulate a rational individual in a latent group to act in a group-oriented way. In such circumstances group action can be obtained only through an incentive that operated, not indiscriminately, like the collective good, upon the group as a whole, but rather *selectively* toward the individuals in the group."). For an argument about how Congress can resolve states' collective action problems under its constitutionally enumerated powers, see Cooter & Siegel, *supra* note 28.

within their state, which they now could not tax because of the new home state default rule.[59] A closer look, however, suggests that by setting the default to a single tax authority for a given policy, some states had reason not to join a compact. Congress's theory assumed that every state had more potential tax revenue from fractionally taxing risks in their state regardless of whether the insured was in their state, rather than revenue from taxing 100% of the risk for policies where the insured's home state was the same as the taxing authority.[60]

In short, Congress assumed that every state would be a winner by entering a compact, when in fact there would be both winners and losers. For example, states with many individuals and entities domiciled within their borders, but with risks all over the country, would likely lose from a tax allocation scheme.[61] These states would remit more taxes to other states than they would gain from taxing likely fewer risks within their jurisdiction from individuals and entities domiciled in other states. For these states, such costs eliminate the incentive to join a compact.

Members of Congress (or, at least, the legislative drafters) were also on notice of these divergent incentives to form a national compact. Representative Dennis Moore, the law's chief sponsor, implicitly acknowledged the collective action problem in a 2006 committee hearing by asking, "[T]he States have been trying to reform the commercial insurance market for years. . . . Will the States be able to make any meaningful regulatory changes in the area of surplus lines . . . without Federal legislation . . . ?"[62] He received answers in the negative from industry experts at the hearing.[63] During the same hearing, there was a colloquy about the statute's perverse incentives between Representative Paul Kanjorski of Pennsylvania and Richard Bouhan, an industry executive:

> [Rep. Kanjorski:] As I understand the logic of the bill, the collector would be the State of the corporate entity where they are living. Let's take Wal-Mart. Suddenly, the State of Arkansas would get tremendous windfall in revenue.

---

[59] 15 U.S.C. § 8201(a).

[60] *See id.*

[61] *See, e.g.*, Michael S. Greve, *Compacts, Cartels, and Congressional Consent*, 68 MO. L. REV. 285, 333-35 (2003) (describing how states might be disincentivized from joining a multistate tax compact due to collective action problems); Mark R. Goodman, *Perspectives: NIMA, SLIMPACT Benefit Different Surplus Lines Constituencies*, BUS. INS. (Oct. 18, 2011, 3:39 PM), http://www.businessinsurance.com/article/20111018/NEWS07/111019895 ("It is difficult to see how the state benefits from allocating to other states the surplus lines tax on large in-state insurance payments. No legislator wants to pass legislation that results in his or her state being a 'loser,' particularly when it comes to tax revenues.").

[62] *Commercial Insurance Modernization Hearing*, *supra* note 18, at 20 (statement of Rep. Gwen Moore).

[63] *See, e.g.*, *id.* (statement of Scott A. Sinder, General Counsel, Council of Insurance Agents and Brokers) ("I believe the answer to that question is absolutely not.").

> *What would incentivize [Arkansas] to enter into a compact to share that with other states?*
>
> Mr. Bouhan: Because there are exposures that Arkansas would have that are from other large national corporations that are domiciled in say New York, Missouri, or California, for which they would get their fair share of the revenue, too.
>
> . . . .
>
> [Rep.] Kanjorski: Don't we have to work something out there now . . . instead of throwing it out there into the ether and allowing compacts to be formed when they may never ultimately be formed?
>
> . . . .
>
> [I]f I were a big winner, it would take me an awful lot of time before I would join a compact to take revenue away from my State. I'm just suggesting that I think that is an important issue that we would have to resolve now.[64]

Congress did not resolve the problem then, nor did it find a solution by the time it passed the bill. The states' congressional incentives to join a single, uniform interstate compact rested on the mere statutory suggestion from Congress that they do so. Moreover, Congress based its interstate compact solution on the flawed assumption that every state had tax revenues to gain from compacting.[65] Such mistakes doomed the policy successes of the NRRA.

Curiously, from the available testimony before Congress and from congressional debate over the NRRA, no actor proposed federal preemption, a quick fix to the problem. This omission suggests that the allocation of power between the federal and state governments still favors the primacy of states in insurance regulation, bolstering the notion that Congress's remedial response must take state primacy into account.

D. *States' Responses to the NRRA*

For the NRRA to work, states were required to act.[66] Unsurprisingly, different states responded differently to the new law.[67] In line with Congress's

[64] *Id.* at 30-32 (statements of Rep. Paul Kanjorski, Chairman, Subcomm. on Capital Mkts., Ins. & Gov't Sponsored Enters. of the H. Comm. on Fin. Servs., and Richard Bouhan, Executive Director, National Association of Professional Surplus Lines Offices, Ltd.) (emphasis added).

[65] *See* 15 U.S.C. § 8201(b)(4); *Commercial Insurance Modernization Hearing*, *supra* note 18, at 30-32 (statement of Rep. Paul Kanjorski, Chairman, Subcomm. on Capital Mkts., Ins. & Gov't Sponsored Enters. of the H. Comm. on Fin. Servs.).

[66] *See* 15 U.S.C. § 8201(b)(4).

[67] *See Insurance Oversight: Policy Implications for U.S. Consumers, Businesses, and Jobs: Hearing Before the Subcomm. on Ins., Hous. & Cmty. Opportunity of the H. Comm. on Fin. Servs.*, 112th Cong. 198 (2011) [hereinafter *Insurance Oversight Hearing*] (statement of Gregory D. Wren, Treasurer, National Conference of Insurance Legislators)

intent, some states did enter into compacts.[68] Contrary to Congress's intent, many states did not respond at all; they kept 100% of multistate policies' premium tax for those insured individuals or entities that were domiciled within their borders.[69] Many states also did not have adequate information to know whether retaining 100% of taxes or joining a tax allocation scheme would be better for them.[70] In an attempt to better facilitate the equitable goal of tax allocation based on the risk's location, Congress created a situation that was more inequitable than the status quo ante. Several states, however, attempted to effect Congress's goal, which are discussed in turn below. The specifics of these attempts can serve as models for Congress's needed national remedial action.

1. SLIMPACT

The closest attempt to form a formal interstate compact is the Surplus Lines Multistate Compliance Compact (SLIMPACT), supported by the National Conference of Insurance Legislators (NCOIL) and the Council of State Governments.[71] The SLIMPACT proposal would create a commission with a representative from each compacting state and a tax clearinghouse, which would be "instrumentalit[ies] of the Compacting States."[72] The commission would set the tax allocation formula and establish a clearinghouse to facilitate application of the formula, ensuring each state received its due share of revenue.[73] SLIMPACT would also empower the commission to set forth "reasonable Rules in order to effectively and efficiently" carry out the compact, which would be binding law on the compacting states.[74] For example, if a state joined the compact yet had statutes contrary to the compact,

(listing the various ways states responded to the NRRA, including joining one of two different compacts; passing legislation to tax 100% of the risk; passing legislation requiring fiscal analysis before joining a compact; passing legislation enabling insurance regulator and governors to enter into a compact; and doing nothing).

68 *See id.* at 199.

69 *See id.* at 198.

70 *See id.* ("For the last year, states have been – and the majority still are – trying to figure out how to best protect their current surplus lines tax monies in a time when all state revenue is critical. To do this properly, states must assess their home-stated versus multi-state risks, data that in most states has not been collected.").

71 SLIMPACT, *supra* note 12, arts. III, IV; *see also* COUNCIL OF STATE GOV'TS, RESOLUTION IN SUPPORT OF A COMPREHENSIVE SURPLUS LINES INSURANCE COMPACT 3-4 (2010), *available at* http://www.csg.org/programs/policyprograms/NCIC/documents/Surplus_Lines_1.pdf ("The Council of State Governments (CSG) supports [SLIMPACT], also supported by [NCOIL], the surplus and excess lines industry, and major national property-casualty and producer organizations – to comply with the NRRA and maximize state non-admitted insurance premium tax collection . . . .").

72 SLIMPACT, *supra* note 12, art. III(4).

73 *Id.* arts. III, IV.

74 *Id.* arts. V(1), VIII(2).

the compact's rules would preempt the state's statutes.[75] For the compact to take effect, at least ten states or states which in aggregate have greater than forty percent of the national nonadmitted insurance premium volume must join.[76] To date, only nine states have joined SLIMPACT, one state shy of becoming operational.[77] The compacting states are Alabama, Indiana, Kansas, Kentucky, New Mexico, North Dakota, Rhode Island, Tennessee, and Vermont.[78]

2. NIMA

In contrast to SLIMPACT, several states formed an alternate agreement, the Nonadmitted Insurance Multi-State Agreement (NIMA), drafted by NAIC. Presently, there are six members: Florida, Louisiana, Puerto Rico, South Dakota, Utah, and Wyoming.[79] Several other jurisdictions (Alaska, Connecticut, Hawaii, Mississippi, Nebraska, and Nevada) were once members of the agreement, but have since left.[80]

Notably, NIMA is an interstate agreement, not an interstate compact.[81] Whereas agreements are not binding on member state legislatures and do not entail cessation of authority, compacts are binding, can preempt state law, and can cede authority to governing bodies that create binding law.[82] True to its name, NIMA fits more comfortably within the agreement framework, as it does not preempt contrary state law and does not require states to cede regulatory authority. SLIMPACT, in contrast, requires all of these.[83] Rather

---

[75] *Id.* art. XVI(1)(b).

[76] *Id.* art. XIII(2).

[77] *Surplus Lines Insurance Multi-State Compliance Compact (SLIMPACT)*, NAT'L CTR. FOR INTERSTATE COMPACTS, http://www.csg.org/NCIC/SLIMPACT.aspx (last visited Jan. 5, 2014).

[78] *Id.*

[79] *See* Press Release, Non-Admitted Ins. Multi-State Agreement, NIMA Elects New Officers (Oct. 31, 2012), http://www.floir.com/siteDocuments/NIMAPressRelease10312012.pdf.

[80] *See* Bradley R. Kelly, *NAPSLO Special Report and Legislative Update*, NAT'L ASS'N OF PROF'L SURPLUS LINES OFFICES, LTD. (July 25, 2012), http://www.napslo.org/imispublic/Content/NavigationMenu/News/ENews/2012/July25SpecialReport.htm. Nevada left NIMA because it had more to gain from not working with other states, which is a plausible reason for why the other states left, as well. *See infra* notes 104-05 and accompanying text.

[81] Memorandum from Rick Masters, Special Counsel for Interstate Compacts, Council of State Gov'ts, to Nat'l Conference of Ins. Legislators et al. 1 (Jan. 26, 2011), *available at* http://www.napslo.org/imispublic/pdf/legreg/NCOILNIMAOpinion.pdf ("NIMA and related legislation is [sic] not an interstate compact . . . .").

[82] *See* CAROLINE N. BROUN ET AL., THE EVOLVING USE AND THE CHANGING ROLE OF INTERSTATE COMPACTS: A PRACTITIONER'S GUIDE 16-20 (2006); Kevin McCarty, *In My Opinion: Why Florida Chose NIMA*, PROP. CASUALTY 360° (July 27, 2011), http://www.propertycasualty360.com/2011/07/27/in-my-opinion.

[83] *See* discussion *supra* Part I.D.1.

than creating a compact-like commission with rulemaking authority, NIMA simply creates a clearinghouse that allocates premium taxes to preserve the status quo tax allocation before the NRRA changed the rules.[84] Without delegating power to a rulemaking commission, NIMA gives states more certainty with what they are joining, as there are no new rules to promulgate. Instead, NIMA requires each state to delegate to the proper department[85] (typically the state's Insurance Commissioners and Revenue Commissioners) the power to remit revenues to the clearinghouse to be redistributed to other states.[86] Also, unlike SLIMPACT, states know the allocation formulas before joining. NIMA's formula is a simple allocation, distributing the premium to the relevant states and then multiplying that portion by the respective state's tax rate.[87] Since each state uses its own tax rate for its portion of the premium, NIMA preserves some autonomy for the states.[88]

NIMA has progressed further than SLIMPACT in practice. On July 1, 2012, NIMA launched its clearinghouse with a website through which policy filers can use a calculator to estimate the allocation of taxes, thus making calculations much easier.[89] From July 1 to September 30, 2012, the

---

84 *See Dodd-Frank Financial Services Regulatory Reform: NAIC Initiatives*, NAT'L ASS'N OF INS. COMM'RS, *available at* http://www.naic.org/index_financial_reform_surplus_lines.htm ("NIMA is not a broad regulatory compact and it does not go far as some regulators and industry may have preferred, but it does provide a means for preserving something close to the status quo where premium taxes are concerned.").

85 NIMA only requires the state have "the legal authority" to join. *See* NONADMITTED INSURANCE MULTI-STATE AGREEMENT pt. III, § 8 (2011) [hereinafter NIMA], *available at* http://www.floir.com/siteDocuments/NIMAFlorida.pdf.

86 *See id.* pt. IV, § 17 ("[E]ach Participating State agrees to require, by statute or rule . . . that the Surplus Lines Licensee or insured who independently procures insurance shall forward such payments and related information . . . to the Clearinghouse . . . .").

87 *Id*. annexes A, B. The tax allocation formula is surprisingly simple:

> Tax Allocation = (Net tax due to each State/net tax due to all States) x Amount collected
>
> Home State Net Taxes = (Taxes collected for the Home State + Taxes due from other Participating States) – Taxes owed to other Participating States
>
> Total Premium Tax to be Collected on Each Multi-State Policy = (Home State's tax rate x Portion of premium allocated to Home State) + (Home State's tax rate x Premium allocated to Non-Participating State if insurer is nonadmitted in that State) + (Participating States' tax rate x Premium allocated to each Participating State if insurer is nonadmitted in that state).

Id. annex B.

88 *See id.* annex B (basing premium tax in part on home-state tax rate).

89 *SLIP Is Now Available*, SURPLUS LINES CLEARINGHOUSE (last visited Jan. 5, 2014), http://www.slclearinghouse.com/News/ClearinghouseNews.aspx?ID=6; *Tax Estimator*, SURPLUS LINES CLEARINGHOUSE (last visited Jan. 5, 2014), http://www.slclearinghouse.com/tools/calculator.aspx.

clearinghouse processed 509 transactions with an aggregate premium of almost thirty-two million dollars, allocating $1,434,768.42 in taxes for participating states.[90]

II. THE INADEQUACY OF STATES' RESPONSES

Although several states attempted to comply with Congress's wish that they form an interstate compact, their efforts still failed to effectuate Congress's intended result: a single, uniform compact. The mere existence of two separate schemes, SLIMPACT and NIMA, demonstrates that Congress's goal of one national system has not come to fruition. Moreover, though SLIMPACT and NIMA are clearly steps toward Congress's intended result, these two schemes ultimately suffer from individualized drawbacks, some created by the compacts themselves and some magnified by the NRRA's perverse incentives framework. Each scheme will now be analyzed in turn.

A. *Critiques of SLIMPACT*

Though SLIMPACT is the states' closest attempt to form an actual compact in its full legal sense, it has failed to gain nationwide support, and has even failed to gain enough support to begin operating. Only nine states have joined SLIMPACT, one state shy of becoming operational.[91] This lack of participation reflects the likely reality that no other state is willing to be the tenth state to make it operational; the stakes are higher for the tenth state.

When considering whether to join SLIMPACT, states face the heavy costs of uncertainty. Uncertainty exists regarding the specifics of the tax allocation formula and the ceding of state authority to a commission with a vague mandate to make "reasonable Rules in order to effectively and efficiently achieve the purposes of this Compact."[92] Ceding taxing authority to such a commission has even led some in the industry to express constitutional separation-of-powers concerns with their respective state constitutions.[93]

Furthermore, there is also uncertainty regarding which states will join. The nine states that joined SLIMPACT are smaller, less corporate, and less likely to have as many insured individuals and entities with multistate nonadmitted

[90] Tiffany Maruniak, *Surplus Lines Clearinghouse Report*, SURPLUS LINES CLEARINGHOUSE (Oct. 1, 2012), http://www.floir.com/siteDocuments/SLClearinghouseReport10012012.pdf.

[91] *See Surplus Lines Insurance Multi-State Compliance Compact (SLIMPACT)*, *supra* note 77.

[92] SLIMPACT, *supra* note 12, art. VIII(1).

[93] *Florida Says Constitutional Issues May Preclude Joining National Surplus Lines Compact*, COLODNY, FASS, TALENFELD, KARLINKSY, ABATE & WEBB, P.A. (Sept. 15, 2010), http://www.cftnews.com/index.php?cmd=article&id=5849; *see also* McCarty, *supra* note 82 ("In Florida, as in other states, a compact that delegates the state's regulatory authority to a non-government entity may not necessarily be constitutional.").

insurance risks within their borders[94] than, for example, New York and California. Put differently, the states that joined SLIMPACT are the states that could only win from joining a tax allocation scheme. Populous, heavily corporate states such as New York and California had little incentive to join a tax allocation compact.[95]

Who joins also matters because the commission is a representative body. SLIMPACT's current membership of smaller states means that any larger state will instantly be the minority. If a large state such as California joined, not only would it probably lose tax revenue, but it would also probably be unable to protect its interests in the commission, as it would be one vote against nine smaller states with contrary interests. Moreover, the inability for a state to know the tax allocation formula, the powers that the commission will exercise, and even who the other players on the commission will eventually be means that a state joining SLIMPACT is gambling on its tax allocation future.[96] These are crucial considerations Congress must take into account when formulating a remedy.

Notably, NCOIL did not create SLIMPACT in direct response to the NRRA's passage, but rather developed SLIMPACT in 2006 and 2007.[97] A stated goal in the compact is to "maintain[] authority within the states."[98] Those lobbying for SLIMPACT's adoption have argued that an aim of the compact is to "significantly reduce the likelihood of federal intervention."[99] The fact that the states had to turn to Congress,[100] however, should have signaled to legislators that the states were unable to coordinate and implement a solution on their own. As SLIMPACT only captured nine states with similar nonadmitted insurance characteristics, SLIMPACT failed both before and after the NRRA's passage.

Ultimately, NCOIL desired a means (a national uniform compact) and an end (little to no federal regulation or influence) that are incompatible.[101] Due to collective action problems, which are compounded by states' varied and even contradictory interests, a national uniform compact requires more than merely

---

94 *See, e.g.*, *Surplus Lines Insurance Multi-State Compliance Compact (SLIMPACT)*, *supra* note 77 (identifying the relatively low-population states of Alabama, Indiana, Kansas, Kentucky, New Mexico, North Dakota, Rhode Island, Tennessee, and Vermont as SLIMPACT signatories).

95 *See* discussion *supra* Part I.C (analyzing the collective action problems that discourage some states from joining interstate tax compacts).

96 *See* Goodman, *supra* note 61.

97 *Insurance Oversight Hearing*, *supra* note 67, at 200.

98 *Id.* at 198.

99 *See Legislative Talking Points*, COUNCIL OF STATE GOV'TS & NAT'L CTR. FOR INTERSTATE COMPACTS, *available at* http://www.csg.org/programs/policyprograms/NCIC/documents/LegislativeTalkingPoints.pdf (last visited Jan. 5, 2014).

100 *See supra* notes 41-42 and accompanying text.

101 *See* discussion *supra* Part I.C.

promulgating that the home state of the insured individual or entity is the policy's only taxing authority. Fixing these problems requires more involvement from a controlling authority. SLIMPACT's ineffectiveness has more to do with the perverse incentives Congress created in the face of the state collective action problem, rather than with NCOIL's failures. This collective action problem is now Congress's problem to fix.

B. *Critiques of NIMA*

NIMA similarly failed to effect Congress's goal of a national interstate compact scheme. Like SLIMPACT, the states that joined NIMA are relatively less populous and less corporate, and comprise only a small segment of nonadmitted multistate insurance volume.[102] Even at NIMA's peak of twelve member states, NIMA only accounted for twenty-two percent of the country's nonadmitted multistate insurance volume.[103]

Though NIMA had more state members than SLIMPACT at one point, NIMA still sufferes from several important drawbacks. First, the NIMA clearinghouse increases transaction costs by charging a usage fee.[104] Second, NIMA requires transaction data to be submitted to the clearinghouse, which in turn permits states to have a better understanding of how much revenue they have to lose or gain from different tax schemes.[105] This, too, increases the cost of insurance. Less intuitively, the data collection permits states to make better informed opinions about whether to stay with the agreement or not. The availability of more information allows a state to observe whether joining NIMA made it a winning or losing state, undermining NIMA's own chances of becoming a national scheme.[106] Finally, NIMA pushes state legislatures to delegate policymaking powers to their respective executive branches, an arguably unconstitutional delegation of legislative power.[107]

---

[102] *See* Kelly, *supra* note 80 (identifying the NIMA jurisdictions of Florida, Louisiana, South Dakota, Utah, and Wyoming, and Puerto Rico).

[103] Press Release, Non-Admitted Insurance Multi-State Agreement, Alaska Joins NIMA (July 22, 2011), http://www.floir.com/siteDocuments/NIMAPressReleaseAlaska07222011.pdf ("With the addition of Alaska, NIMA members now represent 22% of the surplus lines market according to 2009 data.").

[104] *See* NIMA, *supra* note 85, pt. IV, § 15.

[105] *See id.* pt. I.

[106] *See supra* note 64 and accompanying text.

[107] The Council of State Governments explained its arguments for why this delegation of power is unconstitutional in a 2011 memorandum:

> [NIMA] unconstitutionally purports to vest authority in an Executive Branch official (e.g. the Insurance Commissioner) to bind the Legislature of a State which adopts it. NIMA thus usurps Legislative authority because the action which NIMA authorizes to be taken by the Insurance Commissioner contains no limitations or conditions upon which such uniform regulations could be developed or which a state insurance department is otherwise authorized to undertake within its own state.

Memorandum from Rick Masters to Nat'l Conference of Ins. Legislators et al., *supra* note

Though some may argue that SLIMPACT comports better with Congress's intent with its broader, sweeping regulatory power, NIMA beat SLIMPACT to becoming an actual effective mechanism for allocating taxes. Thus, in at least one respect, NIMA better fits Congress's intent. This highlights another consideration for any NRRA remedy: swift action to streamline allocation of nonadmitted multistate insurance taxes.

The reasons for why some states left NIMA deserve closer observation. Nevada was one of six states to join and then leave NIMA.[108] Nevada's Insurance Commissioner Scott Kipper determined that Nevada would take in more revenue if the state left NIMA and took advantage of the NRRA default rule of keeping 100% of the taxation from insured individuals and entities within its jurisdiction.[109] That is, Nevada later discovered that it could only lose by participating in an interstate agreement.

Further exposing Congress's problematic scheme, Commissioner Kipper stated:

> Nevada appreciates having had the opportunity to participate in the formation of NIMA . . . . As more states become involved, or if the federal government amends the Nonadmitted and Reinsurance Reform Act of 2010 to require participation in a multi-state agreement, Nevada may once again, request to become a participating member.[110]

Although not calling for Congress to require states to join a single interstate agreement, Commissioner Kipper nonetheless pointed out the NRRA's incentive problem. He also implicitly offered a solution: increased federal involvement. Even more telling, if his statements are taken at face value, Nevada wanted to enter an allocation agreement, but the NRRA's incentives thwarted such a plan rather than encouraging it.[111] It is not farfetched to surmise that other states were motivated to leave NIMA for similar revenue reasons. Notably, none of the other five states subsequently joined SLIMPACT,[112] but rather became 100% tax retention states. As these states' actions and Commissioner Kipper's statements demonstrate, NIMA is not a solution to the problem Congress that tried to resolve.

81, at 1-2 (citing INS v. Chadha, 462 U.S. 919, 963 (1983)).

[108] Bulletin, Nev. Dep't of Bus. & Indus., Div. of Ins., Guidance Pertaining to Nevada's Withdrawal from NIMA and Exclusive Home-State Taxation of Multi-State Policies of Nonadmitted Insurance (July 2, 2012), http://docs.nv.gov/doi/documents/bulletins/12-005.pdf.

[109] *Id.*

[110] Don Jergler, *Nevada to Exit NIMA*, INS. J. (July 3, 2012), http://www.insurancejournal.com/news/west/2012/07/03/254433.htm (reporting on a statement by Commissioner Kipper).

[111] *See id.*

[112] *Compare* Kelly, *supra* note 80 (identifying the states that left NIMA), *with Surplus Lines Insurance Multi-State Compliance Compact (SLIMPACT)*, *supra* note 77 (identifying the current states in SLIMPACT, none of which is a former NIMA state).

III. POSSIBLE CONGRESSIONAL REMEDIES

There are two primary methods that Congress can use to achieve its intended result of a single interstate scheme: outright federal preemption, and federal incentives to push the states to form a workable compact. The federal incentives-based approach can be broken down into additional methods. First, Congress can condition the receipt of federal funds on the states' formation of an interstate compact. Second, Congress can penalize states that fail to join an interstate compact through its taxing power. Finally, Congress can threaten federal preemption, while stopping short of actually preempting state law.

All of these approaches would likely achieve a national, uniform result. Outright preemption, however, is undesirable because it would alter the longstanding division of federal and state power, thus costing more political capital in light of industry and state lobbying efforts. And neither a conditional spending program nor amendments to the tax code would effectively meet Congress's goal of a single interstate system. A middle approach, involving threatened preemption, mixes elements of both the preemption and incentives approaches, but the intention (or hope) is to never carry out the threat. Threatening federal preemption is simultaneously efficient and sensitive to all parties' interests, since it achieves the NRRA's intended goal of uniformity while respecting the states' guarded primacy over insurance regulation. Consequently, threatening preemption is Congress's best course of action.

A. *Preempt State Law*

If Congress's intended result was simply national uniformity with taxation on multistate nonadmitted insurance risks, Congress has the constitutional power to preempt related state taxation laws[113] because Congress can regulate insurance through its commerce power.[114] Congress, through the NRRA, already preempted state tax allocation laws by stipulating that the home state of the insured individual or entity is the only state that could tax the nonadmitted insurance policy.[115] Congress's hope, however, was that the states would determine how to allocate such taxes.[116] Though efficient if passed, federal preemption is politically costly, making it less desirable and feasible as a remedy for the NRRA.

To achieve national uniformity, without respect for states' power, Congress could prohibit the states from taxing such insurance and just set one federal tax

[113] *See* Aloha Airlines, Inc. v. Dir. of Taxation of Haw., 464 U.S. 7, 12 (1983) ("[W]hen a federal statute unambiguously forbids the States to impose a particular kind of tax on an industry affecting interstate commerce, courts need not look beyond the plain language of the federal statute to determine whether a state statute that imposes such a tax is pre-empted."); *see also* U.S. CONST. art. VI, cl. 2.

[114] *See supra* note 30 and accompanying text (citing United States v. S.-E. Underwriters Ass'n, 322 U.S. 533 (1944)).

[115] *See* 15 U.S.C. § 8201(a) (2012).

[116] *See id.* § 8201(b).

rate. Alternatively, Congress could simply set the tax allocation formula for the states. Although these methods are the easiest in terms of complexity and administrability, these solutions do not take into account Congress's historic treatment of the insurance industry.[117] Congress's intention with the NRRA was not mere national uniformity for uniformity's ease of administration; rather, Congress intended to preserve the status quo of equitable taxation allocation while maintaining the states' power over insurance regulation and taxation.[118] With the first possibility – simply eradicating state taxation of such insurance – Congress was not looking for additional revenue for the federal government and not seeking to deprive states of revenue.[119] The second remedy – Congress setting the allocation formula for all states – would be less politically costly because states would retain revenue. This remedy, however, may be too invasive and may be perceived as another step forward of the federal government taking over insurance regulation.[120]

Congress could also merge these two outright preemption remedies: the federal government could preempt state taxation laws, impose its own uniform federal tax, and allocate the federal taxes back to the states. Such federal tax allocation would likely pass constitutional muster based on Supreme Court precedents. In *New York v. United States*, the Supreme Court held that Congress could regulate via both taxation *and* redistribution of funds to specific states.[121] In *New York*, the spending was for incentive purposes, whereas in this case, for multistate risks, it would be for uniformity, efficiency,

---

[117] *See* discussion *supra* Part I.B.

[118] *See* 15 U.S.C. § 8201(b)(4); discussion *supra* Part I.C.

[119] *See* 15 U.S.C. § 8201(c) (facilitating "the payment of premium taxes among the States").

[120] The Hawaii state legislature, for example, has said the following about a proposed increase in federal regulation of insurance:

> [R]egulation, oversight, and consumer protection have traditionally and historically been powers reserved to state governments under the McCarran-Ferguson Act of 1945; and
>
> [S]tate legislatures are more responsive to the needs of their constituents and the need for insurance products and regulation to meet their state's unique market demands; and
>
> . . .
>
> [I]nitiatives are being contemplated by certain members of the United States Congress that would destroy the state system of insurance regulation and create unwieldy and inaccessible federal bureaucracies . . . .

H.R. Con. Res. No. 156, 23d Leg. (Haw. 2006), *available at* http://www.naic.org/documents/topics_federal_regulator_Hawaii_resolution.pdf. The legislatures of ten other states have passed similar resolutions opposing additional federal regulation of insurance. *See Proposed Federal Insurance Regulation*, *supra* note 37.

[121] New York v. United States, 505 U.S. 144, 171 (1992) (upholding Congress's incentive scheme to make states form nuclear waste disposal agreements by permitting a nuclear waste receiving state to tax waste from a state that failed to join an agreement, and allowing the federal government to tax part of the surcharge and redistribute its received funds to states that did join a waste disposal agreement).

and equity.[122] Under this scheme, the federal government would serve as the clearinghouse, similar to the SLIMPACT and NIMA agreements. Though unprecedented, Congress's broad spending and commerce powers most likely permit the federal government to tax such premiums and redistribute the funds.

These outright preemption schemes, however, are incompatible with the notion that states have primacy over insurance regulation. As mentioned above,[123] the federal government's practice has been to leave most insurance regulation to the states. Congress's outright preemption of state insurance premium taxation would upset a longstanding and long-defended division of federal and state power.[124] As such, Congress would have to spend vast amounts of political capital to pass an unpopular law in the face of heavy opposition from the states and the insurance industry. Specifically, Congress would conflict with many state legislators, state insurance commissioners, state governors, and industry groups.[125] In 2009, for example, the governors of thirty-three states sent a letter to Congress opposing Congress's efforts to federally regulate insurance.[126] Additionally, eleven state legislatures passed legislative resolutions explicitly opposing federal preemption of state insurance laws.[127] Finally, indirectly representing several states' interests, recall that a stated purpose of the SLIMPACT compact was to "significantly reduce the likelihood of federal intervention."[128]

Genuine policy concerns aside, it is not surprising to see these state government actors oppose encroachment upon their power. The opposition from segments of the insurance industry itself,[129] however, demonstrates that

[122] *See* 15 U.S.C. § 8201.

[123] *See* discussion *supra* Part I.B.

[124] The federal government has, however, taken limited steps to become more involved with state insurance laws. *See supra* notes 36, 38 (citing as examples ERISA, the Gramm-Leach-Bliley Act, and the Federal Insurance Office).

[125] *See Proposed Federal Insurance Regulation*, *supra* note 37 (compiling letters of opposition from various government and industry entities).

[126] *See* Letter from Bob Riley et al. to Barney Frank et al., *supra* note 37 ("[W]e . . . ultimately reject[] congressional efforts to create an Optional Federal Charter for the purposes of regulating the insurance industry.").

[127] *See Proposed Federal Insurance Regulation*, *supra* note 37 (indicating that the Alabama, Alaska, Colorado, Hawaii, Idaho, Michigan, North Dakota, Ohio, Oklahoma, Rhode Island, and Texas state legislatures passed resolutions opposing federal regulation of insurance).

[128] *See Legislative Talking Points*, *supra* note 99.

[129] Those industry groups opposing federal preemptive laws include the Independent Insurance Agents & Brokers of America, the National Association of Mutual Insurance Companies, the National Association of Professional Insurance Agents, and the Coalition Opposed to a Federal Insurance Regulator (an organization "comprised of property and casualty companies, life and health insurance companies, and insurance trade associations"). *Proposed Federal Insurance Regulation*, *supra* note 37; *see also* Letter from Gregory D. Wren, Exec. Dir., Coalition Opposed to a Fed. Ins. Regulator, to Rep. Paul Kanjorski,

preserving state power for power's sake is not the only concern with federal preemption; it is a paradigm the industry has relied on for decades.[130] More importantly, opposition from within the industry to even mild federal insurance regulation suggests that the insurance industry would not shy away from lobbying against a heavily coercive preemptive law. As Congress is more than likely aware, the insurance industry itself presumably has more lobbying funds in its war chest than state government actors.[131]

Though all of these preemption remedies are likely legal, this chorus of opposition makes federal preemption for nonadmitted multistate risk tax allocation an unpopular and undesirable remedy. For Congress to achieve its intended result while preserving state primacy over insurance regulation, a more measured remedy is required.

B. *Incentivize an Interstate Compact*

Alternatively, Congress could incentivize the states, nudging them to form a national, uniform system on their own. Congress could do this by attaching strings to federal grants; creating an excise tax on insured individuals' and entities' premiums; not permitting a business cost deduction for such insurance; or mixing preemption with incentives, for example, by threatening preemption unless the states agree to either adopt a uniform law or to compact among themselves. These options permit states to choose if they want to allocate the taxes, preserving some primacy for the states in insurance regulation while achieving Congress's goal of a uniform nationwide insurance scheme.

First, Congress should not try to incentivize states through the creation of a uniform federal law. Although there is well-established congressional precedent for incentivizing the states to adopt uniform laws,[132] whether for hotel fire safety or highway speed limits, a uniform law approach is closer to preemption than pushing the states to form a compact on their own. The

Chairman, Subcomm. on Capital Mkts., Ins. & Gov't Sponsored Enters. of the House Comm. on Fin. Servs. 1 (Apr. 5, 2007), *available at* http://www.naic.org/documents/topics_federal_regulator_COFIR_Letter.pdf.

[130] *See The Need for Insurance Regulatory Reform*, NAT'L ASS'N OF PROF'L INS. AGENTS (Oct. 3, 2007), *available at* http://www.naic.org/documents/topics_federal_regulator_PIA_Statement.pdf.

[131] *See, e.g.*, *Insurance*, OPENSECRETS CTR. FOR RESPONSIVE POLITICS, http://www.opensecrets.org/industries/indus.php?ind=F09 (last visited Jan. 5, 2014) ("In 2007 and 2008, the insurance industry contributed a record $46.7 million to federal parties and candidates.").

[132] *See* JOSEPH F. ZIMMERMAN, INTERSTATE COOPERATION: COMPACTS & ADMINISTRATIVE AGREEMENTS 13-16 (2d ed. 2012). Professor Zimmerman explains that Congress, as early as 1887 with the Hatch Act, used its powers to incentivize the states to enact uniform or near-uniform laws. *See id.* at 13. Other examples include uniform highway speeds, right-on-red turns, legal drinking ages, blood alcohol content level for drivers, and uniform hotel safety standards. *See id.* at 13-16.

NRRA's goal was to allow the states to articulate insurance laws themselves, not have Congress decide the laws for them.[133]

Congress should honor the intent of the NRRA by adopting the more measured method of incentivizing the states to form a compact on their own. Interstate compacts are nothing new to the insurance industry and the states. For example, there is already an Interstate Insurance Product Regulation Compact with forty-one member states.[134] As Professor Joseph F. Zimmerman – a noted scholar on interstate agreements – commented: "To encourage states to negotiate and enter into particular compacts, Congress in 1911 initiated the practice of granting consent to specified compacts prior to their drafting . . . ."[135] This is exactly what Congress did with the NRRA, but as the preceding discussion shows, there are several reasons why prior consent to a compact is not enough of an incentive.[136]

Congress might find some guidance in the Low-Level Radioactive Waste Policy Amendments Act (LLRWPAA) of 1985,[137] which can serve as a model for Congress in the instant insurance concern. To nudge states to compact with each other with waste disposal, Congress permitted states to levy a surcharge on waste from states that did not join a compact.[138] Congress also levied a twenty-five-percent tax on these surcharges, established an escrow account, and redistributed the funds to states that joined a compact.[139] Congress's most extreme incentive was the "take title" provision, which forced the transfer of title of the waste to the states that failed to join a compact within a stated timeframe.[140] The Supreme Court in *New York v. United States* subsequently declared this take title provision unconstitutional,[141] though it upheld the rest of the LLRWPAA's scheme.[142] Importantly, the LLRWPAA's overall incentives scheme proved to be effective, with most states joining an interstate

[133] *See* 15 U.S.C. § 8201(b)(4) (2012).

[134] *See* INTERSTATE INSURANCE PRODUCT REGULATION COMPACT (2003), *available at* http://www.naic.org/store/free/MDL-692.pdf; *About the IIRPC*, INTERSTATE INS. PROD. REGULATION COMM'N, http://www.insurancecompact.org/about.htm (last visited Jan. 5, 2014).

[135] ZIMMERMAN, *supra* note 132, at 13.

[136] *See* discussion *supra* Part II (discussing the failures of SLIMPACT and NIMA).

[137] *See* Low-Level Radioactive Waste Policy Amendments Act of 1985, Pub. L. No. 99-240, 99 Stat. 1842 (1986) (codified as amended at 42 U.S.C. §§ 2011-2023 (2006)).

[138] *See* 42 U.S.C. § 2021e(d).

[139] *Id.*

[140] *Id.* § 2021e(d)(2)(C).

[141] New York v. United States, 505 U.S. 144, 174-78 (1992) (holding that the LLRWPAA's take title provision "is inconsistent with the federal structure of our Government established by the Constitution").

[142] *Id.* at 171-73 (upholding the LLRWPAA's incentives mechanism).

waste disposal compact.[143] With these precedents in mind, Congress has several methods by which it can incentivize a compact.

1. Conditional Spending

Under a conditional spending approach, Congress could withhold funds from states that fail to enter an interstate compact under the spending power.[144] The preliminary consideration with this method is where the money would come from. In an era of increased deficit spending, Congress is unlikely to use its budget for this matter. To raise funds for such grants, Congress could create a double incentive of also taxing multistate risk policies from nonadmitted insurers, similar to the LLRWPAA.[145] There may be constitutional concerns, however, with such a grant program.[146]

In *South Dakota v. Dole*, the Supreme Court articulated limitations on Congress with respect to conditional spending.[147] One limitation is that the funds must be related to the general welfare, though the Court gives Congress substantial deference with the determination of what is in the "general welfare."[148] Although the Court would probably uphold spending federal funds to push states to compact here, arguments could be made that a tax allocation scheme for a small portion of the insurance industry does not rise to the level of benefitting the public's general welfare.[149] The counterargument is that this scheme is about saving costs for the consumer, ensuring that certain risks are

---

[143] BROUN ET AL., *supra* note 82, at 298.

[144] *See* U.S. CONST. art. I, § 8, cl. 1.

[145] *See* 42 U.S.C. § 2021e.

[146] *See infra* note 147.

[147] South Dakota v. Dole, 483 U.S. 203, 207-08 (1987). The Court identified four requirements for a conditional spending scheme to be constitutional. First, the scheme must be "in pursuit of 'the general welfare,'" with some deference to the policy choices of Congress. *Id.* at 207 (quoting Helvering v. Davis, 301 U.S. 619, 641 (1937)). Second, Congress must clearly condition the states' receipt of federal funds. *Id.* Third, the conditional funds must be related "to the federal interest in particular national projects or programs." *Id.* at 207-08 (quoting Massachusetts v. United States, 435 U.S. 444, 461 (1978)) (internal quotation marks omitted). Fourth, the scheme must not be independently barred by other constitutional provisions. *Id.* at 208 (citing Lawrence Cnty. v. Lead-Deadwood Sch. Dist. No. 40-1, 469 U.S. 256, 269-70 (1985)).

[148] *Id.* ("The first of these limitations is derived from the language of the Constitution itself: the exercise of the spending power must be in pursuit of 'the general welfare.' In considering whether a particular expenditure is intended to serve general public purposes, courts should defer substantially to the judgment of Congress." (quoting *Helvering*, 301 U.S. at 641)).

[149] *New York v. United States* concerned the disposal of dangerous radioactive waste and *South Dakota v. Dole* concerned the public's interest in ensuring safety and uniformity in drinking ages. *Compare* New York v. United States, 505 U.S. 144, 149 (1992), *with Dole*, 483 U.S. at 206. Arguably, nonadmitted insurance may not rise to the same level of public interest.

insured, and guaranteeing that states equitably receive revenue. This counterargument will more than likely be deemed constitutionally sufficient, especially if Congress reasonably deems a more uniform insurance scheme to be in the public interest.[150]

Budgetary concerns and general welfare nexus concerns notwithstanding, this conditional spending approach is also inadequate because it probably will not result in a uniform system of taxation. Rather, just like before passage of the NRRA, a patchwork of tax schemes may develop – one scheme among compacting states accepting the funds, and a possible myriad of other, individual tax schemes for states that decline the federal funding. To ensure a single scheme through conditional spending, Congress could make the withholding of funds high enough such that all states could benefit from participating in a compact. As the Supreme Court recently emphasized in *National Federation of Independent Business v. Sebelius* (*NFIB*), however, a coercive withholding of federal funds violates the Constitution.[151] To be sure, withholding funds for compacting purposes potentially could be distinguished from *NFIB*, as the amount withheld in *NFIB* comprised of up to ten percent of the states' budgets.[152] Despite this difference between the Medicaid and the nonadmitted insurance contexts, a conditional spending incentive still exposes itself readily to constitutional challenge because it directly pushes the states with cash incentives to adopt a certain federal policy, which is analytically more similar to the scheme in *NFIB* than threatening preemption is.

More importantly, conditional spending will likely not work for compacting purposes because it still requires action from the states. A few states may not join a compact for principled reasons, possibly citing further intrusion of the federal government in insurance regulation.[153] Moreover, states may fail to compact due to coordination problems, even with a favorable conditional spending incentive.[154] Consequently, conditional spending is inferior to threatening preemption, since the latter develops a uniform scheme regardless of whether the states act. Furthermore, threatening preemption reduces the

[150] *See supra* note 148 and accompanying text.

[151] Nat'l Fed'n of Indep. Bus. v. Sebelius, 132 S. Ct. 2566, 2604-07 (2012) (quoting, e.g., Steward Mach. Co. v. Davis, 301 U.S. 548, 590 (1937)); *see also Dole*, 483 U.S. at 211 (holding that conditional spending cannot rise to the level of coercion).

[152] *Nat'l Fed'n of Indep. Bus.*, 132 S. Ct. at 2604-05 ("The threatened loss of over 10 percent of a State's overall budget, in contrast, is economic dragooning that leaves the States with no real option but to acquiesce in the Medicaid expansion."). For further discussion relating to coercion, see *infra* notes 166-77 and accompanying text.

[153] *See* Letter from Bob Riley et al. to Barney Frank et al., *supra* note 37; *see also* Brian Galle, *Federal Grants, State Decisions*, 88 B.U. L. REV. 875 (2008).

[154] Cooter & Siegel, *supra* note 28, at 183 ("[S]tates could ideally solve the problem of spillovers by bargaining and compacting without the intervention of the federal government. Under the Articles of Confederation, Americans found that voluntary cooperation among several states worked poorly to address these problems. Transaction costs, especially holdouts, obstruct cooperation.").

state holdout problem because reluctant states would find it in their best interests to form a compact, rather than subjecting themselves to Congress's outright preemption.[155]

2. Taxation

Either independently or jointly with conditional spending, Congress could also provide tax incentives to form a national compact via an excise tax on top of state taxes or a prohibition on business cost deductions for insurance policies where the home state fails to join a compact.[156] Similar to the LLRWPAA, Congress could set aside the additional revenue from the federal tax in an escrow account and redistribute the funds to complying states.

Raising taxes is a politically unpopular move, making an excise tax politically costly. Prohibiting a business cost deduction, in contrast, is a more indirect method of increasing one's tax burden. With a deduction prohibition, members of Congress would not have to go on the record as having created a new tax. A drawback of prohibiting the deduction is that its effect is limited to the amount the deduction is worth, whereas an excise tax is more malleable. Malleability is important in tailoring a tax that will be enough to push states to form a compact and to make current NRRA winner states find it appealing to join a compact. The tax must also be high enough to cause states to form a compact to protect policyholders. From the policyholders' point of view, the tax must be high enough for them to call their states to action or for them not to insure their risks, scenarios in which state politicians do not want to find themselves.

The excise tax can be analogized to the individual mandate penalty in the Patient Protection and Affordable Care Act: if *X* fails to do *Y*, then there will be a tax.[157] The chief difference between the individual mandate and the proposed excise tax for the NRRA is that individual policyholders will be taxed not for their failure to act, but rather their respective states' failure to do so. This NRRA tax would likely be constitutional in light of the Supreme Court's decision upholding the constitutionality of the Affordable Care Act's individual mandate based on a broad interpretation of the Taxing Clause.[158]

[155] *See* discussion *infra* Part III.B.3.

[156] *See* I.R.C. § 162 (2012) (permitting a deduction for costs related to a trade or business, including the state taxes on those costs, such as a nonadmitted insurance premium tax). This deduction approach would be limited to nonadmitted insurance coverage for business-related activities, as opposed to coverage for nonbusiness-related activities.

[157] *See* Patient Protection and Affordable Care Act, Pub. L. No. 111-148, § 5000A, 124 Stat. 119, 244-50 (2010) (codified at 26 U.S.C. § 5000A (2012)) (levying an excise tax, or "penalty," upon individuals who fail to obtain health insurance).

[158] *See* Nat'l Fed'n of Indep. Bus. v. Sebelius, 132 S. Ct. 2566, 2601 (2012) (upholding the individual mandate as a tax); *see also* U.S. CONST. art. I, § 8, cl. 1.

Additionally, the fact that the tax's main purpose is not to raise revenue is of little consequence.[159]

3. Threaten Preemption

Taking elements from both the preemption and incentive-based approaches, Congress could also pass legislation setting a deadline by which the states must form a compact or be preempted with Congress's own tax allocation scheme. Although threatening preemption is a hybrid between preemption and incentives, it is categorized here as an incentive scheme because the hope and intention is that the incentive would be persuasive enough so that the threat would never have to be carried out. Congress could threaten to (1) enact its own tax scheme and deny the states any revenue; (2) set the rate for the states and how they must redistribute the revenue; or (3) set its own rate and equitably redistribute the revenue to the states, with the federal government serving like a clearinghouse.[160] Presumably, the states do not desire any of these three possible outcomes, but the second scheme would be most preferred because it most nearly approximates the status quo ante by allocating state revenues. This second option is what Congress wanted, absent the states creating the scheme themselves.[161]

Since Congress has the power to regulate the insurance industry,[162] Congress has both the power to preempt and threaten preemption. This method has several main advantages over the other schemes. First, Congress would not have to spend political capital raising taxes or preempting state law outright. Second, Congress would still incentivize the states to come up with their own solution independently, one of the NRRA's goals. Third, Congress's goal of a national, uniform scheme would ultimately be achieved, one way or another. Consequently, this scheme is Congress's best remedial choice.

To lessen the risk that preemption will actually occur, Congress should require something less than unanimity to avoid a scenario where a few holdout states could cause federal preemption for all. If Congress gives all the states enough time, the holdout states' failure to form a national compact could be interpreted as acquiescence to the federal government's proposed tax allocation scheme. It could also be interpreted as a failure of the states to develop a scheme on their own, even with incentives, thus demonstrating that the states could never come up with a scheme on their own. This method would strike

---

[159] *See Nat'l Fed'n of Indep. Bus.*, 132 S. Ct. at 2596 ("[T]axes that seek to influence conduct are nothing new. . . . Indeed, '[e]very tax is in some measure regulatory. To some extent it interposes an economic impediment to the activity taxed as compared with others not taxed.'" (last alteration in original) (quoting Sonzinsky v. United States, 300 U.S. 506, 513 (1937))).

[160] *See* discussion *supra* Part III.A.

[161] *See* discussion *supra* Part I.C.

[162] *See supra* note 30 and accompanying text (citing United States v. S.-E. Underwriters Ass'n, 322 U.S. 533, 553 (1944)).

the perfect balance between federal and state power, achieving a national tax allocation scheme, and, if the states failed to form a compact, achieving easy administrability.

Threatening federal preemption has congressional precedent and is constitutional. In *New York v. United States*, the Supreme Court stated, "[W]here Congress has the authority to regulate private activity under the Commerce Clause, we have recognized Congress' power to offer States the choice of regulating that activity according to federal standards or having state law pre-empted by federal regulation."[163] The Supreme Court acknowledged that Congress has used this method permissibly before, giving examples such as the Clean Water Act, Occupational Safety and Health Act, Resource Conservation and Recovery Act, and Alaska National Interest Lands Conservation Act.[164]

More recently, the Court reapplied the standard for threatening federal action in *NFIB*.[165] The Affordable Care Act contained provisions that required states to expand Medicaid coverage, with a threat of losing all federal Medicaid funding for failure to comply.[166] The Supreme Court's constitutional inquiry was "whether the financial inducement offered by Congress was so coercive as to pass the point at which pressure turns into compulsion,"[167] or rather whether "Congress was offering only 'relatively mild encouragement to the States.'"[168] In declaring the Medicaid threat unconstitutional,[169] the Supreme Court held it was "much more than 'relatively mild encouragement' – it is a gun to the head," and highlighted how much money was at stake (at least

[163] New York v. United States, 505 U.S. 144, 167 (1992) (citing Hodel v. Va. Surface Mining & Reclamation Ass'n, 452 U.S. 264, 288 (1981)).

[164] *Id.* at 167-68.

[165] Nat'l Fed'n of Indep. Bus. v. Sebelius, 132 S. Ct. 2566, 2603-04 (2012). Although *NFIB* dealt with threatening state receipt of federal funds, not federal preemption of state law, the coerciveness test is still the standard. *See id.* at 2602; *infra* note 171 and accompanying text.

[166] *See, e.g.*, 42 U.S.C. §§ 1396a(a)(10), 1396a(k)(1), 1396u–7(b)(5), 18022(b) (2006 & Supp. IV 2010), *invalidated by Nat'l Fed'n of Indep. Bus.*, 132 S. Ct. at 2608.

[167] *Nat'l Fed'n of Indep. Bus.*, 132 S. Ct. at 2604 (quoting South Dakota v. Dole, 483 U.S. 203, 211 (1987) (internal quotation marks omitted)).

[168] *Id.* (quoting *Dole*, 483 U.S. at 211).

[169] Justices Breyer and Kagan joined this portion of Chief Justice Roberts's opinion. *See id.* at 2574, 2576. Justices Scalia, Kennedy, Thomas, and Alito authored a joint dissent, similarly finding these Medicaid provisions to be unconstitutional due to coercion. *Id.* at 2642, 2666-67 (joint dissent) ("[T]he offer of the Medicaid Expansion was one that Congress understood no State could refuse. The Medicaid Expansion therefore exceeds Congress' spending power and cannot be implemented. . . . Seven Members of the Court agree that the Medicaid Expansion, as enacted by Congress, is unconstitutional."). For an extensive discussion on the Court's coercion holding in *NFIB*, see generally Nicole Huberfeld et al., *Plunging into Endless Difficulties: Medicaid and Coercion in* National Federation of Independent Business v. Sebelius, 93 B.U. L. REV. 1 (2013).

"$3.3 trillion between 2010 and 2019") for the states' respective overall budgets.[170] Though threatening a preemptive federal tax allocation scheme is not the same as the *NFIB* issue of withholding federal funding, the Supreme Court stated generally in *NFIB* that "the Constitution has never been understood to confer upon Congress the ability to require the States to govern according to Congress' instructions."[171]

Such a threatened preemption approach would not be impermissibly coercive because the tax amounts involved with multistate nonadmitted insurance premiums are not significant portions of state budgets.[172] This stands in stark contrast to the importance of conditional, federal Medicaid funding in state budgets, which was a critical factor behind *NFIB*'s rejection of the Affordable Care Act's Medicaid fund withholding.[173] At worst, if the federal government outright preempted all state power to tax these policies, affected states would not lose significant revenue because these states would still keep some tax revenue from any congressionally mandated tax mechanism. In other words, any loss is insignificant because it equals only the difference between a 100% rate and Congress's allocation rate. As such, a difference in rate conceivably would be small; the risk of losing these funds does not force states to accept Congress's statutory scheme, but rather constitutes "mild encouragement," where states are free to choose meaningfully whether to compact or whether to subject themselves to federal preemption.[174] Consequently, using preemption to encourage state legislatures to enact certain

[170] *Nat'l Fed'n of Indep. Bus.*, 132 S. Ct. at 2604-05 (plurality opinion) ("The threatened loss of over 10 percent of a State's overall budget, in contrast, is economic dragooning that leaves the States with no real option but to acquiesce in the Medicaid expansion.").

[171] *Id.* at 2602 (quoting New York v. United States, 505 U.S. 144, 162 (1992)) (internal quotation marks omitted).

[172] *See, e.g.*, THERESE M. GOLDSMITH, MD. INS. ADMIN., REPORT ON THE IMPLEMENTATION OF THE FEDERAL NONADMITTED AND REINSURANCE REFORM ACT OF 2010, at 1-2 (2011), *available at* http://www.mdinsurance.state.md.us/sa/docs/documents/home/reports/implementationofnrra.pdf (stating that the total revenue for the state of Maryland on nonadmitted insurance premium taxes was approximately ten million dollars in 2010). For reference, Maryland's revenue for fiscal year 2010 was over thirty-one billion dollars. *See* MD. DEP'T OF BUDGET & MGMT., EXHIBIT B: ESTIMATED REVENUE FOR THE FISCAL YEAR ENDING JUNE 30, 2010, at 6, *available at* http://dbm.maryland.gov/agencies/operbudget/Documents/2010/fisdig10exb.pdf.

[173] *Nat'l Fed'n of Indep. Bus.*, 132 S. Ct. at 2604 ("Medicaid spending accounts for over 20 percent of the average State's total budget, with federal funds covering 50 to 83 percent of those costs.").

[174] *See id.* at 2604-05 (quoting South Dakota v. Dole, 483 U.S. 203, 211-12 (1987)). For a discussion regarding how another federal incentives scheme may survive *NFIB*'s coercion holding, see Georgina Jones Suzuki, Note, *Clearing the Air After* National Federation of Independent Business v. Sebelius*: The Clean Air Act and the Constitutionality of Highway Sanctions*, 93 B.U. L. REV. 2131, 2145-59 (2013).

laws is materially distinct from essentially forcing state legislatures to enact certain laws through a coercive withholding of federal funds.[175]

Moreover, Congress has already successfully threatened preemption within the insurance industry, further buttressing the permissibility of this approach. In 1999, as part of the Gramm-Leach-Bliley Act, Congress threatened to preempt state insurance licensing requirements unless a majority of the states formulated their own uniform requirements.[176] Demonstrating that the states prefer to form their own rules and preserve their regulatory power, a majority of the states adopted uniform standards, avoiding preemption.[177] Therefore, since threatening preemption succeeds historically, preserves the balance between state and federal power, costs little political capital, and results in a swift and equitable result even if preemption ultimately occurs, this remedy is Congress's best method for creating a national, uniform insurance scheme.

CONCLUSION

Among financial industries, the insurance industry is unique in that states are the primary regulators. For the insurance industry, there is no analogous federal regulator – no Securities and Exchange Commission; no Federal Reserve Board; no Federal Deposit Insurance Corporation. There is the new Federal Insurance Office, but Congress, comporting with its special treatment of the insurance industry, gave it little regulatory power.[178] Such engrained and unique treatment demands a unique remedy – something that strikes a balance between complete federal preemption and a complete federal laissez-faire approach.

Congress, through the NRRA, attempted to walk this tightrope, but fell off halfway through the act. The NRRA intended to fix a state regulatory disorder with multistate risk nonadmitted insurance, and it largely succeeded. Congress

[175] *Compare Nat'l Fed'n of Indep. Bus.*, 132 S. Ct. at 2604-05 (finding that the "threatened loss of over 10 percent of a State's overall budget" is impermissibly coercive), *with id.* (quoting *Dole*, 483 U.S. at 211-12) ("It is easy to see how the *Dole* Court could conclude that the threatened loss of less than half of one percent of South Dakota's budget left the State with a 'prerogative' to reject Congress's desired policy . . . ."). Though the *Dole* analysis and *NFIB*'s Medicaid analysis both relate to conditional spending, the cases shed light on how courts will approach the coerciveness inquiry for the purposes of a threatened preemption approach.

[176] 15 U.S.C. § 6751 (2012) ("The provisions of this subchapter shall take effect unless, not later than 3 years after November 12, 1999, at least a majority of the States – (1) have enacted uniform laws and regulations governing the licensure of individuals and entities authorized to sell and solicit the purchase of insurance within the State; or (2) have enacted reciprocity laws and regulations governing the licensure of nonresident individuals and entities authorized to sell and solicit insurance within those States.").

[177] ZIMMERMAN, *supra* note 132, at 203 ("Thirty-five states were certified as having a uniform licensing system and preemption was avoided.").

[178] *See supra* note 38 and accompanying text.

answered the crucial preliminary questions: who can regulate[179] and who can tax.[180] With tax allocation, however, Congress mixed minimal preemption with too much of a hands-off approach; it attempted to create incentives, but did not create enough. The result was a system of perverse incentives that directly contradicted the goals of the NRRA. Congress should have heeded Representative Kanjorski's clairvoyant words – "I think that this [incentives problem] is an important issue that we would have to resolve now."[181]

Congress has many tools to remedy this problem. With broad commerce, taxing, and spending powers, Congress can craft a tailored remedy which respects the concerns of the states and the insurance industry. It is in Congress's and the nation's best interest to create a national tax allocation scheme. In many respects, however, it is also in Congress's best interest to permit the states to choose whether they want to participate. Consequently, Congress should incentivize the states to form a compact self-tailored to their needs by threatening preemption of state law. Such a method can be used not only for this immediate situation, but also for analogous circumstances within the insurance industry in the future. Congress can and should take this simple, permissible step to carry out a laudable goal.

179 *See* 15 U.S.C. § 8202.

180 *See id.* § 8201(a).

181 *Commercial Insurance Modernization Hearing*, *supra* note 18, at 32 (statement of Rep. Paul Kanjorski, Chairman, Subcomm. on Capital Mkts., Ins. & Gov't Sponsored Enters. of the H. Comm. on Fin. Servs.).