

AAPS Challenges Price Controls in California

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On Sept. 23, 2016, California Gov. Jerry Brown signed into law the strictest wage and price control in history against physicians in our nation: AB 72, which went into effect July 1, 2017, in California. Insurance companies are now trying to emulate it by enacting similar legislation in other states.

AB 72 authorizes private health plans to set the rates of reimbursement for physicians who are not under any contract with them. Traditionally, whenever government sets rates, as in the context of utilities, there is political accountability both for the officials and for the decision-making process. There is almost always the availability of due process to challenge such rate-setting, and there are typically safeguards against the taking of private property in the form of mandating underpayment for services rendered.

Not so for this dangerous new form of wage and price controls that became law in California, whereby the legislature has delegated the rate-setting authority to purely private entities, namely insurance companies. Concerned about the effect of this law in California and the likelihood it may spread to other states, our Association of American Physicians and Surgeons (AAPS) investigated further and discussed this with our members in the Golden State.

We learned that although the law was justified under the pretext of controlling “surprise medical bills,” in fact the genesis of this law was not inspired by that issue. Instead, the law came about because a California agency rejected an attempt by the insurance industry to impose wage and price controls on out-of-network physicians by regulation. What the insurance companies failed to obtain from the administrative state, they then sought directly from the legislature. When that effort sputtered, even in the overwhelmingly liberal California legislature, someone seized upon the public-relations stunt of saying the bill would end “surprise medical billing,” which has never been a genuine, substantial public concern. Most out-of-network hospital bills are to be paid by insurance companies at market rates, and rarely do patients actually face collection efforts on so-called surprise medical bills.

But slick campaigns can result in bad legislation, and such was the case with AB 72. This new law is not merely misguided; it is also unconstitutional. Allowing health plans to regulate reimbursement rates with the authority of government is in violation of the Fifth Amendment safeguard against the taking of property without just compensation (the “Takings Clause”), and the Fourteenth Amendment guarantee of due process of law (the “Due Process Clause”).

Less than a month after AB 72 was signed into law, AAPS filed a lawsuit to overturn it. On Oct 19, 2017, the federal court in Sacramento, Calif., held an historic hearing on these issues in front of a gallery of physicians on one side of the courtroom, and employees of the California Department of Managed Health Care on the other.

Our Legal Arguments against AB 72

“By any measure, handing off regulatory power to a private entity is ‘legislative delegation in its most obnoxious form.’” So observed Supreme Court Justice Samuel Alito in his concurrence to a decision in 2015 that invalidated a federal law delegating regulatory authority to Amtrak, the semi-private railroad company.¹

Yet the new California AB 72 does exactly what is impermissible: it authorizes private entities—health insurance plans—to impose wage and price controls on private physicians who have no relationship with the payers. This law is akin to authorizing one professional football team to set the compensation for players on a competitor’s team, or one oil company to set the price at which its competitors must sell gasoline.

Economically, “out-of-network” physicians are in competition with the plans’ “in-network” physicians, and insurers should not be authorized to set rates for their competitors.

In addition to being unconstitutional for violating the Due Process and Takings clauses, the law is bad policy. If left unchecked, it will result in rationing of care in under-served areas, and will discourage physicians from practicing in California altogether, while boosting the already prodigious profits of insurance companies.

Moreover, even if the pretextual purpose of AB 72 to eliminate “surprise medical bills” were valid, the statute benefits health plans far beyond what that goal would justify. A requirement of transparency, or simply of informed billing consent, would have attained the purported goal of reducing “surprise” medical bills without need to delegate rate-setting authority to private payers. Instead, AB 72 benefits private health plans by broadly authorizing them to set fees for out-of-network physicians, thereby giving insurance companies leverage to drive independent physicians out of business.

In fact, as many AAPS members know, only a small percentage of total medical costs are attributable to physician fees. In the roughly \$600 billion Medicare program “roughly one-fourth was for hospital inpatient services, **12% for physician services**, and 11% for the Part D drug benefit. Another one-fourth of benefit spending was for Medicare Advantage private health plans covering all Part A and Part B benefits.... [emphasis added]”²

Constitutional Violations and Resultant Harm

AB 72 violates the Due Process Clause of the U.S. Constitution by delegating rate-setting authority to private companies, with respect to physicians who are not under any contract with the health plans, and by requiring arbitration by out-of-network physicians on their reimbursements, thereby denying them their due process rights.

AB 72 violates the Takings Clause of the U.S. Constitution because it empowers private insurance companies to deprive out-of-network physicians of the market value for their services, and arbitrarily denies them just compensation for their labor.

AB 72 violates the Equal Protection Clause of the U.S. Constitution by having a disparate impact on minority patients for whom the availability of medical care will sharply decline as AB 72 coerces out-of-network physicians to withdraw services from predominantly minority communities.

Each of these violations of constitutional rights by AB 72 causes harm to AAPS members who practice in California, and to their patients. Accordingly, AAPS sued on behalf of its members in California and their patients, to seek a declaration that AB 72 is unconstitutional and to seek an injunction against it.

The harm to AAPS members caused by AB 72 is substantial. Individual AAPS members, such as California ophthalmologist Michael Couris, M.D., suffer imminent threatened injury, including financial harm, as a result of the enactment and enforcement of AB 72. Additional harm from AB 72, with respect to the Equal Protection claims, have been suffered by patients of AAPS members in the form of reduced availability of medical care.

Out-of-Network Physicians

Out-of-network physicians, who are called “non-contracting” physicians by AB 72, are truly independent physicians unencumbered by the many restrictions imposed by insurance companies on in-network doctors. Out-of-network physicians do not have the benefits or obligations of being contractually bound with insurance companies.

There are both advantages and disadvantages to patients and physicians resulting from an out-of-network status. Some physicians are out of network not by choice, but because insurance companies increased their profits by excluding them for reasons other than quality of care. Out-of-network physicians often lack the referral volume of physicians who are within the network, and as a result, tend to provide more charity care than in-network physicians do. To remain in business, out-of-network physicians may charge more for certain services than the in-network insurance reimbursement rates.

Often, insured patients have obtained policies that require their insurance companies to pay the charges of out-of-network physicians, or at least a substantial percentage of those charges. Moreover, the only meaningful leverage that a physician or hospital has in negotiating a contract with an insurance company is the option of the physician or hospital to go out-of-network and not accept the insurance company rates. Yet AB 72 denies the right of a physician to go out-of-network with an insurance company and charge out-of-network rates.

Specifically, AB 72 requires the following for out-of-network physicians, effective July 1, 2017: “The plan shall reimburse the greater of the average contracted rate or 125 percent of the amount Medicare reimburses.”³ AB 72 thereby prohibits an out-of-network physician from recovering fully on his claims for services lawfully rendered.

This price-setting imposes confiscatory rates in violation of the Due Process Clause. “Confiscatory,” as used in numerous court decisions, refers to rates that are inadequate to fully

compensate for the services provided. In a 1990 case, the Ninth Circuit Court of Appeals found a constitutionally defective failure to “contain any provisions for relief from potentially confiscatory rates.”⁴

The rate mechanism imposed by AB 72 violates the Takings Clause by depriving physicians of their property rights for their labor, without just compensation, and also by transferring property from one private group (physicians) to other private entities, namely insurance companies, in the form of the latter’s underpayment for services.

AB 72’s price setting also harms under-served minority communities. Many out-of-network physicians, including members of AAPS, depend on their ability to bill at market rates for their services to insured patients in order to be able to offer charity or under-compensated care. AB 72 forces out-of-network physicians out of business or into insurance networks that render it infeasible to provide substantial amounts of care to such patients, who are predominantly minorities, thus causing them imminent harm, in the form of lost access to out-of-network physicians and decreased availability of medical care.

The Independent Dispute Resolution Process

By requiring out-of-network physicians to participate in arbitration rather than pursue their claims in court, AB 72 further violates the Due Process Clause. AB 72 improperly shifts the burden onto physicians to challenge the price controls, and also denies them their due process rights to do so.

AB 72 required the California Department of Managed Health Care, by Sep 1, 2017, to “establish an independent dispute resolution process for the purpose of processing and resolving a claim dispute between a health plan and a noncontracting individual health professional for services” rendered.⁵ And while AB 72 generally exempts medical services rendered on an emergency basis, it does not expressly exempt services rendered after transfer of a patient from an emergency room to an intensive-care unit (ICU).

This process imposes on California physicians the equivalent of mandatory binding arbitration. If this merely applied to physicians under contract with insurance health plans, it might be understandable. Instead, it applies broadly to physicians who have no contractual relationship with health insurance companies, i.e., “out-of-network” physicians. AB 72 thereby compels entirely independent physicians first to pursue internal proceedings with the insurance companies, and then participate in a proceeding that is expressly made “binding” by AB 72 as follows [emphasis added]:

Section 1371.30 is added to the Health and Safety Code, immediately following Section 1371.3, to read: 1371.30 ... (d) The decision obtained through the department’s independent dispute resolution process **shall be binding on both parties**. The plan shall implement the decision obtained through the independent dispute resolution process. If dissatisfied, either party may pursue any right, remedy, or penalty established under any other applicable law.⁵

This imposition of the equivalent of binding arbitration on physicians, who have no contractual or other relationship

with the opposing party, a large corporation, raises grave constitutional concerns. AAPS points out that a system of binding arbitration for parties who are strangers to each other is in violation of the Due Process Clause of the U.S. Constitution (Section 1, Fourteenth Amendment).

The California Department of Managed Health Care (DMHC), which is the defendant (through its director) in AAPS's lawsuit, was required by Sep 1, 2017, to develop its process for the Independent Dispute Resolution under AB 72, and the summary of its decision-making procedure as posted by DMHC is as follows:

About the Decision Process

The independent organization reviewing each AB 72 IDRP claim(s) dispute will have a maximum of 30 calendar days following receipt of payment to provide the DMHC with an AB 72 IDRP Decision Letter. The independent organization's decision regarding the appropriate reimbursement amount for the claim(s) dispute shall be based on all relevant information as submitted by the parties to the AB 72 IDRP. This information includes, but is not limited to, information submitted by the parties regarding the factors set forth in Title 28 of the California Code of Regulations, Section 1300.71(a)(3)(B)(i)-(vi), listed here:

- the provider's training, qualifications, and length of time in practice;
- the nature of the services provided;
- the fees usually charged by the provider;
- prevailing provider rates charged in the general geographic area in which the services were rendered;
- other aspects of the economics of the medical provider's practice that are relevant; and
- any unusual circumstances in the case.

The AB 72 IDRP decision drafted by the independent organization will provide a written explanation of the appropriate reimbursement amount decision, and will include a list of appropriate reimbursement amounts by relevant billing code. The independent organization is not limited to the suggested appropriate reimbursement amounts offered by each party when making its decision.⁶

Notably absent is any transparency about the decision-makers; any participation by physicians in the selection of the decision-makers (arbiters); any possibility of having a hearing; any right to rebut the insurance company's submission; and any right to appeal.

Why the Dispute Resolution Process Is Unconstitutional

Were we still in the "Roaring 20s" of free enterprise, its exuberant culture, and the advent of jazz music, there would not be any doubt about the unconstitutionality of the Independent Dispute Resolution Process. Multiple decisions during the 1920s invalidated state legislation that compelled certain industries to submit to arbitration rather than litigate their disputes.⁷⁻⁹ These cases held that attempts by government to fix wages and compel arbitration were constitutionally flawed because the industries being regulated (the meat packing and coal mining industries) were not sufficiently "clothed with a public interest"—i.e., not sufficiently intertwined with pervasive public

interests, as a railroad or utility is—to support government control over the pricing.¹⁰

But then the Great Depression hit, and it disrupted the legal system as much as it did the financial markets. The pressure to end individual rights against government regulation apparently became overwhelming, and ultimately the Supreme Court caved into the demands of the New Deal. From the ashes of economic devastation rose the regulatory state, and rather than block it, the federal courts eventually gave it their blessing.

Dozens of Supreme Court decisions in this field from the 1920s and early 1930s ostensibly remain good law today, but in reality any court that strictly relies on them without referring to their modern counterparts is taking a risk of reversal on appeal. AAPS informed the court that we would prefer it to rely on the pre-Depression precedents, but candidly admitted that those precedents may not carry as much weight today as AAPS would like.

Instead, the leading precedent today on the meaning of due process rights against regulation is the more flexible standard set forth in *Goldberg v. Kelly*.¹¹, pp 266-271 Due process is "flexible and calls for such procedural protections as the particular situation demands," as explained in a subsequent decision in *Morrissey v. Brewer*.¹²

The *Goldberg v. Kelly* line of precedents by the U.S. Supreme Court continues to be cited favorably by multiple federal courts each month. For example, two years ago the U.S. Court of Appeals for the Ninth Circuit, which presides over California and many other Western states, invalidated regulatory procedures relating to housing based on the following explanation in *Nozzi v. Housing Authority*:

Procedural safeguards come in many forms, including, *inter alia*, "timely and adequate notice," pre-termination hearings, the opportunity to present written and oral arguments, and the ability to confront adverse witnesses. See *Goldberg v. Kelly*. Which protections are due in a given case requires a careful analysis of the importance of the rights and the other interests at stake.¹³

There are at least four reasons why AB 72, with its mandatory, binding arbitration-like procedure, fails to satisfy the minimum level of due process required by the U.S. Constitution. Each is explained below.

The Lack of Any Right to a Hearing under the Independent Dispute Resolution Process Violates Due Process.

The process established by AB 72 deprives the physician of any right or even any possibility of being able to present his case at a hearing. "The fundamental requisite of due process of law is **the opportunity to be heard. The hearing must be at a meaningful time and in a meaningful manner,**" explained the Supreme Court in its landmark precedent of *Goldberg v. Kelly* [emphasis added].¹¹, p 267

It is true that in judicial proceedings, not every dispute warrants a hearing in court. But virtually every litigant does have a due process right to request a hearing, and to make a showing for why a hearing would be justified. For example, if an insurance company denies a claim, then a hearing may be necessary for the physician to cross-examine any witnesses who provided statements against him, or against the reasonableness of his fees. "In almost every setting where important decisions turn on

questions of fact, due process requires an opportunity to confront and cross-examine adverse witnesses.”^{11, p 269} The Supreme Court earlier explained, in *Greene v. McElroy*, that “[w]e have formalized these protections in the requirements of confrontation and cross-examination.... This Court has been zealous to protect these rights from erosion. It has spoken out...in all types of cases where administrative...actions were under scrutiny.”¹⁴

Despite these well-established procedural requirements, the arbitration-like proceeding under AB 72 allows for no hearings, ever, no matter how large or important the dispute. This denial of even the possibility of a hearing is a violation of due process.

The Lack of Transparency and Physician Participation in Selecting the Arbiters Violates Due Process.

The Independent Dispute Resolution process lacks transparency, lacks participation by physicians in selecting the decision-makers, and lacks sufficient safeguards against conflicts of interest. For example, the decision-makers could even be receiving compensation, directly or indirectly, from insurance companies.

Due process requires a system that ensures an impartial decision-maker. “And, of course, an impartial decision maker is essential,” the Supreme Court emphasized in *Goldberg v. Kelly*.^{11, p 271} Yet AB 72 fails this basic requirement.

The Lack of Meaningful Judicial Review under AB 72 Violates Due Process.

AB 72 provides that “either party may pursue any right, remedy, or penalty established under any other applicable law.” But its dispute resolution procedure is **binding**, such that under California law judicial review will be meaningful only if there is proof of corruption, fraud, undue means, or substantial prejudice due to misconduct.¹⁵ As the federal court in the Northern District of California has explained, “where parties to a contract agree to binding arbitration, the decision of the arbitrators is not subject to judicial review absent a showing that vacatur is warranted for a reason provided by Cal. Civ. Proc. Code § 1286.2.”¹⁶

When this problem is combined with lack of transparency, it impossible for a physician to prove or even become aware of one-sided partiality or misconduct sufficient to overcome a binding award. This is plainly unconstitutional.

Requiring Participation in a Prior Internal Review with an Insurance Company Violates Due Process.

With AB 72, insurance companies created as many burdens on independent physicians as they could. But obstacles to dispute resolution are themselves violations of due process. AB 72 requires physicians first to participate in an internal review process by payers with whom the physicians have no relationship. As explained by the website of the California Department of Managed Health Care, “Before the DMHC can begin a review, the provider is required to submit the dispute to the payer’s Dispute Resolution Mechanism for a minimum of 45 working days or until receipt of the payer’s written determination, whichever period is shorter.”⁶ This imposes delay and expense, and grants to one side of a dispute an unjustified elevated authority over the other. That is wholly defective from the perspective of due process.

Laws that comport with due process do not require one to submit one’s claim to an adversary and wait for a response before suing him on the claim. In addition to delaying ultimate relief, such a mandatory process could have a disadvantageous effect on a litigant, as he must “show his cards” to his adversary well before the Independent Dispute Resolution process begins, without the payer having the same obligation to disclose its litigation strategy. “[T]here is no doubt that requiring only one side to disclose questions in advance could put the disclosing party at a serious disadvantage in a given case,” observed the U.S. Court of Appeals for the Ninth Circuit in another case.¹⁷ This one-sided burden placed by AB 72 on physicians before they can even initiate the Independent Dispute Resolution procedure violates due process.

Moreover, the Due Process Clause “requires the States to afford certain civil litigants a ‘meaningful opportunity to be heard’ by removing obstacles to their full participation in judicial proceedings.”¹⁸ Requiring an internal review by an adversary with whom a claimant has no relationship, prior to the claimant being able to seek relief in an independent venue, is a due process violation.

Conclusion

The federal court held an extensive, well-attended hearing on Oct 19, 2017, in Sacramento. The learned federal judge was thoroughly prepared and thanked both sides for their detailed briefing of the issues. He requested additional briefing on whether the Independent Dispute Resolution Process is constitutional. He then reserved judgment on the matter until after he has had the opportunity to review the additional briefs, which the parties submitted in November.

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