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## Constitutional Limits on Physician Price Control

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# Constitutional Limits on Physician Price Controls

By THOMAS W. MERRILL\*

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## Introduction

Proposals for the reform of the nation's health care system have highlighted the issue of rising health care costs. Concern about rising costs, in turn, has led to talk of imposing price controls on health care providers.<sup>1</sup> Economists and other experts have condemned price controls as a way to control rising health care costs.<sup>2</sup> They argue that price controls do nothing to alleviate the underlying causes of inflation; instead, price controls merely postpone or redirect price increases, and in the process introduce allocational distortions and inefficiencies. This Article will not elaborate on the policy arguments for or against medical price controls. That task is left to others. Instead, this Article is concerned exclusively with a legal question: what, if any, constitutional limitations apply to the federal government's power to constrain the prices charged by health care providers? The specific focus is on physician price controls, but much of the analysis applies to other health care providers as well.

No claim can be made that physician price controls are per se unconstitutional under current doctrine. For better or worse, it is "settled beyond dispute" that regulation of prices is constitutionally permissible.<sup>3</sup> This does not mean, however, that the Constitution has nothing to say about what *form* a system of physician price controls could take. This Article argues that the Fifth Amendment's Takings and Due Process Clauses would apply to any general system of price controls imposed by the federal government on physician services, and would establish significant limits on how those controls are formulated and carried out.

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1. See, e.g., Dana Priest, *Health Care Price Curbs Advocated*, WASH. POST, May 1, 1993, at A1; Dana Priest, *Medical Price Caps Weighed*, PHILADELPHIA INQUIRER, Feb. 15, 1993, at A1; Diane Levick, *Insurers Shoot at Trial Balloon on Health Care*, HARTFORD COURANT, Feb. 12, 1993, at B1.

2. See, e.g., Stuart M. Butler, *Rube Goldberg, Call Your Office*, N.Y. TIMES, Sept. 28, 1993, at A25; Alain C. Enthoven & Sara J. Singer, *Health Care is Healing Itself*, N.Y. TIMES, Aug. 17, 1993, at A17; Elizabeth M. McCaughey, *Price Controls on Health Care*, WALL ST. J., Nov. 22, 1993, at A14; Donna Smith, *Economists Oppose Clinton Health Price Plan*, Reuter Business Report, Jan. 13, 1994, available in LEXIS, Nexis Library, WIRES File (reporting letter signed by 565 economists opposing medical price controls).

3. *FCC v. Florida Power Corp.*, 480 U.S. 245, 253 (1987). This conclusion, although not uncontroversial, has a long lineage. See *Block v. Hirsh*, 256 U.S. 135 (1921) (upholding wartime rent controls); *Munn v. Illinois*, 94 U.S. 113 (1877) (upholding state regulation of grain elevator rates).

In brief, the argument is as follows. First, the Takings Clause applies to price controls whenever a person has committed significant specific capital (sunk investment costs) to the price-controlled market, and it is not feasible to shift that capital to an uncontrolled market. Physicians make large investments in human capital that cannot be readily transferred to non-medical markets; thus, if physicians' prices are constrained by the government in all relevant medical markets, those price controls are subject to scrutiny under the Takings Clause.

Second, the most appropriate standard for assessing physician price controls under the Takings Clause is the "fair return" standard developed by the Supreme Court in public utility rate cases.<sup>4</sup> Under this standard, physicians are entitled to recover their reasonably incurred costs, plus a fair return on their investment in medical education, training, and equipment. Prices need not be set for each physician individually; they may be fixed on a group basis by looking at the costs and fair return requirements of representative members of the group.<sup>5</sup> Given the nonfungible nature of physician services, however, a highly differentiated system of group rates would be required, reflecting differences in procedures, training levels, and areas of the country. Moreover, a procedure for excluding individual physicians from group rates or reclassifying them as properly belonging to different groups would be required.

Third, the Due Process Clause requires that individual physicians be afforded a hearing on claims that their costs and return requirements mandate their reclassification or exclusion from a given group rate. Although due process generally requires that such a hearing take place before an individual is deprived of property, a post-deprivation hearing in the form of an exemption or variance procedure may be permissible in this context, provided it is expeditious and includes relief designed to make physicians whole for losses sustained by being subjected to inappropriate group price controls.

Cumulatively, these limitations suggest that any system of physician price controls, if it is to be constitutional, would require the creation of an elaborate administrative apparatus. Such an apparatus would have to include economists and health care experts charged with determining the representative costs and human capital invested by physicians in different specialties and regions, and the appropriate return on this investment. It would also require a large cadre of attor-

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4. See, e.g., *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 310 (1989); *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944).

5. See *The Permian Basin Area Rate Cases*, 390 U.S. 747 (1968).

neys and hearing officers both to manage generic proceedings setting group prices and to conduct individual exemption or variance hearings. Whatever else one thinks about the wisdom of price controls, the administrative costs required to comply with these constitutional limitations should weigh heavily in deliberations about the proper design of health care reform. In effect, the constitutionally-mandated administrative costs present yet another reason to prefer market pricing to administered pricing.

One of the most elusive questions raised by the Clinton Administration's reform proposals is how one determines when a system of health care regulation constitutes a proposal for price controls. The bill initially sent to Congress by the Administration calls for setting fees for all physicians providing covered services on a fee-for-service basis—surely a form of price controls.<sup>6</sup> Yet, in public statements about health reform, the Administration has insisted that it is not endorsing price controls.<sup>7</sup> This Article argues that, for constitutional purposes, the relevant inquiry for identifying a system of price controls subject to constitutional limitations involves two questions. First, does a proposal authorize actors clothed in governmental authority to take steps that constrain physician prices? Second, are the physicians subject to such constrained prices entitled to protection of the Takings Clause, that is, are they effectively denied access to a market not subject to government-constrained prices? If these two conditions are met, then the action in question should be subject to the constitutional limitations that the Takings Clause and the Due Process Clause impose on government price controls.

## **I. The Takings Clause and Physician Price Controls**

There are several potential sources of constitutional limitation on government price controls, including the Takings Clause, the Equal Protection Clause, and the Due Process Clause in both its substantive and procedural dimensions. The Supreme Court has held that the standard of review governing challenges to price controls under substantive due process and equal protection is a deferential one.<sup>8</sup> Thus, unless the legislation is very poorly conceived or drafted, any substan-

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6. Health Security Act, H.R. 3600, 103d Cong., 1st Sess. § 1322(c) (1993).

7. See, e.g., Address of the President to the Joint Session of Congress, Sept. 22, 1993, reprinted in WHITE HOUSE DOMESTIC POLICY COUNCIL, HEALTH SECURITY: THE PRESIDENT'S REPORT TO THE AMERICAN PEOPLE 97 (1993).

8. See generally *Pennell v. City of San Jose*, 485 U.S. 1, 11-14 (1988) (citing cases supporting this conclusion in the context of a challenge to a rent control scheme).

tive due process or equal protection challenge to physician price controls is unlikely to prevail.<sup>9</sup> The Takings Clause and the procedural aspect of due process are more potent constitutional constraints.<sup>10</sup> Accordingly, this Article will focus on those provisions.

The threshold question is whether the Takings Clause applies at all to a system of physician price controls. The Supreme Court has made it clear that the Takings Clause imposes significant limits on the power of government to regulate certain prices, most prominently, the rates charged by common carriers and public utilities.<sup>11</sup> On the other hand, other types of price controls, such as usury laws, have never been thought to raise questions under the Takings Clause.<sup>12</sup> What we need then is a theory that tells us which kinds of price controls give rise to Takings Clause scrutiny, and which kinds do not. The relevant case law includes two distinct understandings for answering this threshold question, although they are not recognized as alternatives or identified by name. The first will be called the *legal obligation* theory; the second the *specific capital* theory. This Part of the Article argues that the specific capital theory fits much better into the contemporary understanding of the meaning and purposes of the Takings Clause, and that a general, federally imposed system of physician price controls should be subject to Takings Clause constraints under that theory.

### A. The Legal Obligation and Specific Capital Theories

The legal obligation theory posits that price controls present a Takings Clause issue only when someone is subject to a legal obligation to devote their product or services to the public use. Thus, when

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9. In addition to *Pennell*, Supreme Court cases rejecting substantive due process and equal protection challenges to price controls include: *Sunshine Anthracite Coal Co. v. Adkins*, 310 U.S. 381 (1940) (rejecting substantive due process challenge to Bituminous Coal Act price control scheme); *Nebbia v. New York*, 291 U.S. 502 (1934) (rejecting substantive due process challenge to state milk price controls); *Woods v. Cloyd W. Miller Co.*, 333 U.S. 138 (1948) (rejecting an equal protection challenge to rent control law).

10. See *Tenoco Oil Co. v. Department of Consumer Affairs*, 876 F.2d 1013, 1020 (1st Cir. 1989) (concluding that the principal constraint on price controls today is the Takings Clause).

11. See *Duquesne Light Co. v. Barasch*, 488 U.S. 299 (1989); *The Permian Basin Area Rate Cases*, 390 U.S. 747 (1968); *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944); see also *FCC v. Florida Power Co.*, 480 U.S. 245, 255 (1987) (Powell, J., concurring).

12. See *Griffith v. Connecticut*, 218 U.S. 563, 569 (1910) (stating that it is "elementary" that usury laws fall within the police power of the state and present no substantial constitutional question); Stephen A. Siegel, *Lochner Era Jurisprudence and the American Constitutional Tradition*, 70 N.C. L. REV. 1, 99 (1991).

the government legally compels persons to devote their property to a designated use, the government must assure that they receive just compensation. But when a property owner is legally free to withdraw from the controlled market, no takings issue is presented. In effect, the question is whether a person subject to price controls is barred by law from access to an uncontrolled market.

The specific capital theory focuses not on legal obligations but economic realities. The question is whether a person has invested capital in a price-controlled market that has no value, or at best a substantially reduced value, in any alternative use.<sup>13</sup> To put it another way, is a person subject to price controls barred as a practical matter from access to an uncontrolled market? One reason why it may be economically infeasible to exit a controlled market is that the property owner has assets that are immovable, like a utility power plant. Another reason is that, even if assets are movable, all relevant markets where they might be employed may be equally controlled. Specific capital, namely capital that cannot be moved or transferred to an uncontrolled market, is especially vulnerable to expropriation through price controls, because the owner has little choice but to submit to the government-imposed price. The only alternative is to abandon the asset and forego any recovery of the investment altogether.

Both the legal obligation theory and the specific capital theory can explain the easy cases—why public utility regulation has traditionally been subject to Takings Clause constraints, and why usury laws have not been. Under the legal obligation theory, these results follow because public utilities have a common-carrier obligation to devote their property to public service, but lenders of money do not. Under the specific capital theory, these results follow because public utilities invest heavily in fixed plant assets that cannot be moved to an unregulated jurisdiction; money, in contrast, is the quintessential movable asset, which can easily be transferred from one lending market to another, either within or without a jurisdiction, or, if necessary, can be directly invested or consumed rather than lent.

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13. As one economist has stated, "Asset specificity has reference to the degree to which an asset can be redeployed to alternative uses without sacrifice of productive value. This has a relation to the notion of sunk cost." Oliver E. Williamson, *The Logic of Economic Organization*, 4 J.L. ECON. & ORGANIZATION 65, 70 (1988). Perhaps the best-known application of the concept of specific capital is Benjamin Klein et al., *Vertical Integration, Appropriable Rents, and the Competitive Contracting Process*, 21 J.L. & ECON. 297, 298 (1978). For application of the concept to human capital, see Keith N. Hylton & Maria O. Hylton, *Rent Appropriation and the Labor Law Doctrine of Successorship*, 70 B.U. L. REV. 821, 833-36 (1990). For an application in the context of eminent domain, see Thomas W. Merrill, *The Economics of Public Use*, 72 CORNELL L. REV. 61, 100 (1986).

Although the legal obligation theory and the specific capital theory both explain the polar cases, in intermediate cases they may lead to opposite conclusions. Consider, for example, rent controls. Under the legal obligation theory, rent controls would not be subject to the Takings Clause unless the owner of a controlled building is legally required to remain in the rental market, perhaps by an anti-conversion law.<sup>14</sup> Under the specific capital theory, the question would be whether the building is uniquely suited to the rental market, such that substantial costs would be incurred in exiting from the rental market and converting to some other use. If the answer is yes, as it often would be, then the specific capital theory would require that the Takings Clause be applied to rent controls.

### B. The Weakness of the Legal Obligation Theory

The legal obligation theory finds support in *Bowles v. Willingham*,<sup>15</sup> a Supreme Court decision dealing with emergency World War II rent controls. In the course of addressing a variety of constitutional challenges to these controls, Justice Douglas's opinion for the Court stated: "We are not dealing here with a situation which involves a 'taking' of property."<sup>16</sup> In support of this statement, Justice Douglas observed that under the statute, owners of rental units were legally free to withdraw their units from the rental market.<sup>17</sup>

Lower courts have occasionally relied on *Bowles* for the proposition that the Takings Clause does not apply to price controls unless one is legally obligated to serve the controlled market. For example, the Takings Clause was held to have no application to commodity price ceilings imposed by the Nixon Administration based on this reading of *Bowles*.<sup>18</sup> Similarly, and closer to home, several lower courts have rejected takings challenges to price caps imposed by Con-

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14. See, e.g., *Seawall Assoc. v. City of New York*, 542 N.E.2d 1059 (N.Y. 1989).

15. 321 U.S. 503 (1944).

16. *Id.* at 517.

17. *Id.* In *Yakus v. United States*, 321 U.S. 414 (1944), a companion case arising under the same statute, the Court noted that the "present statute is not open to the objection that petitioners are compelled to serve the public as in the case of a public utility . . ." *Id.* at 437.

18. *Western States Meat Packers Ass'n, Inc. v. Dunlop*, 482 F.2d 1401, 1403-05 (Temp. Emer. Ct. App. 1973). Notwithstanding this decision, other courts construed the Nixon price controls to contain an implicit standard of "fairness and equity" which is not dissimilar to the fair return requirement of the public utility cases decided under the Takings Clause. *Amalgamated Meat Cutters and Butcher Workmen v. Connally*, 337 F. Supp. 737, 757 (D.D.C. 1971) (three-judge court). Other decisions emphasized the ability to seek particularized relief in case of individual hardship, also a feature that would be required under a takings analysis. See *Pacific Coast Meat Jobbers Ass'n v. Cost of Living Council*,



gress under the Medicare and Medicaid programs.<sup>19</sup> Two of these decisions specifically rely on *Bowles* for the proposition that such price caps present no issue under the Takings Clause because providers remain legally free to forego treating patients covered by Medicare and Medicaid and may therefore continue to practice their specialties without being subject to any controls.<sup>20</sup>

Whether the cryptic passage in *Bowles* was actually meant to endorse the legal obligation theory is questionable.<sup>21</sup> But even if this is the proper reading of *Bowles*, the legal obligation theory is hard to square with other settled understandings of modern Takings Clause jurisprudence. Cumulatively, these discordant elements strongly suggest that the specific capital theory provides a better fit with the dominant understanding of the clause.

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481 F.2d 1388, 1391 (Temp. Emer. Ct. App. 1973); *United States v. Lieb*, 462 F.2d 1161, 1167 (Temp. Emer. Ct. App. 1972).

19. See *Garellick v. Sullivan*, 987 F.2d 913 (2d Cir.) (upholding "limiting charge" regulation of physician charges under Medicare Part B), *cert. denied*, 114 S. Ct. 78 (1993); *Whitney v. Heckler*, 780 F.2d 963, 972 (11th Cir. 1986) (upholding temporary rate freeze under Medicare Part B); *Minnesota Ass'n of Health Care Facilities v. Minnesota Dep't of Pub. Welfare*, 742 F.2d 442, 446 (8th Cir. 1984) (upholding state limitation on reimbursement of nursing homes that receive Medicaid), *cert. denied*, 469 U.S. 1215 (1985); see also *Burditt v. United States Dep't of Health and Human Serv.*, 934 F.2d 1362, 1376 (5th Cir. 1991) (upholding against takings challenge a requirement that Medicare providers treat all persons who seek services in emergency rooms).

20. See *Garellick*, 987 F.2d at 916 ("A property owner must be legally compelled to engage in price-regulated activity for regulations to give rise to a taking." (citing *Bowles v. Willingham*, 321 U.S. 503, 517-18 (1944))); *Whitney*, 780 F.2d at 972.

21. Several comments in the opinion suggest that the Court was simply rejecting the argument that emergency rent controls are a per se taking, but was not eliminating the possibility that they might constitute a taking as applied in particular circumstances. For example, immediately after the statement that the Court was "not dealing . . . with a situation which involves a 'taking' of property," *Bowles*, 321 U.S. at 517, Justice Douglas cited and relied on *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944), the leading decision establishing the fair return standard for public utilities under the Takings Clause. *Bowles*, 321 U.S. at 517. Moreover, at the end of the same paragraph Justice Douglas quoted *Block v. Hirsh*, 256 U.S. 135, 155 (1921), for the proposition that property rights are not "exempt" from legislative modification, as evidenced in part by the power of eminent domain, which allows takings of property for just compensation. *Bowles*, 321 U.S. at 517-18. Finally, Justice Douglas observed that just because "property may lose utility and depreciate in value as a consequence of regulation," this has not been "a barrier to the exercise of the police power." *Id.* Together, these comments suggest that the Court was rejecting the idea that the Takings Clause bars all rent controls, but not holding that the Takings Clause has no application to such controls at all.

*Bowles* is also distinguishable by the fact that the scheme upheld by the Court was established under the War Power and was based on the emergency caused by a sudden shortage of housing created by the rapid expansion of defense production in certain areas of the country. The Court indicated that a more relaxed standard of review was appropriate in these circumstances. *Id.* at 519; see also *Yakus*, 321 U.S. at 431-32 (noting the need for Congress to take "practicable and expeditious" steps during wartime).

### 1. Bowles Rests On Outmoded History

First of all, the legal obligation theory appears to be based on an outmoded understanding of why the Takings Clause applies to public utility rate regulation. The legal obligation idea can be traced to a series of decisions rendered in the late nineteenth century, when the Court first held that the Takings Clause constrains state regulation of railroad rates.<sup>22</sup> At the time, the Takings Clause was thought to apply only to formal exercises of the power of eminent domain and to closely related government actions, such as the physical occupation or destruction of property.<sup>23</sup> Accordingly, when the Court held first that the clause imposes limits on state railroad rate regulation, it analogized rate regulation to eminent domain.<sup>24</sup> Just as the government may not take legal title to property for a public use without paying just compensation, the Court reasoned, so the government may not force a utility by law to devote its property to public use without just compensation.<sup>25</sup> Consistent with the analogy, in 1897 the Court held in *Smyth v. Ames*<sup>26</sup> that just compensation had to be measured by the current "fair value" of the property devoted to public use.<sup>27</sup>

The fair value regime established by *Smyth v. Ames* was subject to widespread criticism, most prominently by Justice Brandeis in his seminal concurring opinion in *Missouri ex rel. Southwestern Bell Tele-*

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22. See generally John N. Drobak, *From Turnpike to Nuclear Power: The Constitutional Limits on Utility Rate Regulation*, 65 B.U. L. REV. 65, 70-81 (1985) (recounting history).

23. See, e.g., *Gibson v. United States*, 166 U.S. 269, 275-76 (1897) (noting that an "immense weight of authority" supported the view that there had to be a "physical invasion of the real estate" in order for a taking to occur (quoting *Transportation Co. v. Chicago*, 99 U.S. 635, 642 (1878))).

24. See *Smyth v. Ames*, 169 U.S. 466, 546 (1898) ("The corporation may not be required to use its property for the benefit of the public without receiving just compensation for the services rendered by it."); *Reagan v. Farmers' Loan & Trust Co.*, 154 U.S. 362, 410 (1894) ("If the State were to seek to acquire the title to these roads under its power of eminent domain, is there any doubt that constitutional provisions would require payment to the corporation of just compensation . . . . Is it any less a departure from the obligations of justice to seek to take not the title but the use for the public benefit at less than its market value?"); *The Railroad Comm'n Cases*, 116 U.S. 307, 331 (1886) ("Under pretence of regulating fares and freights, the State cannot require a railroad corporation to carry persons or property without reward; neither can it do that which in law amounts to a taking of private property for public use without just compensation, or without due process of law.").

25. Perhaps the fullest exposition of the analogy is found in Justice Brewer's influential circuit court decision in *Ames v. Union Pac. Ry. Co.*, 64 F. 165, 176-78 (C.C.D. Neb. 1894), *aff'd sub nom. Smyth v. Ames*, 169 U.S. 466 (1898).

26. 169 U.S. 466 (1898).

27. *Id.* at 544.

*phone Co. v. Public Service Commission*.<sup>28</sup> Among other things, Justice Brandeis specifically attacked the eminent domain analogy that underlay the fair value methodology. The root of the problem, he stressed, was that the "property" ultimately at stake was the capital that the shareholders had invested in the utility. Thus, the focus of the inquiry should not be on the current value of the utility's physical plant "taken" by the government for public use, but rather on the "amount prudently invested in [the utility]" by its investors.<sup>29</sup>

As is well known, Brandeis' views eventually triumphed in *Federal Power Commission v. Hope Natural Gas Co.*,<sup>30</sup> decided shortly before *Bowles*. In effect, then, the comments in *Bowles* were already an atavism at the time they were uttered. Under the regime of *Smyth v. Ames*, which rested on an analogy between rate regulation and eminent domain, it made sense to condition the application of the Takings Clause on a finding that one had a legal obligation to serve the public. But after the *Smyth* approach was dethroned in *Hope*, and the Court adopted a standard that focused on fairness to investors, the basis for finding that the Takings Clause applies was radically altered. The Takings Clause was no longer seen as protecting against certain kinds of physical appropriations by the government, but rather as a promise by the government that shareholders will not have their investment-backed expectations frustrated by regulators. Although the Court in *Hope* did not directly endorse the specific capital theory, its analysis is far more consistent with that approach than with the legal obligation idea.<sup>31</sup>

## 2. *Bowles Is Contrary to Modern Regulatory Takings Doctrine*

The legal obligation theory of *Bowles* is also inconsistent with more general developments in Takings Clause law, in particular the emergence of modern regulatory takings doctrine. The watershed regulatory takings case was *Pennsylvania Coal Co. v. Mahon*,<sup>32</sup> where the Court held that the Takings Clause not only forbids the physical appropriation or destruction of property, but also means that "if regulation goes too far it will be recognized as a taking."<sup>33</sup> There was no

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28. 262 U.S. 276, 289 (1923) (Brandeis, J., concurring).

29. *Id.*

30. 320 U.S. 591 (1944).

31. This was confirmed by *The Permian Basin Area Rate Cases*, 390 U.S. 747 (1968), where the Court applied the fair return standard of *Hope* in circumstances where the regulated entity was legally free to abandon the controlled market. See *infra* note 62.

32. 260 U.S. 393 (1922).

33. *Id.* at 415.

suggestion in *Mahon* that the coal company was subject to a legal obligation to mine coal. To the contrary, the Takings Clause was brought into play because the assets in question—pillars of coal in deep mines—were valuable to the company only in mining operations and would have no value to the company in any other use. At least implicitly, therefore, the Court accepted the specific capital theory.

Nor is there anything in the regulatory takings cases that follow upon *Mahon* to suggest that a property owner must show a legal obligation to serve the public before the Takings Clause is triggered. Most of these cases involve land use regulations that are alleged to be so burdensome that they amount to a taking of the owner's property.<sup>34</sup> The Supreme Court has never suggested in these cases that if the land owner is legally free to transfer the land from its current use to some alternative use, this defeats any claim of a taking. To the contrary, the assumption is that the burden of the regulation is measured against any use of the property that was legally permitted at the time specific capital improvements were made.<sup>35</sup> In effect, regulatory takings doctrine, which has been developed largely in the period after *Bowles*, implicitly adopts a specific capital theory for the application of the Takings Clause—not a legal obligation theory.<sup>36</sup>

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34. See, e.g., *Lucas v. South Carolina Coastal Council*, 112 S. Ct. 2886 (1992) (regulation of development of beachfront property); *Nollan v. California Coastal Comm'n*, 483 U.S. 825 (1987) (development exaction); *Keystone Bituminous Coal Ass'n v. DeBenedictis*, 480 U.S. 470 (1987) (mandatory support of surface property by coal mining operator); *Penn Central Transp. Co. v. New York City*, 438 U.S. 104 (1978) (historic preservation ordinance).

35. For example, zoning ordinances that eliminate nonconforming uses have always been understood to present a serious problem under the Takings Clause because they may require the destruction or extensive modification of specific capital. See ROGER A. CUNNINGHAM ET AL., *THE LAW OF PROPERTY* 543 (1984). The problem is especially acute with ordinances that prohibit nonconforming structures. As one commentary has explained: "Most of the investment in a nonconforming structure is 'sunk.' A sunk cost is a cost that a firm will not be able to recover when it goes out of business. When a building is torn down, its salvage value is often close to zero." SHELDON F. KURTZ & HERBERT HOVENKAMP, *AMERICAN PROPERTY LAW* 959 (1987). Not surprisingly, therefore, some courts have held that uncompensated prohibition of nonconforming uses is an unconstitutional taking. See *Ailes v. Decatur County Area Planning Comm'n*, 448 N.E.2d 1057 (Ind. 1983), *cert. denied*, 465 U.S. 1100 (1984). Others have held that nonconforming uses may be eliminated if they are phased out (amortized) over a reasonable period of time, permitting recovery of the owner's specific capital. See, e.g., *Modjeska Sign Studios, Inc. v. Berle*, 373 N.E.2d 255 (N.Y. 1977). In either event, there is general judicial recognition of the need to protect specific capital.

36. Regulatory takings cases not involving land use controls are consistent with this observation. For example, the Court in *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155 (1980), struck down an attempt by the state to authorize courts to retain interest earned on funds deposited by litigants in interpleader cases. The withholding of interest

### 3. *Rent Control Cases Have Not Followed Bowles*

The apparent endorsement of a legal obligation theory in *Bowles* does not even appear to have been applied in the very area at issue in that case—rent controls. Rent control cases preceding *Bowles* do not support the doctrine. In the leading decision of the World War I era, *Block v. Hirsh*,<sup>37</sup> the Court, in an opinion by Justice Holmes, stressed that the controls were temporary, and contained “[m]achinery” designed to “secure to the landlord a reasonable rent.”<sup>38</sup> The Court concluded:

The only matter that seems to us open to debate is whether the statute goes too far. For just as there comes a point at which the police power ceases and leaves only that of eminent domain, it may be conceded that regulations of the present sort pressed to a certain height might amount to a taking without due process of law.<sup>39</sup>

In effect, the Court strongly intimated that the principles of the Takings Clause govern rent controls, forbidding controls that would deny the owner a reasonable return on investment.

Indeed, in a somewhat cryptic passage, *Block v. Hirsh* appears specifically to reject the legal obligation theory. The landlord in that case sought to distinguish *Munn v. Illinois*,<sup>40</sup> which upheld state regulation of prices charged by grain elevators, on the ground that “a grain elevator may go out of business whereas here the use is fastened upon the land.”<sup>41</sup> Holmes rejected the distinction, noting that “[t]he power to go out of business, when it exists, is an illusory answer to gas companies and waterworks . . . .”<sup>42</sup> The point, presumably, was that even if a gas or water company was legally free to exit the market, this would do nothing to protect its specific assets from expropriation through price controls.<sup>43</sup>

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was held to be a taking, even though there was no suggestion that litigants were legally obligated to use state interpleader proceedings to resolve their disputes. *See id.* at 156-57.

37. 256 U.S. 135 (1921).

38. *Id.* at 157.

39. *Id.* at 156.

40. 94 U.S. 113 (1877).

41. *Block*, 256 U.S. at 157.

42. *Id.*

43. Other cases of this era also appear to assume that the Takings Clause prohibits price controls that do not assure a reasonable return on investment, without respect to whether the controlled entity is subject to a legal obligation to serve the market. *See Highland v. Russell Car Co.*, 279 U.S. 253, 258 (1929) (upholding the Lever Act, permitting the president to fix the maximum price on coal during wartime, but stressing that plaintiff did not allege that the price was not compensatory or that it failed to give him a reasonable profit); *Edgar A. Levy Leasing Co. v. Siegel*, 258 U.S. 242, 250 (1922) (upholding against

Similarly, two recent cases involving rent controls contain no suggestion that the Takings Clause would not apply to such controls if the owner were free to abandon the rental market. In *Pennell v. City of San Jose*,<sup>44</sup> the Court held that a rent control ordinance that allowed regulators to take tenant hardship into account was not facially invalid under the Due Process and Equal Protection Clauses.<sup>45</sup> But the Court discussed separately the contention that the ordinance violated the Takings Clause. The Court declined to resolve this contention because it found that the claim was premature in the absence of any evidence that the tenant hardship clause had ever been relied on in fixing rents.<sup>46</sup> Significantly, however, there was no suggestion that *Bowles* had rendered the Takings Clause inapplicable to rent control statutes where the owner was free to leave the market. Nor is it possible that the Court was unaware of *Bowles*, because the Court explicitly relied on that decision in the portion of its opinion discussing the Due Process and Equal Protection challenges.<sup>47</sup>

More recently, in *Yee v. City of Escondido*,<sup>48</sup> the Court entertained another challenge to a rent control ordinance under the Takings Clause. The Court held that a system of rent controls on mobile home lots, in conjunction with a rule preventing the landowner from selecting new tenants, did not constitute a per se taking of the owner's property.<sup>49</sup> Nevertheless, the Court indicated that the scheme would be open to a takings challenge as applied, although it ultimately concluded that this issue had not been presented in the petition for certiorari.<sup>50</sup> Again, there was no suggestion that *Bowles* had rendered the Takings Clause irrelevant to rent controls if the owner was legally free to abandon the market; the Court's decision would make no sense if this had been its understanding.

Recent lower court decisions also have rejected the notion that a Takings Clause issue is presented if a property owner is legally free to exit the market or abandon the property. The First Circuit declined to rely on *Bowles* in rejecting a takings challenge to wholesale gasoline price controls imposed in Puerto Rico, noting that the "supposed free-

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vagueness challenge a standard requiring "just and reasonable rent" and noting the similarity to the language of the Takings Clause).

44. 485 U.S. 1 (1988).

45. *Id.* at 11-15.

46. *Id.* at 9-10.

47. *Id.* at 13.

48. 112 S. Ct. 1522 (1992).

49. *Id.* at 1528-31.

50. *Id.* at 1531-34.

dom to temporarily leave the market may be largely illusory.”<sup>51</sup> Similarly, the New Jersey Supreme Court has condemned as “fictitious” the notion that the owner of a rental apartment building is free to abandon the market.<sup>52</sup> The court observed: “Although in theory the owner of a large apartment building may convert it to other uses or tear it down and construct something else in its place, in practice such a course is ordinarily economically prohibitive, and to force it would be confiscatory.”<sup>53</sup>

#### 4. *The Legal Obligation Theory Conflicts With Accepted Takings Clause Policy*

Finally and perhaps most importantly, the legal obligation theory finds little support in the general purposes of the Takings Clause. The Court has frequently observed that the central purpose of the Takings Clause is “to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole.”<sup>54</sup> In other words, the Clause prohibits targeted forms of redistribution that unfairly single out one group or segment of society to bear costs that should be spread more widely. It is difficult to see how this concern would apply only where there is a legal obligation to serve the market. To the contrary, the sense of unfair redistribution potentially posed by price controls arises *only* because persons subject to controls have specific capital at risk, and are therefore vulnerable to expropriation. A legal obligation not accompanied by such an effect would hardly be said to give rise to any perception of unfairness at all.<sup>55</sup>

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51. *Tenoco Oil Co. v. Department of Consumer Affairs*, 876 F.2d 1013, 1027 n.21 (1st Cir. 1989).

52. *Hutton Park Gardens v. Town Council*, 350 A.2d 1, 14-15 n.9 (N.J. 1975).

53. *Id.*

54. *Armstrong v. United States*, 364 U.S. 40, 49 (1960). For recent cases relying on this statement of purpose, see *First English Evangelical Lutheran Church v. County of Los Angeles*, 482 U.S. 304, 318-19 (1987); *Connolly v. Pension Benefit Guar. Corp.*, 475 U.S. 211, 227 (1986); *Penn Central Transp. Co. v. New York City*, 438 U.S. 104, 123 (1978); *Pennell v. City of San Jose*, 485 U.S. 1, 9 (1988).

55. Academic theories about the purposes of the Takings Clause also provide no support for limiting the Clause to circumstances where a property owner is legally constrained from leaving the market. One theory posits that the Clause is designed to assure efficient decisions about government resource acquisition by avoiding the “fiscal illusion” associated with thinking that government may acquire scarce resources for free. See Thomas W. Merrill, *Rent Seeking and the Compensation Principle*, 80 Nw. U. L. REV. 1561, 1583-84 (1986) (citing authorities). Clearly, this concern is present when resources in the form of specific assets are vulnerable to government appropriation, as well as when resources are legally restricted to a given market.

The only purpose that adoption of the legal obligation theory would serve is a reduction in litigation costs. Identifying a legal obligation to serve the public undoubtedly entails a more formalistic analysis than identifying specific capital and hence is presumably a cheaper rule to apply. For example, determining whether an entity has a common carrier obligation presents a legal question that can be determined in most cases without an evidentiary hearing. But the legal obligation theory is seriously underinclusive in the sense that it would leave unprotected a large number of property owners who are vulnerable to expropriation through price controls. The question then is whether the potential savings in litigation costs justifies the greater potential for injustice in the form of unfair redistributions. Generally speaking, a reduction in litigation costs has not been sufficient reason to support contraction of constitutional rights,<sup>56</sup> and this has been the conclusion reached under the Takings Clause as well, as witnessed by expansion of the Clause beyond physical takings to include regulatory takings.

In sum, although the legal obligation theory finds arguable support in *Bowles*, a decision resting in large part on the War Power, it is seriously at odds with major developments in Takings Clause jurisprudence in the last half century. The specific capital theory provides a far better fit with modern law, and should be used in determining

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A second theory stresses that the Takings Clause functions like an insurance policy, protecting property owners against the risk of loss through government appropriation. *Id.* at 1580-81 (citing authorities). This rationale also applies to specific capital as well as property legally obligated to serve a particular market.

A third theory, related to the second, stresses the "demoralization costs" that occur when property-owning minorities are forced to make disproportionate sacrifices imposed on them by the majority. See Frank I. Michelman, *Property, Utility, and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law*, 80 HARV. L. REV. 1165, 1214 (1967). This too justifies no distinction between the legal obligation and specific capital ideas.

Finally, some commentators have attempted to ground the Takings Clause in public choice theory, either by stressing the role of the clause in discouraging rent seeking in the form of attempts by groups to use the government to appropriate the property of others, see RICHARD A. EPSTEIN, *TAKINGS: PRIVATE PROPERTY AND THE POWER OF EMINENT DOMAIN* (1985); Merrill, *supra*, at 1577-78, or by stressing the concerted opposition that property owners might present to government projects that require the use of their property if they were not compensated. Daniel A. Farber, *Economic Analysis and Just Compensation*, 12 INT'L REV. L. & ECON. 125 (1992). Obviously, neither of these concerns is limited to circumstances where there is a legal obligation to serve the market, but would apply anytime a property owner has specific assets at risk.

56. See, e.g., *Memorial Hosp. v. Maricopa County*, 415 U.S. 250, 263 (1974) (stating that "conservation of the taxpayers' purse" is ordinarily not a sufficient reason for burdening protected rights).



whether any particular system of price controls is subject to the Takings Clause.

### C. Physician Investments in Specific Human Capital

There can be little doubt that price controls on physicians should be subject to the Takings Clause under the specific capital theory. Physicians make huge investments in specialized training and equipment. This investment initially includes the direct costs of medical school, such as tuition and fees. More importantly, it also includes the opportunity costs of foregone earnings and leisure incurred during the long and arduous process of medical training.<sup>57</sup> Together, these direct outlays and opportunity costs constitute a major investment in human capital.<sup>58</sup>

This investment in human capital is also unquestionably specific capital in the sense that it would have little or no value if not devoted to the practice of medicine.<sup>59</sup> Physician human capital is obviously

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57. In addition, of course, there are costs associated with acquiring office space and the necessary equipment to engage in the practice of medicine. The costs of setting up a practice upon graduation from medical school are also considerable. See Charles D. Bankhead, *Solo Practice*, MED. WORLD NEWS, June 11, 1990, at 31 (stating that the costs of setting up a practice approach \$100,000); Carol B. Golin, *Medical Practice Trends: Starting Up Solo—What it Takes Today*, 5 J. OF MED. PRAC. MGMT. 24, 24 (1989) (stating that setting up a family practice requires \$50,000 initially and up to \$6,000 to cover monthly expenses); see also Arthur Owens, *Starting Out: Success Is A Longer Reach These Days*, MED. ECON., Jan. 11, 1993, at 164 (reporting that 41% of physicians require five years or more to repay practice start-up loans).

58. In 1991-92, the median annual tuition for a public medical school was \$6,826 and was \$19,790 for a private medical school. American Medical Association, Report of the Council on Medical Education Regarding Ways to Reduce the Cost of Medical School Education 1 (unpublished report on file with the *Hastings Constitutional Law Quarterly*). Undoubtedly the largest element of investment, however, is the opportunity costs associated with a medical education, that is, the foregone earnings and leisure a medical student gives up during medical education and training. Unfortunately, there appears to be no general study regarding the opportunity costs of a medical education. One court, however, seeking to determine the value of medical degree as part of a division of property upon divorce found that a married couple lost \$250,000 in net earnings while the husband attended medical school. *Rhodes v. Rhodes*, 754 P.2d 1333, 1334 (Alaska 1988). This figure does not include foregone leisure time, and would probably range higher in more urban markets. If physician fees are to be fixed by some type of government regulation, an accurate measure of opportunity costs would have to be developed in order to assure a fair return on total physician investment in human capital. Significant administrative costs would undoubtedly be associated with such an undertaking.

59. This common sense perception is not new. See *Dent v. West Virginia*, 129 U.S. 114, 121-22 (1889) (noting that practice of medicine requires "years of study and great learning for [its] successful prosecution" and that the interest or "estate" in continuing that practice "is often of great value to the possessors, and cannot be arbitrarily taken from them, any more than their real or personal property can be thus taken").

not completely immovable, like a power plant or railroad right-of-way. Thus, if physician price controls were imposed by local or even state governments, physicians could relocate to other jurisdictions without controls.<sup>60</sup> Of course, for physicians with established practices who have accumulated extensive patient good will, even this option would likely entail a serious sacrifice. When controls are imposed or mandated at a federal level, however, there can be no doubt that physician investment must be regarded as specific capital. The only escape from federally mandated price controls would be expatriation, a step that for most physicians would be too drastic to contemplate.

Physician human capital can also be shifted, within limits, from one segment of the medical market to another. For this reason, decisions upholding price caps on Medicaid and Medicare reimbursement<sup>61</sup> are arguably justified under the specific capital theory, at least if Medicaid and Medicare patients represent only a small portion of the relevant market for a given specialty. Again, however, this qualification does not apply to any proposal for a general federal regime of physician price controls. Such a regime would eliminate access to any uncontrolled market in the United States. It would thus place the extensive specific human capital of physicians directly at risk of expropriation, and would trigger the application of the Takings Clause.<sup>62</sup>

#### D. The Relevance of Professional Licensure

There is a further argument that might be invoked in support of the proposition that the Takings Clause ought not apply to physician price controls. Physicians obtain licenses to practice medicine from the state—licenses that are necessary to engage in the practice of

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60. Even if individual physicians did not relocate, local jurisdictions would be constrained in setting controlled prices by the fact that new physicians would be reluctant to locate in a price controlled jurisdiction. The resulting threat of a doctor shortage would temper the severity of the regulation. See Vicki Been, *"Exit" as a Constraint on Land Use Exactions: Rethinking the Unconstitutional Conditions Doctrine*, 91 COLUM. L. REV. 473, 506-28 (1991).

61. See cases cited *supra* note 19.

62. In *The Permian Basin Area Rate Cases*, 390 U.S. 747 (1968), the Court placed great weight on the fact that gas producers could escape federal controls by seeking authority from the Federal Power Commission to abandon the price-regulated interstate market and serve only the intrastate market. *Id.* at 772-73. The Commission had indicated that this authority would be freely granted. *Id.* at 773. Even so, the Court indicated that the fair return requirement from the Takings Clause governed its inquiry. *Id.* at 790-92. A system of physician price controls designed to preclude any access to an uncontrolled market presents far more serious takings questions.

medicine.<sup>63</sup> Economists have long argued that such licensing programs can be used to restrict entry into a profession and thus allow incumbent practitioners to earn monopoly rents.<sup>64</sup> Accordingly, an argument might be made that the Takings Clause should not apply to physician price controls because these controls simply compensate for the monopoly rents created by government licensing.<sup>65</sup>

The assumptions of the argument are debatable at best. Few observers believe that the rapid rise in medical costs in recent years has been caused by government restrictions on the supply of doctors.<sup>66</sup> Instead, rising prices are primarily a function of high demand for physician services, fueled in part by government subsidies of health care expenditures and health insurance, and in part by the rapid introduction of new technologies.<sup>67</sup>

But even if it were true that government licensing laws have restricted the supply of physicians, it would not follow that the Takings Clause is irrelevant to physician price controls. After all, the Takings Clause clearly applies to public utility price controls, and public utilities are typically granted explicit monopoly rights in the form of a certificate of public convenience and necessity.<sup>68</sup> Indeed, as the public utility example suggests, the solution to the potential abuses of monopoly power created by government licensure is not to give the government unrestrained power of regulation. Instead, it is to adopt a system of regulation that seeks to protect both the consumer interest in avoiding monopoly prices *and* the investor interest in being given an opportunity to earn a fair return on investment.<sup>69</sup>

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63. See, e.g., CAL. BUS. & PROF. CODE §§ 2050-2051 (West 1990); ILL. ANN. STAT. ch., 225 para. 60/3 (Smith-Hurd 1993); see generally Timothy S. Jost, *The Necessary and Proper Role of Regulation to Assure the Quality of Health Care*, 25 Hous. L. Rev. 525 (1988).

64. See, e.g., Walter Gellhorn, *The Abuse of Occupational Licensing*, 44 U. Chi. L. Rev. 6, 13-18 (1976).

65. Similar arguments have been made in support of mandatory pro bono obligations for lawyers. See Jennifer G. Brown, *Rethinking "The Practice of Law,"* 41 EMORY L.J. 451, 454-55 (1992). For criticism, see Jonathan R. Macey, *Mandatory Pro Bono: Comfort for the Poor or Welfare for the Rich?*, 77 CORNELL L. REV. 1115, 1121-22 (1992).

66. See generally Macey, *supra* note 65, at 1121-22 (making a similar observation about the supply of lawyers).

67. HENRY J. AARON, *SERIOUS AND UNSTABLE CONDITION: FINANCING AMERICA'S HEALTH CARE* 9, 12, 39-40, 49, 53, 60 (1991); Randall R. Boubjerg, *Competition Versus Regulation in Medical Care: An Overdrawn Dichotomy*, 34 VAND. L. REV. 965, 965-73 (1981). On the role of new technologies, see Joseph P. Newhouse, *An Iconoclastic View of Health Cost Containment*, HEALTH AFF., Supp. 1993, at 152.

68. 1 A.J.G. PRIEST, *PRINCIPLES OF PUBLIC UTILITY REGULATION* 347-77 (1969).

69. See *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944).

## II. The Appropriate Takings Standard

Given that the Takings Clause applies to any general, federal system of physician price controls, the next question concerns what legal standard should be used in determining the constitutionality of any such system of controls under the Clause. Here again, there are two dominant options: the ad hoc multipart balancing test applied by the Supreme Court in regulatory takings cases, and the fair return standard developed by the Court for use in public utility rate cases.

### A. Ad Hoc Balancing or Fair Return: Determining the Appropriate Standard

The first option, the regulatory takings balancing standard, traces its modern form to the Supreme Court's 1978 decision in *Penn Central Transportation Co. v. New York City*.<sup>70</sup> It requires that courts examine three factors: the economic impact of the regulation at issue, the "investment-backed expectations" of those affected, and the character of the governmental action.<sup>71</sup> The standard contemplates an "ad hoc, factual" inquiry into the application of these factors in each particular case.<sup>72</sup> Since 1978, this regulatory takings standard has been applied predominantly in land use cases,<sup>73</sup> but has also been employed in a diverse range of takings controversies involving, among other things, regulation of trade secrets,<sup>74</sup> pensions,<sup>75</sup> and welfare benefits.<sup>76</sup>

The second option, the fair return standard, has been developed in the public utility context and dates from the Court's decision in *Federal Power Commission v. Hope Natural Gas Co.*<sup>77</sup> That standard permits regulators to consider both consumer and investor interests, and to set rates within a zone of reasonable outcomes.<sup>78</sup> At a mini-

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70. 438 U.S. 104, 124 (1978). The ad hoc nature of the inquiry was anticipated by Justice Holmes' opinion in *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 415 (1922).

71. *Penn Central*, 438 U.S. at 124.

72. *Lucas v. South Carolina Coastal Council*, 112 S. Ct. 2886, 2893 (1992) (quoting *Penn Central*, 438 U.S. at 124).

73. See cases cited *supra* note 34.

74. See, e.g., *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1005 (1984).

75. See, e.g., *Connolly v. Pension Benefit Guar. Corp.*, 475 U.S. 211, 224-25 (1986).

76. See, e.g., *Bowen v. Gilliard*, 483 U.S. 587, 606-07 (1987).

77. 320 U.S. 591 (1944). *Hope* did not mandate that regulators use a fair return on original investment approach; it simply required that the "total effect" of the rate order be just and reasonable. *Id.* at 602. Nevertheless, state and federal regulators have uniformly responded to the decision by adopting the fair return on original investment approach advocated by Justice Brandeis. See 1 ALFRED E. KAHN, *THE ECONOMICS OF REGULATION: PRINCIPLES AND INSTITUTIONS* 39-41 (1970).

78. See *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 314 (1989); *Hope*, 320 U.S. at 603.

mum, however, the standard requires that rates be set at a level that permits the utility "to operate successfully, to maintain its financial integrity, to attract capital, and to compensate its investors for the risk assumed . . . ." <sup>79</sup> Thus, the fair return standard generally requires that a utility be given an opportunity to recover all its reasonably incurred costs and to earn a fair return on all its prudentially made investment. As the Court explained in its most recent decision in this area, *Duquesne Light Co. v. Barasch*, <sup>80</sup> a regulated utility "is entitled to such rates as will permit it to earn a return . . . equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties." <sup>81</sup>

The Supreme Court has not spoken to the question of what standard should apply to price controls outside the public utility context, and it is not inconceivable that the *Penn Central* regulatory takings test would ultimately be adopted as the measure of the constitutionality of physician price controls. <sup>82</sup> For a variety of reasons, however, the fair return standard provides a much better benchmark.

First and most obviously, the fair return standard is designed for the specific purpose of assessing the constitutionality of price controls. Accordingly, the fair return standard addresses the factors that would be of greatest concern in assessing a system of physician price controls. These include the interest of consumers in avoiding excess charges and the interest of providers in earning a return on investment "commensurate with the returns on investments in other enterprises having corresponding risks." <sup>83</sup> The regulatory takings standard, in contrast, offers little guidance for reconciling these concerns. Moreover, the fair return standard has proven to be adaptable to schemes for establishing maximum charges for large numbers of similarly-situated producers, while tailoring those controls to relevant differences

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79. *Hope*, 320 U.S. at 605; see *Duquesne*, 488 U.S. at 314; *The Permian Basin Area Rate Cases*, 390 U.S. 747, 790-92 (1968).

80. 488 U.S. 299 (1989).

81. *Id.* at 314-15 (quoting *Bluefield Water Works & Improvement Co. v. Public Serv. Comm'n*, 262 U.S. 679, 692 (1923)).

82. A number of federal district courts have applied this standard in assessing takings challenges to rent controls. See, e.g., *Rent Stabilization Ass'n, Inc. v. Dinkins*, 805 F. Supp. 159 (S.D.N.Y. 1992), *aff'd*, 5 F.3d 591 (2d Cir. 1993); *Richardson v. City of Honolulu*, 802 F. Supp. 326 (D. Haw. 1992); *Gibbs v. Southeastern Inv. Corp.*, 705 F. Supp. 738, 744 (D. Conn. 1989); *Tirolerland, Inc. v. Lake Placid 1980 Olympic Games, Inc.*, 592 F. Supp. 304 (N.D.N.Y. 1984).

83. *Hope*, 320 U.S. at 603.

among producers.<sup>84</sup> In contrast, the regulatory takings standard, because of its ad hoc nature, might prove to be unworkable if applied to a large-scale system of controls on physician prices.

Second, the fair return standard reflects a century of Supreme Court litigation over rate regulation and, in its current form, has remained stable for nearly fifty years.<sup>85</sup> The standard has withstood the test of time and proven its workability in countless rate proceedings before state and federal regulatory agencies and courts. In contrast, the regulatory takings balancing test dates in its modern form only from 1978, and it is not clear that it enjoys the full support of the current Supreme Court, especially Justice Scalia.<sup>86</sup>

Third, although the Supreme Court has never addressed whether the regulatory takings standard applies to price controls outside the public utility context, lower courts are turning increasingly to the fair return standard in these circumstances. For example, the fair return standard has recently been applied to state initiatives to cap or roll back auto insurance rates.<sup>87</sup> In addition, state supreme courts in recent years have adopted the fair return standard in examining the constitutionality of municipal rent control schemes.<sup>88</sup>

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84. See *Permian Basin*, 390 U.S. 747 (1968), discussed *infra* at text accompanying notes 91-94.

85. See *Duquesne Light Co. v. Barasch*, 488 U.S. 299 (1989) (reaffirming *Federal Power Comm'n v. Hope Natural Gas*, 320 U.S. 591 (1944)).

86. Justice Scalia generally disapproves of multi-factored, ad hoc balancing tests because they lead to unequal treatment and deprive the law of desired predictability. Antonin Scalia, *The Rule of Law as a Law of Rules*, 56 U. CHI. L. REV. 1175, 1178-79 (1989). Justice Scalia's opinion for the Court in *Lucas v. South Carolina Coastal Council*, 112 S. Ct. 2886 (1992), which recognizes a new "categorical rule" for government action that deprives an owner of all economic value in property, is consistent with this general antipathy to balancing.

87. See, e.g., *Guaranty Nat'l Ins. Co. v. Gates*, 916 F.2d 508 (9th Cir. 1990) (striking down Nevada statute freezing auto insurance rates because it failed to guarantee a fair return to insurance companies); *Calfarm Ins. Co. v. Deukmejian*, 771 P.2d 1247 (Cal. 1989) (striking down portion of a California initiative freezing automobile insurance rates because it failed to guarantee a fair return to insurers); *State Farm Mut. Auto. Ins. Co. v. State*, 590 A.2d 191 (N.J. 1991) (upholding New Jersey regulation of automobile insurance rates under fair return standard).

88. See, e.g., *Birkenfeld v. City of Berkeley*, 550 P.2d 1001 (Cal. 1976) (applying public utility standard and striking down municipal rent control amendment as not assuring a fair return to property owners); *Helmsley v. Borough of Fort Lee*, 394 A.2d 65 (N.J. 1978) (striking down municipal rent control ordinance for failing to provide procedures necessary to guarantee fair return to landlords); *Hutton Park Gardens v. Town Council*, 350 A.2d 1, 14-16 (N.J. 1975) (reviewing precedents and concluding that municipal rent control ordinances should be assessed under public utility rate standards); *Jeffery v. McCullough*, 652 P.2d 9, 12 (Wash. 1982) (applying fair return standard in upholding ordinance regulating moorage fees charged to floating home owners).

In sum, considerations of policy, history, and lower court precedent all suggest that the fair return standard is a more appropriate benchmark for assessing the constitutionality of physician price controls under the Takings Clause.

### B. The Effect of Group Price Controls

Regulators typically apply the fair return standard to each individual regulated entity on an individual basis. In some circumstances, however, the Supreme Court has permitted rates or prices to be set on an area or group basis.<sup>89</sup> In effect, rates are set on the basis of the costs and rate of return requirements of the "representative" producer. High-cost producers accordingly receive a lower than normal rate of return. Low-cost producers receive a higher than normal rate of return.<sup>90</sup>

The leading Supreme Court case on group utility rates, *The Permian Basin Area Rate Cases*, concerned field prices of natural gas for an entire production area. In upholding the fixing of group prices in this context, the Court stated that the regulator must have "before it representative evidence, ample in quantity to measure with appropriate precision the financial and other requirements of the parties."<sup>91</sup> What constitutes "representative evidence" and "appropriate precision," the Court implied, will vary from one context to the next.<sup>92</sup>

One factor of overriding importance in determining the required representativeness and precision of group rates is the fungibility of the controlled product or service. Natural gas, as the Court noted in *Permian Basin*, is a highly fungible commodity.<sup>93</sup> Gas from one producer is generally indistinguishable from gas from another. Indeed, gas from multiple sources is typically intermingled in the pipelines before it is delivered to consumers.<sup>94</sup>

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89. See, e.g., *Federal Power Comm'n v. Texaco, Inc.*, 417 U.S. 380, 387-90 (1974); *The Permian Basin Area Rate Cases*, 390 U.S. 747 (1968); *Bowles v. Willingham*, 321 U.S. 503 (1944).

90. See *Federal Energy Regulatory Comm'n v. Pennzoil Producing Co.*, 439 U.S. 508, 517 (1979); *Permian Basin*, 390 U.S. at 769; *Bowles*, 321 U.S. at 518.

91. *Permian Basin* at 769; see also *The New England Div. Case*, 261 U.S. 184, 196-97 (1923) (holding that when railroad rates are set on a group basis, evidence must be "typical in character, and ample in quantity, to justify the finding made in respect to each division of each rate of every carrier").

92. *Permian Basin*, 390 U.S. at 769.

93. See *id.* at 757.

94. Even so, the Federal Power Commission in *Permian Basin* set different prices in different gas producing regions, provided for different prices for different types of gas, and authorized adjustments from standard prices based on BTU content. *Id.* at 762-63.

Physician services, in contrast, are not fungible. The quality of medical care and the diagnostic and therapeutic techniques employed differ considerably based on the physician's individual training, experience, and professional judgment. Consequently, group rates of the type upheld in *Permian Basin* cannot be transposed without modification to the physician services market.

Cases dealing with rent controls are also instructive here. The Supreme Court has, at least as a wartime measure, sanctioned the use of group rates in fixing rents,<sup>95</sup> and rental housing units are less fungible than natural gas. The rental stock varies widely in terms of physical amenities, quality of construction, and degree of maintenance. Landlord costs will also vary widely, depending on such factors as the landlord's embedded cost of capital. Recognizing these variables, local rent controls almost always reflect a high degree of sensitivity to individual costs in the structure of controlled prices.<sup>96</sup> This sensitivity is achieved by taking the market's pre-existing structure of rents as the point of departure and then providing for periodic adjustments based on an economic index designed to reflect rising costs.<sup>97</sup> Beyond this basic approach, courts have increasingly recognized that rent controls that remain in effect for any significant period of time will generate severe distortions in the pricing structure, requiring more frequent access to mechanisms for individual adjustments in the rents for particular structures.<sup>98</sup>

Physician services are probably even less fungible than rental housing. The variables that enter into the valuation of physician services are far more numerous and subjective than those that apply to rental housing. Moreover, the human capital invested in medical training is probably less transferable to other markets than is (at least some) rental housing. In these circumstances, any system of physician price controls must provide, if anything, an even higher degree of differentiation than that which is found in the typical rent control statute. At a minimum, any system of physician price controls would have to distinguish between different medical procedures, different physician training levels, and different areas of the country.

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95. *Bowles*, 321 U.S. at 517.

96. For a comprehensive survey of rent control ordinances and cost-adjustment mechanisms, see Kenneth K. Baar, *Guidelines For Drafting Rent Control Laws: Lessons of a Decade*, 35 RUTGERS L. REV. 723 (1983).

97. *Id.* at 765-81.

98. See *Birkenfeld v. City of Berkeley*, 550 P.2d 1001, 1029-30 (Cal. 1976); *Apartment & Office Bldg. Assoc. v. Washington*, 343 A.2d 323, 329-31 (D.C. Ct. App. 1975); *Helmsley v. Borough of Fort Lee*, 394 A.2d 65, 76-80 (N.J. 1978).



There are two distinct models that might satisfy these requirements. One is the current Resource-Based Relative-Value Scale (RBRVS) utilized in Medicare reimbursement.<sup>99</sup> The RBRVS seeks to construct reasonable physician charges for different medical services on the basis of a study of the relative work and complexity involved in providing the services. The extensive research underlying the RBRVS and the manifold problems associated with its implementation suggest the highly detailed process necessary to calculate a properly differentiated system of physician price controls.<sup>100</sup>

The other possible model would be a system of controls modeled after the typical rent control ordinance. This approach would start with the preexisting structure of physician prices, and then permit periodic aggregate adjustments based on changes in some index of costs. These aggregate adjustments would then be supplemented by a mechanism for individual exemptions or variances from group prices. As the experience with rent controls suggests, the longer such a system remains in effect, the more important provisions for individual exemptions would become.

Whichever model is chosen—the construction of “fair” prices based on the value of inputs as reflected in the RBRVS, or a freeze in prices followed by adjustments as reflected in the typical rent control scheme—the complexity of the process should be evident. The complexity follows directly from the constitutional understanding that group prices must be based on representative costs, combined with the fact that physician services are not fungible. If the Takings Clause applies to physician price controls, if the fair return standard is applied in implementing the requirements of the Clause, and if the representative costs understanding of the group rate cases is adopted in applying the fair return test, then this complexity is inevitable.

### III. Due Process

In addition to assuring that price controls are based on representative costs, any system of price controls must provide for individualized hearings for physicians who raise legitimate questions of fact about whether group price controls allow them an opportunity to earn

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99. 42 U.S.C. § 1395w-4 (1988); 42 C.F.R. §§ 414.1 to 453 (1993).

100. The unit of the Department of Health and Human Services responsible for implementing the RBRVS, the Health Care Financing Administration, issued proposed rules establishing initial fee scales for physicians under the RBRVS that take up 186 pages in the Federal Register. *See* Medicare Program; Fee Schedule for Physicians' Services, 56 Fed. Reg. 25,792 (1991).

a fair return on their investment. This requirement flows not only from the Court's Takings Clause jurisprudence, but also from considerations of procedural due process.

Price controls are clearly subject to procedural due process constraints. A physician's right to practice medicine is a property right protected by the Due Process Clause.<sup>101</sup> A physician could be deprived of this right by overly-rigorous price controls. Certainly, any time price controls are imposed in circumstances where physicians are denied access to an uncontrolled market such that the Takings Clause applies, the Due Process Clause would apply as well.<sup>102</sup>

### A. The Necessity of a Hearing

The first due process question is whether physicians are entitled to any kind of individual hearing when they are subjected to group price controls. The Supreme Court has long distinguished between government action that applies to large numbers of similarly-situated persons and action that may or may not apply to persons depending on their individual circumstances.<sup>103</sup> In the former category, procedural due process does not require an individualized hearing.<sup>104</sup> For example, an increase in the valuation of all property in a community would not give rise to individualized hearing rights.<sup>105</sup> In contrast, when the government takes action that threatens to deprive individuals of their property on grounds that are particular to each individual, due process requires some kind of individualized hearing.<sup>106</sup> Thus, a proposal to impose a special assessment on a particular parcel of prop-

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101. See *Dent v. West Virginia*, 129 U.S. 114, 121-22 (1889); *Lowe v. Scott*, 959 F.2d 323, 334 (1st Cir. 1992); *Keney v. Derbyshire*, 718 F.2d 352, 354 (10th Cir. 1983); see also *Barry v. Barchi*, 443 U.S. 55 (1979) (occupational license is property for due process purposes); *Bell v. Burson*, 402 U.S. 535 (1971) (driver's license is property); *Goldberg v. Kelly*, 397 U.S. 254, 262 n.8 (1970) (welfare payments are property).

102. See *Nelson v. City of New York*, 352 U.S. 103, 108-09 (1965); *Bailey v. Anderson*, 326 U.S. 203, 204 (1945).

103. Compare *Bi-Metallic Inc. v. State Bd. of Equalization*, 239 U.S. 441 (1915) (no individual hearing required before across-the-board increase in valuation of all property implemented) with *Londoner v. City of Denver*, 210 U.S. 373 (1908) (individual hearing required before determining "whether, in what amount, and upon whom" a special assessment for street paving would be imposed).

104. E.g., *Atkins v. Parker*, 472 U.S. 115, 130 n.33 (1985); *Minnesota State Bd. for Community Colleges v. Knight*, 465 U.S. 271, 283 (1984); *Bi-Metallic*, 239 U.S. at 445.

105. *Bi-Metallic*, 239 U.S. at 445.

106. E.g., *Memphis Light, Gas & Water Div. v. Craft*, 436 U.S. 1, 16 (1978); *United States v. Florida E. Coast Ry. Co.*, 410 U.S. 224, 244-45 (1973); *Londoner*, 210 U.S. at 385-86.

erty would trigger a right to an individualized hearing on issues of fact bearing on the proper assessment of that parcel.<sup>107</sup>

Whether group price controls give rise to hearing rights under this distinction is problematic. From what might be called the revenue perspective, group price controls look like generalized rules of equal effect: all members of the group must charge and receive the same prices. But this appearance of uniform treatment is illusory unless the costs of each member of the group are identical. If the costs or return requirements of individual members of the group differ, then some may be denied a fair return on investment if they are subjected to a single uniform pricing structure. In these circumstances, therefore, the facts about whether the group price yields a fair return would vary depending on individual circumstances, indicating that individualized hearings *are* required.

The solution to the dilemma that the courts generally have reached, without any precise rationale or supporting theory, is that due process does not require an individual hearing concerning the level at which group rates are fixed, but does require individualized hearings on requests for exemptions from group rates.<sup>108</sup> This solution makes sense, provided the group rates are established on a properly individuated basis in the first place—that is, prices have been fixed on the basis of truly representative costs and return requirements. Assuming this requirement is met, all persons who are genuinely members of the group have no cause for complaint. On the other hand, anyone who can fairly claim that they do not properly belong in the group because of their own peculiar circumstances has a due process right to an individual hearing.

## B. Pre- or Post-Deprivation Hearing

The difficult question from the perspective of modern due process doctrine is why a *post*-deprivation hearing would be sufficient

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107. *Londoner*, 210 U.S. at 380-86.

108. See, e.g., *The Permian Basin Area Rate Cases*, 390 U.S. 747, 770 (1968); *Yakus v. United States*, 321 U.S. 414, 436 (1944); *Bowles v. Willingham*, 321 U.S. 503, 519-21 (1944); *150 East 47th Street Corp. v. Creedon*, 162 F.2d 206, 210 (Emer. Ct. App. 1947). Although the Due Process Clause does not require individualized hearings before group prices are fixed, the Administration Procedure Act and traditions of procedural regularity suggest that consultations with representatives of organized medicine should be held before group prices are established. Such prior consultations took place in connection with the price controls in the early 1970s and were emphasized by courts reviewing challenges to that price-setting process. See *Western States Meat Packers Ass'n v. Dunlop*, 482 F.2d 1401, 1404 (Temp. Emer. Ct. App. 1973); *Pacific Coast Meat Jobbers Ass'n v. Cost of Living Council*, 481 F.2d 1388, 1391 (Temp. Emer. Ct. App. 1973).

when one claims a right to be exempted from group rates. The general rule of due process today is "that an individual be given an opportunity for a hearing *before* he is deprived of any significant property interest."<sup>109</sup> The Court recently enforced this rule in the context of a civil forfeiture proceeding, where the property right at issue was the loss of \$900 a month in rental income, which the Court characterized as "a significant portion of the exploitable economic value" of the defendant's home.<sup>110</sup> The same could easily be said of price controls that threaten to deprive a physician of a fair return on specific assets in the form of human capital.

To be sure, pre-deprivation hearings are not always required. The general standard, set forth in *Mathews v. Eldridge*,<sup>111</sup> requires that courts balance the public and the private interests involved, as well as the likely value of the procedures, in determining whether pre- or post-deprivation hearings are required and, if required, what their elements should be.<sup>112</sup> The individual interest here—the physician's interest in protecting the value of his investment—is obviously substantial. The question is whether there is a sufficient off-setting interest in postponing consideration of individual claims of exemption. The World War II era price control cases, which sustained a post-deprivation exemption procedure, placed great weight on the fact of war-time emergency and the need to act promptly to stem inflationary pressures caused by the shock of sudden changes in demand.<sup>113</sup> These factors are not plausibly present with respect to physician price controls during an otherwise noninflationary era. But the older cases also stress "the disorganization which would result if enforcement of price orders were delayed or sporadic or were unequal or conflicting in different parts of the country."<sup>114</sup> And they suggest that where large numbers of individual producers are involved in a system of group price controls, it would be impractical to afford every producer an individualized hearing before controls were instituted. These themes of uniformity and practical necessity were also picked up and highlighted in *Permian Basin*.<sup>115</sup>

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109. *Cleveland Bd. of Educ. v. Loudermill*, 470 U.S. 532, 542 (1985) (quoting *Boddie v. Connecticut*, 401 U.S. 371, 379 (1971)); accord *United States v. James Daniel Good Real Property*, 114 S. Ct. 492, 498 (1993); *Goldberg v. Kelly*, 397 U.S. 254, 264-66 (1970).

110. *James Daniel*, 114 S. Ct. at 501.

111. 424 U.S. 319 (1976).

112. *Id.* at 334-35.

113. *Yakus*, 321 U.S. at 436; *Bowles*, 321 U.S. at 520-21.

114. *Yakus*, 321 U.S. at 432.

115. *The Permian Basin Area Rate Cases*, 390 U.S. 747, 770 (1968).

The analytical framework of *Mathews*, informed by the considerations of uniformity and practical necessity discussed in the group price control cases, suggests that a post-deprivation hearing on claims of exemption is permissible. Given the critical effect of price controls on physician's livelihood, however, *Mathews* requires at least that every individual physician be afforded an opportunity to present evidence in a prompt post-deprivation hearing concerning specific costs of training and practice and any other individual factors relating to the fairness of being included in a given price control group.<sup>116</sup>

### C. Necessary Hearing Procedures

Assuming that a post-deprivation hearing is sufficient for due process purposes, exactly what procedures would be required in such a hearing? Here the rent control cases provide the best guidance. Courts reviewing rent control schemes have recognized that the procedure for individualized adjustments must be an expeditious one. As the California Supreme Court observed:

It is clear that if the base rent for all controlled units were to remain as the maximum rent for an indefinite period many or most rent ceilings would be or become confiscatory. For such rent ceilings of indefinite duration an adjustment mechanism is constitutionally necessary to provide for changes in circumstances. . . . The mechanism is sufficient for the required purpose only if it is capable of providing adjustments in maximum rents without a substantially greater incidence and degree of delay than is practically necessary.<sup>117</sup>

The New Jersey Supreme Court has offered more detailed guidance as to what constitutes an adequate adjustment mechanism. Such a mechanism is one that (1) processes applications for adjustments expeditiously (in no more than two to four months); (2) provides for enhanced revenues to offset the consequences of regulatory lag or delay; (3) provides clear and precise criteria for awarding adjustments; (4) permits applications to be processed at minimal cost to the applicants; and (5) assures that similarly situated applications for

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116. See *id.* at 772 (finding no reason "to suppose that petitions for relief [from area rates] will not be expeditiously evaluated.").

117. *Birkenfeld v. City of Berkeley*, 550 P.2d 1001, 1030 (Cal. 1976); accord *Helmsley v. Borough of Fort Lee*, 394 A.2d 65, 86 (N.J. 1978) (stating that rent control ordinance must protect landlords' interests "by providing prompt, fair, and efficacious administrative relief"); see also *Apartment & Office Building Ass'n v. Washington*, 343 A.2d 323 (D.C. Ct. App. 1975) (rent control regulations must include a mechanism for passing through increased costs to tenants).

adjustments are treated alike.<sup>118</sup> Similar factors are relevant in establishing the requisite elements of a post-deprivation adjustment mechanism under any system of physician price controls. A highly expeditious exemption procedure is one way to assure that price controls do not deny physicians a fair return. If expedition cannot be achieved, then some mechanism must be provided for recovering revenues to offset the effects of delay in cases where an exemption is ultimately granted.

#### IV. Identifying Physician Price Controls

Price controls that single out one profession are obviously unpopular with those subject to the controls. They are also controversial because of the widespread conviction among economists and policy analysts that they are at best futile, and at worst destructive of innovation and quality in health care.<sup>119</sup> Given the opposition to price controls, it is perhaps not surprising that controversy has erupted over whether specific health reform proposals do or do not amount to price controls.<sup>120</sup> Little purpose would be served by attempting in a law review article to classify specific proposals as either constituting price controls or something else. Cost containment proposals proliferate and permutate too rapidly to make analysis of any particular proposals worthwhile. What can and should be attempted, however, at least in a preliminary fashion, is a discussion of the general criteria that should be employed in determining whether a specific proposal does in fact call for price controls subject to the Takings Clause.

##### A. The Threshold Questions

Here, a two-part inquiry seems advisable. The first inquiry is whether a proposal calls for government action that causes prices to fall or to rise less rapidly. This inquiry, in turn, can be broken down into two subsidiary questions: (1) whether there is governmental action, and (2) whether that action causes a moderation in the rise of prices. The first question is the conventional inquiry into whether

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118. *Helmsley*, 394 A.2d at 79-80.

119. Peter Passell, *The Dangers of Declaring War on Doctors*, N.Y. TIMES, Mar. 21, 1993, at C5.

120. See Milt Freudenheim, *Drug Companies Feeling Pressure of Clinton's Plan to Keep Their Prices Down*, N.Y. TIMES, Sept. 30, 1993, at A22; Elizabeth McCaughey, *She's Baaack!*, NEW REPUBLIC, Feb. 28, 1994, at 17; Robert Pear with Stephen Labaton, *Officials Predict Deluge of Suits on Health Plan*, N.Y. TIMES, Sept. 27, 1993, at A1.

there is "state action."<sup>121</sup> The second question is essentially one of determining causation.<sup>122</sup>

The state action question is easy if the challenged action is directly commanded by federal statute or by a federal regulatory agency. It is also easy if the action is ordered by a purchasing cooperative or "health alliance" that is organized as an agency of either the federal or a state government.<sup>123</sup> The question starts to become close if the "alliances" are organized not as governmental agencies, but as non-profit corporations. The Supreme Court has indicated that state action will be found "if the State creates the legal framework governing the conduct, if it delegates its authority to the private actor, or sometimes if it knowingly accepts the benefits derived from unconstitutional behavior."<sup>124</sup> Very likely each of these circumstances would be present with respect to the proposed health alliances, whose composition, powers, and duties are spelled out in great detail in the draft legislation.<sup>125</sup> If final legislation is enacted that bears a significant resemblance to these proposals there is little doubt that the health alliances would be state actors for purposes of the Constitution, even if organized as non-profit corporations.<sup>126</sup>

The causation question may also be easy or difficult, depending on the circumstances. Obviously, if a government actor (Congress, a national health board, or a regional alliance) directly fixes physician prices, as the Administration bill proposes for fee-for-service physicians,<sup>127</sup> then the causation question is easy. The more difficult issues

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121. See, e.g., *NCAA v. Tarkanian*, 488 U.S. 179 (1988).

122. All this is fairly conventional. As the Supreme Court has stated in the context of determining municipal liability under 42 U.S.C. § 1983, the "proper analysis" requires a court to determine "(1) whether plaintiff's harm was caused by a constitutional violation, and (2) if so, whether the [government] is responsible for that violation." *Collins v. City of Harker Heights*, 112 S. Ct. 1061, 1066 (1992).

123. The Administration's proposed legislation states that regional health alliances are to be established as either "a non-profit organization, an independent state agency, or an agency of the State . . ." Health Security Act, *supra* note 6, § 1301.

124. *Tarkanian*, 488 U.S. at 182.

125. Health Security Act, *supra* note 6, §§ 1301-1394.

126. Cases involving investor-owned public utilities, which exercise far less governmental power than the health alliances, support this conclusion. See *PUC v. Pollak*, 343 U.S. 451 (1952) (finding state action where transit company derived its powers from Congress, exercised a "substantial monopoly" over transit services, and was subject to regulatory supervision of public utility commission and commission had refused to set aside conduct in question); see also *Jackson v. Metropolitan Edison Co.*, 419 U.S. 345 (1974) (noting that whether entity has "something of a governmentally protected monopoly" relevant to inquiry, but finding no state action where state does not place its "imprimatur" on the challenged practice).

127. See *supra* note 6.

arise with respect to proposals for "managed competition," "global budget constraints," and other proposals for structural changes in the delivery of health care services. Not every government action that affects the structure of the marketplace, and hence prices, can be said to cause price constraints. The antitrust laws are an example. The fact that the federal government prohibits price fixing by manufacturers of widgets may affect the price of widgets, but no one would suggest that the antitrust laws are the cause of whatever prices we observe being negotiated in the widget market. On the other hand, if the government were to establish a monopoly agent for all sales of widgets, there can be little doubt that the government-created monopolist would be regarded as causally responsible for a rise in prices (although the exact magnitude of the price rise would be a function both of restricted supply—which the monopolist would control—and the level of demand—which presumably would be independent of government control). The same analysis should be applied to structural changes that take the form of a government-created monopsony purchasing agent for physician services. Thus, if regional alliances are set up to exercise what amounts to monopoly power, the prices they impose should be regarded as controlled prices for constitutional purposes.

#### **B. Determining if the Takings Clause Is Implicated**

Assuming that governmental action causing a moderation in price changes is identified, the second general question would be whether these price controls trigger scrutiny under the Takings Clause. This is the inquiry discussed in Part I of this Article. The key question is whether the price controls are imposed in such a way that physicians are effectively denied access to an uncontrolled market. Physicians denied access to an uncontrolled market have specific capital at risk and are entitled to the protection of the Takings Clause.

Obviously, not every government action that establishes or constrains physician prices will trigger Takings Clause scrutiny under this standard. When the Veterans Administration sets salaries for attending physicians at V.A. Hospitals, no Takings Clause issue is presented because this price-setting action does not foreclose any physician from obtaining access to a market where compensation is not fixed by the government. On the other hand, if the government divides the market between group-care physicians and fee-for-service physicians, and subjects group-care physicians to a monopsony purchasing agent, while directly setting fees in the other segment of the market, there



can be little doubt that physicians have been denied access to an uncontrolled market.

In short, the relevant inquiry is not so much a matter of seizing upon the correct verbal definition of "price controls." Instead, the questions should be: First, has the government acted to constrain physician prices? And second, has the government closed off virtually all avenues of escape from its regime of constrained pricing? Affirmative answers to these questions should trigger the Takings and Due Process Clauses limitations discussed in this Article, whether or not the government action has been given any particular label.

### **Conclusion**

In considering legislation intended to restrict the growth of health care costs, Congress must keep certain fundamental constitutional principles in the forefront of its deliberations. First, it must assure that any price controls are structured to comply with the fair return standard of the Takings Clause. In the context of the medical profession, this means that any system of price controls must be tailored to different medical services, geographic regions, and degrees of physician training and experience. Second, any system of controls must also provide an expeditious mechanism for physicians to claim an exemption from group price controls. And third, the Due Process Clause requires that physicians be afforded individualized hearings on such requests.

These constitutional constraints are a matter of fundamental fairness to physicians, who have made major sacrifices to develop the skills and training needed to practice their professions. These sacrifices constitute a form of human capital which is not readily transferable to any other occupation. As result, physicians are vulnerable to government action that would literally take their investment without providing just compensation.

These constitutional limits are also important in determining the ultimate success or failure of health care reform. Any effort to reduce health care costs by squeezing physician earnings will run up against the constitutional constraints imposed by the Takings and the Due Process Clauses. Even if no court ever strikes down particular controlled prices, these constitutional constraints will exact a major toll in the form of the administrative costs of assuring that this does not happen. Obviously, dollars spent on public-utility style rate hearings and hearings on requests for individual variances will not improve the quality of health care or make access to health care more equitable.

The substantial costs of complying with the constitutional limits on physician price controls thus provide another reason—if one is needed—for leaving price controls out of health care reform.