

# **Election 2018: Bay Area Localities Push Boundaries of Preemption with Initiative to Cap Healthcare Prices**

Sammy Chang, Research Fellow | October 30, 2018

This coming election, Palo Alto and Livermore voters will decide whether to cap health care pricing to 115% of direct patient care and quality improvement costs. Officially known as the Accountable and Affordable Health Care Initiative, and colloquially as Measure F for Palo Alto and Measure U for Livermore, these local initiatives face opposition from opponents who assert that federal and state laws preempt and invalidate the measures. On its face, this could have spelled the end to these measures. Preemption is a tried and true way to overturn local initiatives, and health care has long been considered a realm for federal and state regulation. However, thus far, California superior court judges have rejected the argument that these local initiatives are preempted and refused to remove them from the ballot. If passed, these measures may be a novel way to accomplish rate setting, albeit on a local level.

## **Accountable and Affordable Health Care Initiative: What Charges Does It Cap?**

Back in 2017, Service Employees International Union United Health Care Workers (SEIU-UHW) filed nearly identical ballot measures for the November 2018 election in five San Francisco Bay area municipalities: Emeryville, Livermore, Palo Alto, Pleasanton, and Redwood City. Each of the ballot measures was called the “Accountable and Affordable Health Care Initiative” (hereinafter known as “the measure”) and was heralded as lowering health care prices within these municipalities. Palo Alto and Livermore successfully put the initiative on the ballot

as Measure F and Measure U, respectively, while Pleasanton, Emeryville, and Redwood City did not gather enough signatures for the November 2018 election.[\[1\]](#)

These measures would limit the amount hospitals,[\[2\]](#) medical clinics,[\[3\]](#) and other health care providers can charge to patients, insurance companies, and other non-governmental payers. The maximum chargeable amount would be 115% of the “reasonable” costs for direct patient care[\[4\]](#) and quality improvement.[\[5\]](#) If the hospital, clinic, or provider exceeds this amount by more than \$20, they would be required to issue, annually, a rebate or reduction in the amount billed.

### **Viewpoints Differ on Impact and Viability of the Measures**

The proposal to cap health care costs has been controversial from both policy and legal standpoints. Like the rate-setting bill AB 3087 from earlier this year, this measure pits labor unions, which support price control, against providers and hospitals, which oppose it. Supporters of the measure point out that Stanford Health Care charges “264% more than the statewide average to treat patients for alcohol or drug abuse, 142% more to treat patients with chest pain, and 121% more to treat patients with kidney failure,” and has about “\$700 million in reserves.”[\[6\]](#) They also cite to a Becker’s Hospital Review article that noted Stanford Health Care had an operating income of \$74.3 million in the first quarter of fiscal year 2018, up from an operating income of \$28 million in the first quarter of fiscal year 2017.[\[7\]](#) Additionally, supporters argue that providers can still make a profit as patients enjoy lower healthcare costs.

Providers, on the other hand, vehemently oppose this measure. Stanford Health Care, based in Palo Alto and owner of ValleyCare Hospital in Livermore, and the Palo Alto Medical Foundation argue that the measure has “impossible administrative requirements” for providers, that the city lacks the resources for the “massive” administrative or financial demands,[\[8\]](#) and that the measure does not require “out of state companies” to pass these rebates to Palo Alto patients, allowing them to instead pocket the rebates without the patients ever seeing the savings.[\[9\]](#) In a letter to the Palo Alto City Attorney, Stanford’s Chief Hospital Counsel argued that the initiative would result in a 20-25% drop in revenue that would exceed Stanford’s

margin.[\[10\]](#) Additionally, both the mayor of Palo Alto and Livermore wrote arguments against the measure, noting high administrative costs to the city. Finally, many opponents, citing the City of Livermore’s Section 9212 Report (“Zaretsky report”), have stated that this would drive providers away from the municipalities that pass the measure, which would result in fewer providers and consequently less access to care.[\[11\]](#)

In addition to policy concerns, critics question the initiative’s legal validity, arguing that federal and state legislation preempt these local measures. Historically, cities have not regulated health care pricing, and city attorneys and city governments agree that they shouldn’t start now. Both the Palo Alto City Attorney and the Palo Alto City Council staff asserted that “[h]ealth care pricing and reimbursement [involve] complex areas of regulation that are addressed by several federal and state laws.”[\[12\]](#) Similarly, the Livermore City Attorney noted that this measure “appears to be the first ordinance of its kind”[\[13\]](#) and expressed his belief that “healthcare is a statewide issue.”[\[14\]](#) He equated this initiative to Livermore “adopt[ing] a different vehicle code, just for the city, which would go against state vehicle codes.”[\[15\]](#)

### **Preemption 101: Are Localities Preempted from Regulating Health Care?**

The doctrine of preemption asserts that a higher level of government may nullify the laws of a lower level of government.[\[16\]](#) Preemption is enshrined in the Supremacy Clause of the U.S. Constitution, which states that “This Constitution, and the laws of the United States . . . shall be the supreme law of the land . . . laws of any State to the contrary *notwithstanding*.”[\[17\]](#) The California Constitution has its own version of the supremacy clause for localities, stating that “[a] county or city may make and enforce . . . ordinances and regulations *not in conflict* with general laws.”[\[18\]](#) This doctrine comes into play when a federal and state law or a state and local law conflicts with one another. In both instances, the law enacted by the higher level of government would prevail. For example, if a federal law required all toys to be red and a state law mandated that all yoyos be blue, the federal law would preempt the state law so that all yoyos must be red instead of blue.

Preemption can come in three flavors: express, in which the law explicitly preempts; field or implied, in which the law intends to exclusively occupy the area of regulation; and conflict, in which the lower government law conflicts with the higher government law in a way that it is impossible to comply with both.<sup>[19]</sup> That said, the California Supreme Court has been “particularly ‘reluctant to infer legislative intent to preempt a field covered by municipal regulation when there is a significant local interest to be served that may differ from one locality to another.’”<sup>[20]</sup> Instead, the Court has held that “absent a clear indication of preemptive intent from the Legislature, [that] such regulation is not preempted by state statute.”<sup>[21]</sup>

However, state legislatures have become aggressive in passing legislation that preempts local ordinances.<sup>[22]</sup> Nearly half of all states preempt any local ordinances regarding minimum wage, and about three-fourth of all states, including California, preempt local ordinances regarding ride sharing and tax and expenditure limitations.<sup>[23]</sup> As such, preemption has been considered a threat to local innovation.<sup>[24]</sup>

### **Courts Find No Federal or State Preemption of the Measure**

In opposition of the measures on the ground of preemption, Stanford Health Care, Emeryville’s city attorney, and the City of Livermore filed suit in Palo Alto,<sup>[25]</sup> Emeryville,<sup>[26]</sup> and Livermore,<sup>[27]</sup> respectively. The three cases involve nearly identical allegations and defenses.

Plaintiffs including Stanford Health Care allege that California’s Knox Keene Act (Knox-Keene), the federal Affordable Care Act (ACA),<sup>[28]</sup> the California Insurance Code, and federal Employee Retirement and Security Act (ERISA) preempt the measures.<sup>[29]</sup> Furthermore, an amicus brief by the American Hospital Association argues that it is “quite telling” when there is “total absence of any examples of a city like Livermore affirmatively imposing price controls.”<sup>[30]</sup>

Defendants argue that the measures regulate providers, not health service plans under the Knox-Keene or insurers under the California Insurance Code.<sup>[31]</sup> Thus, neither Knox-Keene nor the California Insurance Code preempts the measure.

Additionally, defendants argue that the ACA only preempts the local law if it “hinder[s] or impede[s]” the application of ACA.[\[32\]](#) They argue that annual cap on payments is not addressed by the ACA, therefore the local law cannot hinder or impede the application of the ACA.[\[33\]](#)

Agreeing with the defendants in all three cases, the courts refused to intervene and allowed the ballot measures to move forward.

#### *Palo Alto’s Measure F Remains on the Ballot:*

In *Stanford Health Care v. Beth Minor, et al* (Case No. 18CV330068), Stanford Health Care and Palo Alto Medical Foundation petitioned the Santa Clara County Superior Court to remove Measure F from the ballot. On August 1, Judge Mark Pierce rejected Stanford’s preemption argument, holding that “petitioners have not made a compelling showing for interfering with the initiative power.”[\[34\]](#) He ruled that both the Knox-Keene and the ACA refer to the regulation of health care service plans, while Measure F regulates costs charged by providers.[\[35\]](#) As such, neither Knox-Keene nor ACA preempts Palo Alto’s Measure F.

#### *Emeryville Required to Provide Title and Summary of Measure:*

In *Michael Guina v. Marilyn Smith* (Case No. RG18887782), Emeryville City Attorney Michael Guina petitioned the court to stay his duty to provide a ballot title and summary of Emeryville’s measure. Since an initiative cannot circulate without such information, a stay would effectively halt the measure. In this case, the court also rejected the preemption arguments. Judge Paul D. Herbert found that the “Ballot Measure does not clearly duplicate, conflict with, or enter an area already fully occupied by [general California law] and federal law.”[\[36\]](#) He further ruled that Knox-Keene, Insurance Code, Medi-Cal, Hospital Fair Policing Policies Act, ACA, Internal Revenue Code, Medicare and Medicaid, Emergency Treatment and Labor Act (EMTALA), and ERISA do not concern what the measure aims to do.[\[37\]](#) While the measure ultimately failed to reach the ballot, the court’s ruling is another strike against the preemption argument.

#### *Livermore’s Measure U Remains on the Ballot:*

In *City of Livermore v. Tim Dupuis* (Case No. RG18911516), Judge Kimberly E. Colwell rejected the City of Livermore's attempt to remove Measure U from the ballot. Judge Colwell held that "all arguments advanced by petitioner [including preemption] can be litigated" after the election and that "if the initiative is not approved, the parties' dispute will be moot."[\[38\]](#) As such, she did not address any of the preemption concerns.

#### *A Future Opportunity for Legal Challenge:*

It should be noted that while the courts allowed the measures to move forward, legal challenges may potentially come back at a later stage.[\[39\]](#) For example, in *Stanford vs. Minor*, Judge Pierce left the door open for plaintiffs to bring back a confiscation cause of action, which occurs when the government takes private property for public use without just compensation. Stanford Health Care alleges that the measure's price control would deprive the providers of a "fair return" (i.e., a fair payment for the investments) because it is arbitrary and without "economic justification,"[\[40\]](#) and thus constitutes a confiscation.[\[41\]](#) Judge Pierce held that "whether the initiative will be confiscatory as applied can be determined only after the election,"[\[42\]](#) but for now, allegations of confiscation were "speculative and premature."[\[43\]](#)

## **Conclusion**

As Palo Alto and Livermore voters consider whether to cap health care pricing to 115% of direct patient care and quality improvement costs, lawsuits in the form of preemption challenges have threatened to derail the efforts. Yet, so far, the courts are allowing the local initiatives to play out. While preemption arguments have been defeated pre-vote, courts have left the door open to litigate the measures after their passage. California superior court judges, by refusing to remove the measures from the ballot, are allowing this novel approach to move forward.

It should be noted, however, that in the midst of these local efforts, the state legislature has also attempted to regulate health care pricing via the short-lived AB 3087. If a similar rate-setting bill passes the state legislature in the future, it would

most likely preempt Palo Alto's Measure F and Livermore's Measure U.

Regardless, if these measures pass, opponents will certainly revive the legal challenges to prevent their implementation. It will be up to the courts to determine whether health care pricing is within the exclusive realm of state authority, or whether a locality has the right to regulate health care pricing. So far, courts think localities should get a chance to.

---

[1] Angela Ruggiero, *Livermore sued over city measure for healthcare costs; asks court to rule on legality*, East Bay Times (Aug. 11, 2018).

[2] The measure would exempt children, public, or VA hospitals. See Proposed Sec. 5.40.020(d), Palo Alto Accountable and Affordable Health Care Initiative (2018); Proposed Sec. 8.21.020(d), Livermore Accountable and Affordable Health Care Initiative (2018).

[3] The measure would exempt chronic dialysis clinic, children hospital's clinics or clinics exclusively for children, community or free clinics, clinics that offer reproductive health care services or family planning, a VA clinic, or a clinic licensed to "a county, a city, a city and county, the State of California, the University of California, a local health care district, a local health authority, or any other political subdivision of the state." Proposed Sec. 5.40.020(e), Palo Alto Accountable and Affordable Health Care Initiative (2018); Proposed Sec. 8.21.020(e), Livermore Accountable and Affordable Health Care Initiative (2018).

[4] While the measure defines that cost of direct patient care as the "provider's reasonable operating costs and costs to provide care to patients," it goes on to specifically state that "reasonable cost of direct patient care" would include (a) salaries, wages, and benefits of staff excluding managerial staff; (b) staff training and development; (c) pharmaceuticals and supplies; (d) facility costs like rent, maintenance, and utilities; (e) laboratory testing; and (f) depreciation and amortization of buildings, leasehold improvements, patient supplies, equipment, and

information systems. Proposed Sec. 5.40.030(b)(1), Palo Alto Accountable and Affordable Health Care Initiative (2018); Proposed Sec. 8.21.030(b)(1), Livermore Accountable and Affordable Health Care Initiative (2018).

[5] The quality improvement costs would include but not limited to “maintain[ing], access[ing] or exchang[ing] electronic health information; support[ing] health information technologies; train[ing] non-managerial personnel engaged in direct patient care; and provid[ing] patient-centered education and counseling.” Proposed Sec. 5.40.020(c), Palo Alto Accountable and Affordable Health Care Initiative (2018); Proposed Sec. 8.21.020(c), Livermore Accountable and Affordable Health Care Initiative (2018).

[6] Argument for Measure F (2018).

[7] Ayla Ellison, *Stanford Health Care’s operation income more than doubles in Q1*, Becker’s Hospital Review (Jan. 25, 2018).

[8] The Palo Alto City Council Staff Report (ID #9342) agreed with the critics’ second point, stating that “[a]t this time, the City does not have expertise or experience in the regulation of health care costs or health care generally” and that the “City does not currently have staff personnel who would be able to implement this program.” The staff report was also concerned over the cost and feasibility of implement given that “this type of program has not been adopted at the local level.” City of Livermore’s Section 9212 Report suggested that Measure U for Livermore would cost \$1.9 million annually and an additional \$750,000 to \$1 million in startup costs.

[9] Liz Kniss, et. Al., Argument Against Measure F (2018).

[10] Sarah J. DiBoise, Letter to Molly Stump - Re: “Palo Alto Accountable and Affordable Health Care Initiative” at pg. 4 (June 1, 2018). *See also* William Cleverley, Ph.D., Impact of Livermore California Ballot Initiative on Stanford Health Care - ValleyCare Hospital (2018) (commissioned by Stanford Health Care - ValleyCare and stating that ValleyCare will have a loss of \$7 million and be forced to cutback or close services).

[11] See Henry W. Zaretsky, Section 9212 Report - Livermore Accountable and Affordable Health Care Initiative (July 20, 2018) (commissioned by Livermore City Council as an independent analysis). See also Clevereley, *supra* note 10.

[12] Palo Alto City Council Staff Report (ID #9342) at 5. See Molly S. Stump, City Attorney's Impartial Analysis of Measure F (Aug. 21, 2018) (observing that "health care regulation has largely been the province of the state and federal governments").

[13] Jason Alcala, City Attorney's Impartial Analysis of Measure U (2018).

[14] Ruggiero, *supra* note 1.

[15] *Id.*

[16] See National League of Cities, City Rights in an Era of Preemption: A State-by-State Analysis at 3 (2017) (hereinafter NLC); Jennifer Pomeranz & Mark Pertschuk, *State Preemption: A Significant and Quiet Threat to Public Health in the United States*, 107 American J. of Public Health 900, 900 (2017).

[17] U.S. Const. art. IV (emphasis added)

[18] Cal. Const. art. XI, § 7 (emphasis added).

[19] See Ann Taylor Schwing, *Preemption*, 1 Cal. Affirmative Def. § 7:19 (2d ed., April 2018 update).

[20] Big Creek Lumber Co. v. Cty. of Santa Cruz, 38 Cal. 4th 1139, 1149 (2006).

[21] *Id.*

[22] NLC, *supra* note 16, at 3. See National Policy and Legal Analysis Network to Prevent Childhood Obesity (NPLAN), The Consequences of Preemption for Public Health Advocacy (2010) (stating "preemption on state and local governments have become almost routine in legislative and rule-making processes in recent years, particularly when health and consumer protection issues are involved"). See also Lori Riverstone-Newell, *Rise of State Preemption Laws in Response to Local Policy Innovation*, 47 Publius: The Journal of Federalism 403, 406 (noting the "surge of

preemption legislation” by states due industry groups, conservative organizations, and Republican control of state legislature).

[23] NLC, *supra* note 16, at 3.

[24] Pomeranz & Pertschuk, *supra* note 16, at 902. *See also* NPLAN, *supra* note 22.

[25] *Stanford Health Care v. Beth Minor, et al* (Case No. 18CV330068). Beth Minor is the City Clerk of Palo Alto and the Election Official for the city.

[26] *Michael Guina v. Marilyn Smith* (Case No. RG18887782). Michael Guina is the Emeryville City Attorney. Marilyn Smith is an individual who, on behalf of SEIU, filed a Notice of Intent in Emeryville. A Notice of Intent is required before an initiative can circulate and qualify for the ballot.

[27] *City of Livermore v. Tim Dupuis* (Case No. RG18911516). Tim Dupuis is the Alameda County Registrar of Voters, and the official in charge of putting the initiative on the ballot.

[28] *See* F. Curt Kirschner Jr., Letter to Molly Stump – Re: “Palo Alto Accountable and Affordable Health Care Initiative” at pg. 1 (June 13, 2018).

[29] Gennady Sheyner, *Opponents Gear Up for Battle Over Health Care*, Palo Alto Weekly (Sept. 14, 2018).

[30] Brief of Amicus Curiae American Hospital Association at 11, *Livermore v. Dupuis*, No. RG18911516 (Cal. Super. Ct., Alameda County July 27, 2018).

[31] Real Party in Interest’s Opposition to the Petition for Writ of Mandate at 13-14, 16, *Livermore v. Dupuis*, No. RG18911516 (Cal. Super. Ct., Alameda County Aug. 2, 2018).

[32] *Id.* at 17.

[33] *Id.*

[34] Gennady Sheyner, *Judge Allows Health-care Initiative to Proceed*, Palo Alto Weekly (Aug. 6, 2018).

[35] *Id.*

[36] Order Denying Motion for Stay of Litigation at 5-6, *Guina v. Smith*, No. RG18-887782 (Cal. Super. Ct., Alameda County Jun. 25, 2018).

[37] *Id.*

[38] Order Denying Petition for Writ of Mandate, *Livermore v. Dupuis*, No. RG18911516 (Cal. Super. Ct., Alameda County Aug. 17, 2018).

[39] *See* note 38; Order Denying Motion for Stay of Litigation at 11, *Guina v. Smith*, No. RG18-887782 (Cal. Super. Ct., Alameda County Jun. 25, 2018) (limiting the scope of judgment by holding that this judgment pertains to whether “the asserted invalidity of the Ballot Measure is clear beyond a doubt” and not “whether the Ballot Measure is constitutional on its face, or whether the Ballot Measure is constitutional as applied”).

[40] *See* Amended Opening Brief in Support of Plaintiff and Petitioner City of Livermore’s Petition for Writ of Mandate at 17, *Livermore v. Dupuis*, No. RG18911516 (Cal. Super. Ct., Alameda County July 20, 2018) (the “fair return” argument was made in all three cases).

[41] *See* Debra Zumait, Letter to Molly Stump - Re: “Palo Alto Accountable and Affordable Health Care Initiative” at pg. 5 (June 6, 2018). *See also* Amended Opening Brief in Support of Plaintiff and Petitioner City of Livermore’s Petition for Writ of Mandate at 17, *Livermore v. Dupuis*, No. RG18911516 (Cal. Super. Ct., Alameda County July 20, 2018) (the “fair return” argument was made in all three cases).

[42] Gillian Brassil, *Legality Questions Surround Palo Alto’s Measure F, Which Would Regulate Health Costs*, Peninsula Press (Oct. 24, 2018). *See also* Stump, *supra* note 12 (writing the “court determined that the legal questions about Measure F could be decided after the election if the measure is approved”).

[43] Sheyner, *supra* note 29. Judge Herbert, in *Guina v. Smith*, also echoed this sentiment, holding that the “court will not presume a conclusion before the measure is even presented to the voters.” Order Denying Motion for Stay of Litigation at 8,

Guina v. Smith, No. RG18-887782 (Cal. Super. Ct., Alameda County Jun. 25, 2018).